Public Debt under Limited Private Credit
Pierre Yared, Columbia University

There is a conventional wisdom in economics that public debt can serve as a substitute for private credit if private borrowing is limited. The purpose of this paper is to show that, while a government could in principle use such a policy to fully relax borrowing limits, this is not generally optimal. In our economy, agents invest in a short-term asset, a long-term asset, and government bonds. Agents are subject to idiosyncratic liquidity shocks prior to the maturity of the long-term asset. We show that a high public debt policy fully relaxes private borrowing limits and is suboptimal. This is because agents expecting such a policy respond by investing less than is socially optimal in the short asset which can protect them in the event of a liquidity shock. The optimal policy is more constrained and it induces a wedge between the technological rate of return on the long asset and the rate of return on bonds. In such a regime, agents subject to liquidity shocks are also borrowing constrained, and this expectation of being borrowing constrained induces them to invest the optimal level in the short asset. (JEL: H63, E62, G20)

School Attendance and Child Labor - A Model of Collective Behavior
Holger Strulik, University of Hannover

This article investigates how community attitudes affect school attendance and child labor and how aggregate behavior of the community feeds back on the formation of schooling attitudes. The theory takes aggregate and idiosyncratic poverty into account as an important driver of absence from school and provides an explanation for why equally poor villages or regions can display very different attitudes towards schooling. Distinguishing between three modes of child time allocation, school attendance, work, and leisure, the article shows how child labor productivity and the time costs of schooling contribute to the existence of a locally stable anti-schooling norm and how policy can exploit social dynamics and help a community to escape permanently from low attendance at school and child labor. (JEL: I20 I29 J13 O12)

The Effect of Joint Custody on Family Outcomes
Martin Halla, University of Linz

Since the 1970s almost all US states have introduced a form of joint custody after divorce. I analyze the causal effect of these custody law reforms on different family outcomes. My identification strategy exploits the different timing of reforms across the US states. Estimations based on state panel data suggest that the introduction of joint custody led to an increase in marriage rates, an increase in overall fertility (including a shift from non-marital to marital fertility), and an increase in divorce rates for older couples. Accordingly, female labor market participation decreased. Further, male suicide rates and domestic violence fell in treated states. The empirical evidence is consistent with the hypothesis that joint custody increased the relative bargaining power of men within marriage. (JEL: J12, J13, J18, K36, D13)
Auction Design without Commitment

Hannu Vartiainen, HECER and University of Helsinki

In anonymous platforms like the Internet, committing to honor the outcome of an auction is difficult since the seller can benefit by reauctioning the good. We argue that how information is processed within the auction mechanism is crucially important in such circumstances. In our model, the seller uses an intermediary to extract information from the buyers but is not tied to sell the good with terms that the mechanism proposes. Instead, she may reauction the good again via some other intermediary. There are no restrictions on how many times and through which mechanisms the good can be reauctioned. The buyers may also choose their outside option at any stage of the game. We argue that a sequentially rational seller can only implement a version of the English auction, in particular the popular version where bidders employ proxy bids. This is a consequence of the informational properties of the English action: it reveals just the right information for the seller to be able to commit to the mechanism. (JEL: C72, D44, D78)

Does Idiosyncratic Business Risk Matter for Growth?

Claudio Michelacci, CEMFI, Center for Monetary and Financial Studies and Fabiano Schivardi, University of Cagliari and EIEF

Several imperfections can prevent entrepreneurs from diversifying away the idiosyncratic risk of their business. As a result idiosyncratic risk discourages entrepreneurial activity and hinders growth, with the effects being stronger in economies with lower risk diversification opportunities. In accordance with this prediction, we find that OECD countries with low levels of risk diversification opportunities (as measured by the relevance of family firms or of widely held companies) perform relatively worse (in terms of productivity, investment, and business creation) in sectors characterized by high idiosyncratic risk. Differently from previous literature, we allow risk to be country specific. Since risk is endogenous to risk diversification opportunities, we instrument its value using sectoral risk in the US, a country where idiosyncratic business risk can be more easily diversified away. Tackling the endogeneity of risk and recognizing that it varies by country magnifies the estimated effects of risk on growth. (JEL: F3, G1, O4)

Do Better Paid Politicians Perform Better? Disentangling Incentives from Selection

Stefano Gagliarducci, Tor Vergata University and Tommaso Nannicini, Bocconi University

The wage paid to politicians affects both the choice of citizens to run for office and the performance of those who are appointed. First, if skilled individuals shy away from politics because of higher opportunities in the private sector, an increase in politicians' pay may change their mind. Second, if the reelection prospects of incumbents depend on their in-office deeds, a higher wage may foster performance. We use data on all Italian municipal governments from 1993 to 2001 and test these hypotheses in a quasi-experimental setup. In Italy, the wage of mayors depends on population size and sharply rises at different thresholds. We apply a regression discontinuity design to the only threshold that uniquely identifies a wage increase: 5,000 inhabitants. Exploiting the existence of a two-term limit, we further disentangle the composition from the incentive component of the effect of the wage on performance. Our results show that a higher wage attracts more educated candidates, and that better paid politicians size down the government machinery by improving efficiency. Importantly, most of this effect is driven by the selection of competent politicians, rather than by the incentive to be reelected. (JEL: M52, D72, J45, H70)
Uncertain Demand, Consumer Loss Aversion, and Flat-Rate Tariffs
Fabian Herweg, University of Munich and Konrad Mierendorff, University of Zurich

We consider a model of firm pricing and consumer choice, where consumers are loss averse and uncertain about their future demand. Possibly, consumers in our model prefer a flat rate to a measured tariff, even though this choice does not minimize their expected billing amount—a behavior in line with ample empirical evidence. We solve for the profit-maximizing two-part tariff, which is a flat rate if (a) marginal costs are not too high, (b) loss aversion is intense, and (c) there are strong variations in demand. Moreover, we analyze the optimal nonlinear tariff. This tariff has a large flat part when a flat rate is optimal among the class of two-part tariffs. (JEL: D11, D43, L11)

Politicians at Work. The Private Returns and Social Costs of Political Connections
Federico Cingano, Bank of Italy and Paolo Pinotti, Università Bocconi

We quantify the private returns and social costs of political connections exploiting a unique longitudinal dataset that combines matched employer-employee data for a representative sample of Italian firms with administrative archives on the universe of individuals appointed in local governments over the period 1985-97. According to our results, the revenue premium granted by political connections amounts to 5.7% on average, it is obtained through changes in domestic sales but not in exports, and it is not related to improvements in firm productivity. The connection premium is positive for upstream producers for the public administration only, and larger (up to 22%) in areas characterized by high public expenditure and high levels of corruption. These findings suggest that the gains in market power derive from public demand shifts towards politically connected firms. We estimate such shifts reduce the provision of public goods by approximately 20%. (JEL: D21, D73, H72, J31)

Ranking the Schools: How School-Quality Information Affects School Choice in the Netherlands
Pierre Koning, Free University of Amsterdam and Karen van der Wiel, CPB Netherlands Bureau of Economic Policy Analysis

This paper analyzes whether information about the quality of high schools published in a national newspaper affects school choice in the Netherlands. We find that negative (positive) school-quality scores decrease (increase) the number of first-year students who choose a school after the year of publication. These effects are only large for the college-preparatory track, such that a school receiving the most positive score for its most academic track sees 16 to 18 more first-year students enrol. We find that parents respond to the most recent and most prominently displayed information. The effects of information about school quality do not seem to be greater in regions with larger relevant newspaper circulation, suggesting that direct exposure to news about school quality does not explain the response to this information. (JEL: I20, D10, D83)