Institution-Induced Productivity Differences and Patterns of International Capital Flows

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This paper studies theoretically how the cross-country differences in the institutional quality (IQ) of the domestic credit markets shape the patterns of international capital flows when such IQ differences also cause productivity differences across countries. IQ affects productivity by changing productivity-agency cost trade-offs across heterogeneous investment projects. Such institution-induced productivity differences are shown to have effects on the investment and capital flows that are opposite of exogenous productivity differences. This implies that the overall effect of IQ could generate U-shaped responses of the investment and capital flows. Among other things, this means that capital could flow from middle-income countries to both low-income and high-income countries, and that, starting from a very low IQ, a country could experience both a growth and a current account surplus after a successful institutional reform. More generally, the results here provide some cautions when interpreting the empirical evidence on the role of productivity differences and institutional differences on capital flows. It also calls into question the validity of treating the degree of financial frictions as a proxy for the quality of financial institutions, as commonly done in the literature.

(JEL: E22, F49, O16)

From Shame to Game in One Hundred Years: An Economic Model of the Rise in Premarital Sex and Its De-Stigmatization

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Societies socialize children about sex. This is done in the presence of peer-group effects, which may encourage undesirable behavior. Parents want the best for their children. Still, they weigh the marginal gains from socializing their children against its costs. Churches and states may stigmatize sex, both because of a concern about the welfare of their flocks and the need to control the cost of charity associated with out-of-wedlock births. Modern contraceptives have profoundly affected the calculus for instilling sexual mores. As contraception improves there is less need for parents, churches and states to inculcate sexual mores. Technology affects culture.

(JEL: D58, J13, O15, N30)

On the Relative Efficiency of Performance Pay and Non-Contingent Incentives

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We report evidence from a large field experiment comparing the effectiveness of contingent and non-contingent incentives in eliciting costly effort for a large range of payment levels. The company with which we worked sent 7,250 letters asking customers to complete a survey. Some letters promised to pay amounts ranging from $1 to $30 upon compliance (contingent incentives), whereas others already contained the money in the request envelopes (non-contingent incentives). Compared to no payment, very small contingent payments lower the response rate while small non-contingent payments raise the response rate. As expected, response rates rise with the size of the incentive offered. The response rate in the non-contingent incentives rises more rapidly for low amounts of incentive, but then flattens out and reaches lower levels than under contingent payments. We discuss how the optimal policy regarding the use of each size and type of incentives crucially depends on firms’ objectives.

(JEL: D21, D93)
Is There a Fiscal Free Lunch in a Liquidity Trap?
Christopher J. Erceg, Federal Reserve Board and Jesper Lindé, Federal Reserve Board

This paper uses a DSGE model to examine the effects of an expansion in government spending in a liquidity trap. If the liquidity trap is very prolonged, the spending multiplier can be much larger than in normal circumstances, and the budgetary costs minimal. But given this "fiscal free lunch," it is unclear why policymakers would want to limit the size of fiscal expansion. Our paper addresses this question in a model environment in which the duration of the liquidity trap is determined endogenously, and depends on the size of the fiscal stimulus. We show that even if the multiplier is high for small increases in government spending, it may decrease substantially at higher spending levels; thus, it is crucial to distinguish between the marginal and average responses of output and government debt. (JEL: E52, E58)

Shocking Stuff: Technology, Hours, and Factor Substitution
Cristiano Cantore, University of Surrey, Miguel Leon-Ledesma, University of Kent, Peter McAdam, European Central Bank, and Alpo Willman, European Central Bank

The response of hours to technology shocks is a key controversy in macroeconomics. We show that differences between RBC and NK models hinge on highly restrictive views of technology. We introduce CES production technologies and demonstrate that the response of hours depends on the factor-augmenting nature of shocks and the capital-labor substitution elasticity in both models. We develop analytical expressions to establish the thresholds determining its sign. This opens new margins for shock identification combining theory and VAR evidence. We discuss how our models provide new robust restrictions for empirical work, especially using the labor income share. (JEL: E32, E23, E25)

Group Inequality
Samuel Bowles, Santa Fe Institute and University of Siena, Glenn C. Loury, Brown University, and Rajiv Sethi, Barnard College, Columbia University and Santa Fe Institute

We explore the combined effect of segregation in social networks, peer effects, and the relative size of a historically disadvantaged group on the incentives to invest in market-rewarded skills and the dynamics of inequality between social groups. We identify conditions under which group inequality will persist in the absence of differences in ability, credit constraints, or labor market discrimination when segregation is sufficiently great. Under these conditions, group inequality may be amplified if initial group differences are negligible. Increases in social integration may destabilize an unequal state and make group equality possible, but the distributional and human capital effects of this depend on the demographic composition of the population. When the size of the initially disadvantaged group is sufficiently small, integration can lower the long run costs of human capital investment in both groups and result in an increase the aggregate skill share. In contrast, when the initially disadvantaged group is large, integration can induce a fall in the aggregate skill share as the costs of human capital investment rise in both groups. (JEL: D31, Z13, J71)

The International Dimension of Productivity and Demand Shocks in the US Economy
Giancarlo Corsetti, University of Cambridge, Luca Dedola, European Central Bank, and Sylvain Leduc, European Central Bank

This paper analyzes the cross-country effects of productivity and demand disturbances in the US identified with sign restrictions based on standard theory. Productivity gains in US manufacturing increase US consumption and investment vis-à-vis foreign countries, resulting in a trade deficit and higher international prices of US goods, despite the rise in their supply. Financial adjustment works via a higher global value of US equities, real dollar appreciation, and an expansion of US gross foreign liabilities as well as assets. Positive demand shocks to US manufacturing also increase investment and cause a real dollar appreciation, but have limited effects on the trade balance and net foreign assets. Our findings emphasize the importance for macroeconomic interdependence of endogenous fluctuations in aggregate demand across countries in response to business cycle shocks. Our empirical
characterization of macroeconomic interdependence emphasizes the key role of endogenous fluctuations in aggregate demand across countries in response to business cycle shocks. (JEL: F32, F41, F42)

Trade Quotas and Buyer Power with an Application to the EU Natural Gas Market
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We consider a market in which domestic buyers negotiate contracts with foreign sellers, and explore how trade quotas can help to increase the buyers' countervailing power. We use the Shapley value to describe bargaining power and the distribution of the trade surplus in such a bilateral oligopoly. By exploiting strategic externalities among the buyers, bilateral trade quotas can improve the buyers' bargaining positions. In contrast, aggregate trade restrictions on all buyers' trade never improve buyer surplus. Minimum quotas on imports from fringe suppliers can benefit non-affected buyers, as these enjoy positive externalities. We apply these insights to the EU market for natural gas and show that the effects of trade quotas on EU gas importers' power can be significant. (JEL: F12, L12, L41, C71, Q48)

Market Distortions and Government Transparency
Facundo Albornoz, Birmingham University, Joan Esteban, Instituto de Análisis Económico (CSIC), Barcelona and Barcelona Graduate School of Economics, and Paolo Vanin, Università di Bologna

This paper investigates how government transparency depends on economic distortions. We first consider an abstract class of economies, in which a benevolent policy maker is privately informed about the exogenous state of the economy and contemplates whether to release this information. Our key result is that distortions limit communication: even if transparency is ex-ante Pareto superior to opaqueness, it is not an equilibrium whenever distortions are sufficiently high. We next confirm this broad insight in two applied contexts, in which monopoly power and income taxes are the specific sources of distortions. (JEL: D82, E61)

Communication, Coordination and Networks
Syngjoo Choi, University College London and Jihong Lee, Seoul National University

We study experimentally the role of the network structure of pre-play communication in determination of outcome and behavior in a multi-player coordination game with conflicting preferences. The trade-off between efficiency and equity of coordination outcomes and its link to the network structure of communication are explored. Our results show substantial variations in both efficiency and equity of coordination outcomes across networks. While, as expected, increasing the length of communication improves the chance of successful coordination, it also reduces the asymmetry in the distribution of coordinated outcomes. We identify behaviors that explain variations in the distribution of coordinated outcomes both within and across networks. In all treatments, coordination is mostly explained by convergence in communication. (JEL: C70, C92, D61, D63, D82)

Do Transfer Taxes Reduce Intergenerational Transfers?
Tullio Jappelli, University of Naples Federico II, Mario Padula, University Ca' Foscari of Venice, and Giovanni Pica, University of Salerno

We estimate the effect of taxes on intergenerational transfers exploiting a sequence of Italian reforms culminating with the abolishment of transfer taxes. We use the 1993-2006 Survey of Household Income and Wealth, which has data on real estate transfers received and information on potential donors as well as recipients. Differences-in-differences estimates indicate that the abolition of transfer taxes increased the probability that high-wealth donors make a transfer by 2 percentage points and square meters transferred by 9.3 meters relative to poorer donors. (JEL: H24, E21)