JEEA Volume 16-3, June 2018
Abstracts

***Schumpeter Lecture-2016*: Frictional Coordination**
George-Marios Angeletos, Massachussets Institute of Technology

The notion that business cycles are driven by demand shocks is subtle. I first review some of the conceptual and empirical challenges faced when trying to accommodate this notion in micro-founded, general-equilibrium models. I next review my own research, which sheds new light on the observed business cycles by accommodating frictional coordination in the form of higher-order uncertainty. This makes room for forces akin to animal spirits even when the equilibrium is unique. It allows demand shocks to generate realistic business cycles even when nominal rigidity is absent or undone by appropriate monetary policy. It modifies the general-equilibrium predictions of workhorse macroeconomic models in manners that seem both conceptually appealing and empirically relevant. And it offers new guidance to policy.

Institutions, Volatility and Investment
Timothy Besley, LSE and CIFAR, and Hannes Mueller, IAE(CSIC) and Barcelona GSE

Countries with strong executive constraints have lower growth volatility but similar average growth to those with weak constraints. This paper argues that this may explain the relationship between executive constraints and inflows of foreign investment. It uses a a novel dataset of Dutch sector-level investments between 1983 and 2012 to explore this issue. It formulates an economic model of investment and uses data on the mean and variance of productivity growth to explain the relationship between investment inflows and executive constraints. The model can account for the aggregate change in inflows when strong executive constraints are adopted in terms of the reduction in the volatility in productivity growth. The data and model together suggest a natural way of thinking about country-level heterogeneity in investment inflows following the adoption of strong executive constraints.

When Credit Dries Up: Job Losses in the Great Recession
Samuel Bentolila, CEMFI, Marcel Jansen, Universidad Autnoma de Madrid and Federa, and Gabriel Jiménez, Banco de España

We study whether the solvency problems of Spains weakest banks in the Great Recession have caused employment losses outside the financial sector. Our analysis focuses on the set of banks that were bailed out by the Spanish authorities. Data from the credit register of the Bank of Spain indicate that these banks curtailed lending well in advance of their bailout. We show the existence of a credit supply shock, controling for unobserved heterogeneity through firm fixed effects, and assess its impact on employment. To this aim, we compare the changes in employment between 2006 and 2010 at client firms of weak banks to those at comparable firms with no significant pre-crisis relationship to weak banks. Our estimates imply that around 24% of job losses at firms attached to weak banks in our sample are due to this exposure. This accounts for one-half of the employment losses at firms that survived

and one-third of employment losses at those that closed down.

Credit Supply During a Sovereign Debt Crisis
Marcello Bofondi, Bank of Italy, Luisa Carpinelli, Bank of Italy, and Enrico Sette, Bank of Italy

We study the patterns of credit supply in Italy following the burst of the European sovereign debt crisis in 2011. Comparing lending to the same firm we find that domestic banks reduced credit supply, increased interest rates on credit granted and lowered the probability of accepting loan applications more than foreign banks, which were less affected by the sovereign crisis. The credit contraction is the consequence of a largely country-specific effect, not explained by heterogeneity in bank characteristics, but associated to a generalized increase in the cost of funding of Italian banks. Looking across firms, we find that credit restrictions by domestic banks were not fully compensated by foreign banks' lending, implying that Italian firms experienced an aggregate credit shortage.

Small is Beautiful: Motivational Allocation in the Non-Profit Sector
Gani Aldashev, Université libre de Bruxelles (ULB), ECARES and CRED, Esteban Jaimovich, University of Surrey, and Thierry Verdier, Paris School of Economics and CEPR

We build an occupational-choice general-equilibrium model with for-profit firms, non-profit organizations, and endogenous private warm-glow donations. Lack of monitoring on the use of funds implies that an increase of funds of the non-profit sector (because of a higher income in the for-profit sector, a stronger preference for giving, or an inflow of foreign aid) worsens the motivational composition and performance of the non-profit sector. We also analyze the conditions under which donors (through linking donations to the motivational composition of the non-profit sector), non-profits themselves (through peer monitoring), or the government (using a tax-financed public funding of non-profits) can eliminate the low-effectiveness equilibrium. We present supporting case-study evidence from developing-country NGO sector and humanitarian emergencies.

The Limits of Political Compromise: Debt Ceilings and Political Turnover
Alexandre B. Cunha, Federal University of Rio de Janeiro, and Emanuel Ornelas, Sao Paulo School of Economics-FGV and CEPR, CESifo and CEP

We study the desirability of limits on the public debt and of political turnover in an economy where incumbents have an incentive to set public expenditures above the socially optimal level due to rent-seeking motives. Parties alternate in office and cannot commit to future policies, but they can forge a political compromise where each party curbs excessive spending when in office if it expects future governments to do the same. In contrast to the received literature, we find that strict limits on government borrowing can exacerbate political economy distortions by making a political compromise unsustainable. This tends to happen when political turnover is limited. Conversely, a tight limit on the public debt fosters a compromise that yields the efficient outcome if political turnover is vigorous. Our analysis thus suggests that to sustain good economic policies, a society needs to restrict either the extent of political turnover or the ability of governments to issue debt, but not both.

What Makes Voters Turn Out: The Effects of Polls and Beliefs

Marina Agranov, Division of the Humanities and Social Sciences, Caltech, Jacob K. Goeree, AGORA Center for Market Design and UNSW Australia Business School and International Faculty, and University of Cologne, Julian Romero, University of Arizona, and Leeat Yariv, Division of the Humanities and Social Sciences, Caltech

We use laboratory experiments to test for one of the foundations of the rational voter paradigm - that voters respond to probabilities of being pivotal. We exploit a setup that entails stark theoretical effects of information concerning the preference distribution (as revealed through polls) on costly participation decisions. We find that voting propensity increases systematically with subjects' predictions of their preferred alternative's advantage. Consequently, pre-election polls do not exhibit the detrimental welfare effects that extant theoretical work predicts. They lead to more participation by the expected majority and generate more landslide elections.

The Horizontally S-Shaped Laffer Curve

Patrick Fève, Toulouse School of Economics, Julien Matheron, Banque de France, and Jean-Guillaume Sahuc, Banque de France

In a neoclassical growth model with incomplete markets and heterogeneous, liquidity-constrained agents, the properties of the Laffer curve depend on whether debt or transfers are adjusted to balance the government budget constraint. The Laffer curve conditional on public debt is horizontally S-shaped. Two opposing forces explain this result. First, when government wealth increases, the fiscal burden declines, calling for lower tax rates. Second, because the interest rate decreases when government wealth increases, fiscal revenues may also decline, calling for higher taxes. For sufficiently negative government debt, the second force dominates, leading to the odd shape of the Laffer curve conditional on debt.

What Works? A Meta Analysis of Recent Active Labor Market Program Evaluations

David Card, UC Berkeley and NBER, Jochen Kluve, Humboldt University and RWI Essen, and Andrea Weber, Central European University and WU Vienna

We summarize the estimates from over 200 recent studies of active labor market programs. We classify the estimates by type of program and participant group, and distinguish between three different post-program time horizons. Using regression models for the estimated program effect (for studies that model the probability of employment) and for the sign and significance of the estimated effect (for all the studies in our sample) we conclude that: (1) average impacts are close to zero in the short run, but become more positive 2-3 years after completion of the program; (2) the time profile of impacts varies by type of program, with larger average gains for programs that emphasize human capital accumulation; (3) there is systematic heterogeneity across participant groups, with larger impacts for females and participants who enter from long term unemployment; (4) active labor market programs are more likely to show positive impacts in a recession.