On March 24, the Program for Economic Research sponsored the 2009 Spring Economics Forum, “Reforming Financial Regulation: Fundamental Principles and Urgent Steps”. The event featured a presentation by Hyun Shin of Princeton University, with responses from Patrick Bolton, Frederick Mishkin, and Edward Morrison, and was moderated by Michael Woodford. The forum discussed questions on how to improve the current international financial climate through impending regulation in advance of this year’s G20 summit, and was attended by over 200 faculty, students, and colleagues from around the Columbia campus.

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UNDERGRADUATES TAKE ON SUMMER ECONOMICS RESEARCH INTERNSHIPS

This summer, two undergraduate economics majors won support from the Program for Economic Research to pursue interdisciplinary research in economics with Columbia faculty.

Elijah de la Campa (CC’10) worked with Elizabeth Ty Wilde, a professor of health policy and management at the Mailman School of Public Health. “I learned that it is difficult to obtain statistical records from sprawling bureaucracies,” he says. Campa worked with Professor Wilde on the creation of a statistical model of the prevalence of drug use in public schools nationwide. “I found the job of research assistant to be perfectly suited to my interests, and I am now pursuing full-time research associate positions with various economic consulting firms and public agencies for after graduation,” he says. “And I am seriously considering obtaining my Ph.D. in economics.”

Danni Pi (CC’11) spent her summer examining legislation passed state by state that was designed to address climate change with Professor Michael Gerrard of Columbia Law School. After reviewing California’s AB 32 as a model by which to compare other state laws, Pi went on to examine their legal implications and obstacles. For Professor John Mut- ter of Earth and Environmental Sciences, she worked on developing a methodology for the comparison of the effects natural disasters have on different types of economies and countries. “In many of the papers I read, debate was centered on the discount rate and or cost-benefit analysis, which were concepts I could understand with my academic training in Microeconomics, Development Economics and Macroeconomics,” says Pi. “However, some do not take into account low probability but high risk situations, which has become a major flaw in the field of environmental economics. My strong opinions proved to me that I was truly indeed interested in the field of academic economics and that I should reconsider attending law school immediately after graduation. This internship got me into thinking about going to graduate school and furthering my studies in Economics.”
It is now ten years since I arrived at Columbia, and I have never looked back. I have been fortunate to be at other great universities, each with its charms, but for me none hold the magic of Columbia. The Morningside campus is a jewel box, populated by brilliant faculty, earnest students, talented administrators, and dedicated staff. When you put moving people in an enclosed space, they bump into each other, and they move faster. That metaphor belongs to physics rather than economics, but it works for me. I feel lucky to be here.

When I showed up at Columbia in 1999, the Economics Department was smaller than it is today. The department had 25 or so full-time-equivalent members or FTEs. This is a university’s quirky way of keeping track of its faculty. Some members of the department only count as one-half or two-thirds FTE because they are also members of other departments. Today, the department’s professors and lecturers add up to more than 40 FTEs. Most of these FTEs were not here ten years ago. In this and other ways, the department renewed itself in the space of decade, and in doing so became a top ten economics department again. And the prospect of continued advancement for Columbia Economics in the next decade is an exciting challenge. Why not be a top five department?

The department is blessed with more than a few famous members, including three live-and-kicking Nobel Prize winners, who all have done great work to improve dramatically our knowledge of how modern economies work. But proud as I am of our most distinguished professors, I think the department is equally blessed with a vibrant core of prominent young senior and rising junior faculty members. The department has been trying harder to mentor and provide crucial research support to its junior faculty, and the effort is paying off handsomely. The soundness and speed with which our assistant and associate professors build their reputations is breathtaking. Our faculty is much more than the sum its parts. We bump into each other and we move faster. We are excited by the ideas that run through the department halls, charging our research and teaching.

The Economics graduate program changed a lot in ten years. I don’t doubt that the quality of Ph.D. courses at Columbia Economics always was terrific. That had to be the case with the brilliant faculty in the department’s ranks. But the relatively small number of FTEs must have made it difficult sometimes to advise effectively graduate students writing their dissertations. Today the department has a structured system of graduate colloquia, where our students regularly present their work in progress. The resulting finished dissertations are impressive. Our Ph.D. candidates are winning their degrees faster and making more important contributions to knowledge. We are better able to support our Ph.D. students while they do their research, although more generous financial offers by other top departments often lure the most promising students that we would like to attract to Columbia.

Something that has not changed much in my ten years is Columbia undergraduates, and particularly the Economics majors. Most years I teach a senior seminar. The names and faces in the class change each year, but the energy, curiosity, and work ethic of my students are reliable. I always feel that teaching these seminars keeps me just a bit younger, and I will miss doing that as much while I chair – and perhaps my bones will ache a bit more. Our undergraduates are the roughest but perhaps the most valuable jewels on our campus, and our department does a good job at burnishing them. At the end of four years, we produce valedictorians, Rhodes Scholars, future professors, and maybe even a future Nobel Prize winner or two, but we also

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CHE Elected Fellow of the Econometric Society

Professor Yeon-Koo Che was elected a 2009 Fellow of the Econometric Society. Che is the Kelvin J. Lancaster Professor of Economic Theory and specializes in mechanism design, auction theory, contracts and organizations.

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help produce many more young citizens who are better equipped for the future by virtue of knowing more about how the economy works. There is good reason why Economics is the most popular major at Columbia, even though our classes too often are capped or crowded because of a relatively high student-faculty ratio - even after the expansion of FTES!

I mostly have tried to avoid university administrators during my academic career – until recently I always expected that the mere act of holding out my hand to a dean or provost or vice president of any stripe would be followed a week or two later by an invitation to join a committee. Since stepping into the position of chair this summer I have had little choice but to work with administrators, and I have say that so far I like it. They are a talented, hard working, and well-intentioned lot.

Columbia is also is blessed with strong, visionary leadership at the top, and Economics has benefitted greatly from this. As much as I like my administrator friends, I do expect to go back to avoiding them three years from now, when I step down and return to my usual research and teaching haunts. But in the meantime, I think we will be able to get some important things done.

And what a mistake it is to take the staff for granted! These marvelous people make the classes run on time. They take care of the rest of us with endearing patience and cheer. They keep us from bumping into walls. I now need them more than ever.

When I meet my friends and colleagues at conferences these days – yes I still go to those – and tell them I am the new Economics chair, some are not sure whether to express congratulations or condolences. They do have a point. While an honor to be chosen, the chair’s job is a lot of work that crowds other things I want to do. But mostly it is an opportunity to work with interesting people - bumping into each other - to make a difference differently from my usual research and teaching, and I embrace that. Columbia and its people, like every other institution and everyone else, are dealing with challenging economic times. But in many ways it is a good time to be the new chair of Columbia Economics. We are on the move.

I look forward to telling you more about us in future editions of this letter.

Yours truly,

Michael H. Riordan
Featured speaker Hyun Shin (Hughes-Rogers Professor of Economics, Princeton University) began the talk by positing that the failure of investment bank Bear Stearns was due to decisions made by the bank’s creditors. Shin went on to describe indications that the mortgage market has gone from a bank-based system to a predominantly market-based system, showing how market-based institutions overtook the banks in 1990 and now own close to two thirds of mortgages. When banks see a decline in their assets, according to Shin, rather than raising equity the banks will reduce their assets. Shin described that this has resulted in a new form of bank run – asset deleveraging. To avoid such a run on banks, Shin proposes a ladder of policy responses, including a stage where dividends are suspended in a bank.

Patrick Bolton (Zalaznick Professor of Business and Professor of Economics) agreed with Shin’s observation that the move from a bank-based system to a market-based system has resulted in deleveraging, but felt that this ought to “change completely our philosophy on bank regulation.” He pointed out that when runs occur outside of the protection of deposit insurance, there would be no protections for governments with this kind of risk. He also supported temporarily lifting capital regulations in mark-to-market accounting while the crisis persists, and then bringing them back after the crisis is over.

Frederick Mishkin (Lerner Professor of Banking and Financial Institutions) spoke about the role of the central banks, in particular with regard to asset price bubbles. Mishkin, a former governor of the Federal Reserve, mentioned that when a bubble is driven by a credit boom, leading to a huge acceleration in asset prices, the process of identifying and confirming that bubble becomes easier. Mishkin also pointed out that monetary policy is the wrong tool for dealing with these bubbles; he argued that macro-prudential supervision would be much more effective. The issue however, is how to create a systemic regulator for conducting this macro-prudential supervision, but one who would not succumb to political pressures.

Lastly, Edward Morrison (Professor of Law) particularly focused on the failure of non-bank institutions such as hedge funds that might pose systemic risk and which are not subject to the insolvency laws of the FDIC. Adding to Mishkin’s point about the role of the systemic regulator, Morrison spoke about the government’s resolve in letting the regulator address the bubbles before they pop.
With the number of jobs lost and the unemployment rate reaching their highest levels since the early 1980s, there is continuing debate on how to stimulate job creation. Yet, even once the economy and job creation picks up again, most workers who lost their job during this recession are likely feel the effect for sometime to come. Judging from past recessions, the labor market should have recovered after about 3-4 years from the current low. Yet, for the average worker who lost a job, earnings may be substantially lower over the next 15 to 20 years. These large earnings losses may be accompanied by increases in job and earnings instability lasting a decade, losses in life expectancy, and reduced home ownership.

These findings arise from a series of studies following workers laid off during the 1982 recession. The 1982 recession was the last U.S. recession involving large scale job destruction and double digit rates of unemployment. To study the effect of layoff during the 1982 recession on long-term outcomes, my coauthors and I have obtained annual data on workers' earnings, career outcomes, and their employers from the Social Security Administration spanning the entire U.S. labor market over 30 years (von Wachter, Song, and Manchester 2009). Using this data, we compare earnings over the short and long run of workers who lost their stable job at a good employer when their firm suffered a sudden mass-layoff with similar workers who did not lose their job.

We find that job displacement during a mass-layoff lowers earnings initially by about thirty percent; 15 to 20 years later, the earnings loss is still about 15-20%. Only about a quarter of workers ever recover their old earnings level. Thus, even though the economy recovered after a few years following the 1982 recession, laid off workers felt the consequences for a much longer period. These findings cannot be explained by firms laying off less productive workers, or because layoffs occur in declining sectors or firms. Similarly, we find that workers of all demographic groups, of all levels of earnings, and from all industries suffer substantial losses. While the magnitudes differ, there is no group of workers exempted from substantial earnings losses.

The fact that losses are pervasive throughout the labor market suggests there is no reason to presume that lasting earnings losses are limited to the 1982 recession. In fact, our data allows us to reproduce the finding for job losses occurring in each year of the 1980s and 1990s. The results show that even workers displaced in boom times suffer non-negligible earnings losses. We find a clear cyclical component in the cost of job displacement, with lower unemployment rates leading to lower earnings declines and somewhat faster recovery. Yet, only a boom such as in the late 1990s tends to completely erase earnings gaps associated with job displacement.

Using the same research strategy, we also find that the incidence of mobility across jobs, industries, and regions rises sharply after job loss. Careers stabilize slowly, and ten years after the initial loss workers have settled in a new job, industry, and state, typically at a lower level of earnings. During this phase of adjustment, the volatility of earnings rises and falls again. Given the large number of workers laid off in the early 1980s, these patterns contributed to a rise and decline in mobility and instability in the U.S. labor market as a whole. And given the high incidence of job destruction, it is likely that a similar pattern of prolonged instability would arise in the aftermath of the current recession.

Using a separate data source containing information on both job loss and exact date of death for over twenty five years, we show that during this initial phase of 'intensive stress,' the mortality rate rises substantially for job losers (Sullivan and von Wachter 2009). As workers settle, the mortality rate declines again. Yet it remains permanently above that of those workers who did not lose their jobs. For a worker losing his job in middle age, if sustained indefinitely, this mortality rate implies a loss in life expectancy of about one and half years. These results complement findings in the literature suggesting that layoffs affect many aspects of workers' lives, from earnings and consumption to health and child care.

The finding of large scale earnings losses at layoffs gives new impulses to the economic modeling of the labor market, as they are difficult to explain for many standard micro and macro economic theories. From a theoretical point of view, it appears implausible that workers and firms would not find a way to internalize at least part of the large earnings losses we find. In fact, many economic models assume that job separations must be mutually efficient for workers and firms – yet this seems implausible in the light of the large losses we find.

There are two leading explanations for the cost of displacement during recessions. On the one hand, some industries may be shrinking, leading workers with skills that may not be demanded

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anymore. On the other hand, it appears that at least some of the workers losing their jobs may have had higher than average wages. These wage premiums may have arisen from a long period of job search, or because workers bargained their wages up in good economic times (Schmieder and von Wächter 2009a). If firms have to restructure, because of difficult economic conditions, such wage premiums are lost and may take a long time recover.

Studies of first-time labor market entrants also shed light on the channels through which recessions affect long-term career outcomes. Workers entering the labor market in a recession suffer earnings consequences lasting 10-15 years, depending on the strength of the recession and on their education background. A key mechanism behind the initial loss is that entrants find jobs at lower paying employers (Oreopoulos, von Wächter and Heisz 2008). A first part of earnings recovery occurs by finding better employers. A second part then occurs within the firm as workers move up the career ladder or accumulate specific skills. A similar process may occur for job losers, probably at a slower pace as mature workers may be less mobile.

The long-term earnings losses we find also shed a new perspective on government policy. The main policy tool to deal with large-scale job losses has been to extend the duration of unemployment insurance (UI) from six months to up to two years. Besides providing immediate income assistance to the unemployed, the goal is to help workers in the search for new jobs. A well known problem with UI is that it may itself prevent workers from accepting new jobs. This is a particular problem in large recessions, where the wage that many workers can realistically get is likely to have fallen, for example due to industry restructuring.

To assess whether extended duration of unemployment benefits in recessions indeed helps to prolong unemployment, Schmieder and von Wächter (2009b) have studied large extensions of UI durations in Germany. The short and long-term effects of layoffs in Germany are similar to those in the U.S. (Schmieder and von Wächter 2009c). Using information on all workers who ever became unemployed in Germany over the last thirty years, we exploit the fact that the duration of benefits in Germany depends on exact age. The fact that workers above and below the age threshold differ by just a few weeks of birth and are thus very similar leads us to study almost random variation in benefit duration – close to the ideal experiment a researcher would want to run but cannot.

We do not find that that extended UI has stronger disincentive effects in recessions. On the other hand, we also do not find that extended UI helps workers get better jobs. At best, workers staying unemployed longer tend to have slightly lower earnings. This finding may not come as a surprise – it may simply be too difficult to make up for the large declines in earnings from losses in industry specific skills or the quality of job matches formed over many years by searching longer.

Given the insufficiency of UI to cover the large and long-term earnings losses, a potential concern is that job losers will turn to other government programs that are typically not meant to help smooth economic losses. The two main candidates are federal disability insurance and Old Age Social Security benefits. Using the same data source as above, we are in the progress of studying whether workers eligible for these programs are more likely to permanently exit the labor force, putting a burden on social security.

Overall, our findings suggest that we may see the shadow of the so-called “great recession” of 2008 on laid off workers and the labor market for some time to come and long when the recession itself is over. Displaced workers not only face diminished earnings prospects, but also a prolonged period of job and earnings instability. Many of them are likely to be among first affected in a new downturn. A picture emerges where the cost of recessions appears substantial, and is distributed highly unequally in the population, with job losers and labor market entrants bearing most of the brunt. It also appears that the U.S. labor market is less forgiving than generally believed.

These findings may require new ways of thinking about the labor market that allow for such long-term costs alongside with the potential benefits of restructuring and reallocation.

Till von Wächter is an Associate Professor of Economics at Columbia. He has recently been awarded a five-year (R01) research grant from the National Institute of Aging for his project “The Short and Long-Term Effects of Job and Earnings Losses on Health Outcomes”.

Papers Cited:

“Long-Term Earnings Losses due to Mass-Layoffs During the 1982 Recession: An Analysis Using U.S. Administrative Data from 1974 to 2004” (joint with Jae Song and Joyce Manchester, 2009)


“The Labor Supply Effects of Unemployment Insurance on Labor Supply and Search Outcomes” (joint with Johannes Schmieder and Stefan Bender, Columbia University, Department of Economics Discussion Paper No. 0910-08, 2009b)

“The Long-Term Impact of Job Displacement in Germany During the 1982 Recession on Earnings, Income, and Employment” (joint with Johannes Schmieder and Stefan Bender, Columbia University, Department of Economics Discussion Paper No. 0910-07, 2009c)


1 The incidence and cost of job losses we find are larger than what is implied by the Displaced Worker Supplement of the Current Population Survey, the main source of information of job loss of the Bureau of Labor Statistic. In von Wachter, Handwerker, and Hildreth (2008) we show that the Displaced Worker Survey misses substantial parts of the phenomenon of job loss, partly because a bias in individuals’ recall of job loss, partly because of a lack of a control group.

2 In von Wächter and Handwerker (2009b), we also find that job losers are less likely to own a house. This is likely to be partially due to the long term earnings reduction we find.
Professor Xavier Sala-i-Martin gave a talk to an audience of Columbia alumni in the Faculty Room of Low Library on April 6, inaugurating him as the first holder of the Grossman Chair in Development Economics.

Roger Guesnerie, of the College de France and Paris School of Economics, gave an invited lecture attended by members of the Columbia community on April 29 at Columbia Law School. The lecture was co-sponsored by the Committee on Global Thought, the Center for Research on Environmental Decisions and the Center for Climate Change Law.

“THE ECONOMICS OF CLIMATE POLICY: CHOICES FOR EUROPE AND THE US”
Columbia University invites alumni from the Department of Economics to join fellow graduate alumni and friends for the departmental reunion on Saturday, April 10, 2010. Reunion will be a wonderful time to reconnect with former classmates, colleagues, and faculty; learn about the latest developments in your field of study; and celebrate excellence in graduate education at Columbia.

Reunions are free for alumni and guests. The days’ events will include breakfast special sessions with current faculty and students, lunch, and an evening cocktail reception.

Third-year student Petra Persson will present her second-year paper “Reputable Friends as Watchdogs: Social Ties and Governance” at the AEA meetings in Atlanta in January 2010 in the session “Information, Uncertainty, Networks”.


In July, Johannes Schmieder presented his paper “Labor Costs and the Evolution of New Establishments” at the NBER Summer Institute “The Labor Supply Effects of Unemployment Insurance: Regression Discontinuity and Structural Estimates”, a joint work with Till von Wachter and Stefan Bender, was accepted at the Census RDC conference and will be presented there this October.

Lastly, “Fetal Exposures to Toxic Releases and Infant Health” with Janet Currie, was published in the AER Papers and Proceedings this May, and in the Journal of Health Economics this summer.

Walker Hanlon received the Vickrey Prize for best paper by a fourth-year student for his paper, “Clusters, Trade, and Growth”, which introduces a model that explores the effects of trade in a dynamic setting with many heterogeneous industries. Previous models in this genre suggested that trade should increase growth in some trading economies while reducing it in others. In a more general setting, the paper shows that trade can increase growth in all trading economies, if it acts to build industry clusters. Conversely, trade can reduce growth in both trading economies if it acts to destroy industry clusters. These results have implications for the application of trade, technology, and industrial policies.

Yinghua He was awarded the Wueller Prize for the best summer research proposal for his paper, “Sophistication and Efficiency in the Boston Mechanism: School Choice in Beijing”. Assuming that students’ preferences are private information, the paper models school choice the under the Boston mechanism as a simultaneous game of incomplete information. Due to the lack of strategy-proofness, submitted preference lists are not necessarily students’ true preferences. The paper describes a set of equilibrium conditions on students’ behavior which are then used to formulate the likelihood function. A simulated maximum likelihood method is used for the estimation. The result shows the behavior of players as a whole is not far from a Bayesian Nash equilibrium, suggesting most of the players are sophisticated. The paper was also presented at the Econometric Society North American Summer Meeting, which was held on June 4-7, 2009 in Boston, MA.
The department sponsors a discussion paper series for faculty, co-authors, and visitors. Download the full text of these papers at: http://www.columbia.edu/cu/economics/

Female Labor Market Conditions and Family Formation, 0809-08
— Ayako Kondo
Slack labor market conditions for women relative to men increase marriage rates for young women. One concern is that this increase may be from marginal marriages due to some females lowering their reservation match quality, and so lead to future divorces and possibly to increases in female headship and poverty. This paper examines the long-term consequences of such marriages using data from the Survey of Income and Program Participation and the Panel Study of Income Dynamics. I find that the marriages induced by relatively poor economic conditions for women reflect shifts in the timing of marriage among young women who would eventually marry anyway. Labor market conditions at age 18-20 do not affect the fraction of women who will marry by age 30. Further, labor market conditions at marriage are uncorrelated with the probability of divorce or with spouses' characteristics, and marrying young in response to labor market shocks does not significantly affect a woman's fertility or labor supply. These findings are consistent with a model in which economic conditions affect women's search intensity without affecting their reservation match quality.

Expanding “Choice” in School Choice, 0809-09
— Atila Abdulkadiroglu, Yeon-Koo Che and Yosuke Yasuda
Truthful revelation of preferences has emerged as a desideratum in the design of school choice programs. Gale-Shapley’s deferred acceptance mechanism is strategy-proof for students but limits their ability to communicate their preference intensities. This results in ex-ante inefficiency when ties at school prefer-

ces are broken randomly. We propose a variant of deferred acceptance mechanism which allows students to influence how they are treated in ties. It maintains truthful revelation of ordinal preferences and supports a greater scope of efficiency.

Bidding with Securities: Comment, 0809-10
— Yeon-Koo Che and Jinwoo Kim
Peter DeMarzo, Ilan Kremer and Andrzej Skrzypacz (2005, henceforth DKS) analyzed auctions in which bidders compete in securities. They show that a steeper security leads to a higher expected revenue for the seller, and also use this to establish the revenue ranking between standard auctions. In this comment, we obtain the opposite results to DKS’s by assuming that a higher return requires a higher investment cost. Given this latter assumption, steeper securities are more vulnerable to adverse selection, and may yield lower expected revenue, than flatter ones.

The Racial Geography of Vice, 0809-11
— Brendan O’Flaherty and Rajiv Sethi
Street vice (anonymous prostitution, gambling, and the sale of illicit drugs) is spatially concentrated, confined largely to black neighborhoods in central cities, even though demand is quite evenly distributed throughout the general population. We show how this pattern can arise through the interacting location decisions of sellers, buyers, and non-user households. Areas with high demand density (cities) have lower prices and more tightly packed sellers in equilibrium relative to areas with lower demand density (suburbs) under autarky. When trade between city and suburb is possible, competitive pressure from the city lowers suburban prices and seller density. Higher income households distance themselves from street vice, causing the exposed population to become poorer and disproportionately black. Even mild preferences over neighborhood racial composition can then induce lower incomes whites to exit, resulting in racial segregation. The relationship between segregation and exposure to vice can be non-monotonic and discontinuous: decreased segregation implies greater sorting by income, and hence larger wage disparities between city and suburb. If such disparities get too large, all sales can shift discontinuously to the city and result in higher overall black exposure even though more blacks now reside in the suburbs.

Information-Constrained State-Dependent Pricing, 0809-12
— Michael Woodford
I present a generalization of the standard (full-information) model of state-dependent pricing in which decisions about when to review a firm’s existing price must be made on the basis of imprecise awareness of current market conditions. The imperfect information is endogenized using a variant of the theory of “rational inattention” proposed by Sims (1998, 2003, 2006). This results in a one-parameter family of models, indexed by the cost of information, which nests both the standard state-dependent pricing model and the Calvo model of price adjustment as limiting cases (corresponding to a zero information cost and an unboundedly large information cost respectively). For intermediate levels of the information cost, the model is equivalent to a “generalized Ss model” with a continuous “adjustment hazard” of the kind proposed by Caballero and Engel (1993a, 1993b), but provides an economic motivation for the hazard function and very specific predictions about its form. For high enough levels of the information cost, the Calvo model of price-setting is found to be a reasonable approximation to the exact equilibrium dynamics, except in the case of (infrequent) large shocks. When the model is calibrated to match the frequency and size distribution of price changes observed in microeconomic data sets, prices are found to be much less flexible than in a full-infor-

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Credit Spreads and Monetary Policy, 0910-01
– Vasco Cúrdia and Michael Woodford

We consider the desirability of modifying a standard Taylor rule for a central bank’s interest-rate policy to incorporate either an adjustment for changes in interest-rate spreads (as proposed by Taylor, 2008, and by McCulley and Toloui, 2008) or a response to variations in the aggregate volume of credit (as proposed by Christiano et al., 2007). We consider the consequences of such adjustments for the way in which policy would respond to a variety of types of possible economic disturbances, including (but not limited to) disturbances originating in the financial sector that increase equilibrium spreads and contract the supply of credit. We conduct our analysis using the simple DSGE model with credit frictions developed in Cúrdia and Woodford (2009), and compare the equilibrium responses to a variety of disturbances under the modified Taylor rules to those under a policy that would maximize average expected utility. According to our model, a spread adjustment can improve upon the standard Taylor rule, but the optimal size is unlikely to be as large as the one proposed, and the same type of adjustment is not desirable regardless of the source of the variation in credit spreads. A response to credit is less likely to be helpful, and the desirable size (and even sign) of response to credit is less robust to alternative assumptions about the nature and persistence of the disturbances to the economy.

Resolving Conflicting Preferences in School Choice: the “Boston” Mechanism Reconsidered, 0910-02
– Atila Abdulkadiroglu, Yeon-Koo Che, and Yosuke Yasuda

The Boston mechanism is among the most popular school choice procedures in use. Yet, the mechanism has been criticized for its poor incentive and welfare performances, which led the Boston Public Schools to recently replace it with Gale and Shapley’s deferred acceptance algorithm (henceforth, DA). The DA elicits truthful revelation of “ordinal” preferences whereas the Boston mechanism does not; but the latter induces participants to reveal their “cardinal” preferences (i.e., their relative preference intensities) whereas the former does not. We show that cardinal preferences matter more when families have similar ordinal preferences and schools have coarse priorities, two common features of many school choice environments. Specifically, when students have the same ordinal preferences and schools have no priorities, the Boston mechanism Pareto dominates the DA in ex ante welfare. The Boston mechanism may not harm but rather benefit participants who may not strategize well. In the presence of school priorities, the Boston mechanism also tends to facilitate a greater access than the DA to good schools by those lacking priorities at those schools. These results contrast with the standard view, and caution against a hasty rejection of the Boston mechanism in favor of mechanisms such as the DA.

Preferences and Equilibrium in Monopoly and Duopoly, 0910-03
– Yongmin Chen and Michael H. Riordan

This paper takes the new approach of using a copula to characterize consumer preferences in a discrete choice model of product differentiation, and applies it to the economics of monopoly and duopoly. The comparative statics of demand strength and preference diversity, both properties of the marginal distribution of values for each product variety, are strikingly similar across market structures. Preference dependence, a property of the copula and an indicator of product differentiation, is a key determinant of whether prices are higher in multiproduct industries compared to single-product monopoly. Furthermore, the effects of preference on prices and profits influence equilibrium product selection. Remarkably, a horizontally-differentiated duopoly sometimes can foreclose a higher-quality monopoly to the detriment of consumer and social welfare.

Son Preference, Sex Selection and Economic Development: Theory and Evidence from South Korea, 0910-04
– Yongmin Chen and Michael H. Riordan

Motivated by high and rising sex ratios in countries such as India and China, we
formulate a theoretical framework for analyzing the impact of economic development on parental sex choice when sons are culturally prized and children provide old age support. Two key assumptions drive our model. First, the cultural valuation of children vary not only with gender but also with marital status. In particular, while a married son is preferred to a married daughter, the latter is preferred to an unmarried son. Second, we assume that faced with a shortage of brides, poor parents will have a harder time marrying their sons than rich parents. Our model predicts male sex ratios at low levels of development, where the surplus sons are chosen by the poorest who forego grand-children for old age support. With development, incomes and the bride price rise, allowing the poorest reproductive children. Consequently, sex ratios fall, and the relationship between parental income and offspring maleness turns positive. We also present corroborative evidence from South Korea, a now developed country which shares with India and China a strong patriarchal culture and a recent past of poverty.

Group Incentives for Teachers: The Impact of the NYC School-Wide Bonus Program on Educational Outcomes, 0910-05
— Sarena Goodman and Lesley Turner

In current debates regarding the future of education, teacher compensation schemes are often criticized for their lack of performance-based pay. Proponents of merit pay for teachers argue that tying teacher salaries to student achievement will induce teachers to focus on the success of their students and stimulate innovation in the school system as a whole. In this paper, we use a randomized policy experiment conducted in the New York City public school system to explore the effects of one group-based pay scheme. We investigate potential impacts of incentive pay over two academic years (2007-2008 and 2008-2009) on student performance on annual math and reading exams, teacher absences, and responses to environmental surveys of teachers and students. We also consider whether the program had differential outcomes on groups within schools that were especially likely to be targeted, given the particular incentive structure of the program. Last, we explore relative impacts on the market for teachers by examining end-of-year teacher turnover and the quality composition of newly hired teachers. In general, we find no significant effects of this program. However, there is some evidence that the program reduced teacher absenteeism in schools with a small number of teachers, and that these effects were weakened in larger schools by the presence of free-riding.
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(Paris School of Economics) April 27-May 1

Bart Lipman
(Boston University)
May 4-8

Yoram Weiss
(Tel Aviv University)
May 11-15

RECENT FACULTY BOOKS

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The Aid Trap: Hard Truths About Ending Poverty

By R. Glenn Hubbard and William Duggan (Columbia University Press, August, 2009)

A bold fusion of ethics and smart business, this book shows how the same energy, goodwill, and money that we devote to charity can help business save the world. By diverting a major share of charitable aid into the local business sector of poor countries, citizens take the lead in the growth of their own economies. While the aid system supports noble goals, a local well-digging company cannot compete with a foreign charity that digs wells for free. By investing in that local company, a sustainable system of development can take root.

NBER Macroeconomics Annual 2008, Volume 23

Edited by Daron Acemoglu, Kenneth Rogoff, and Michael Woodford, (University of Chicago Press, July 2009)

The contributors to this volume analyze the forces behind India’s emerging role as a world economic player and identify the hidden weaknesses that, if unaddressed, may slow the country’s growth. Chapters suggest how to transform India’s primarily rural population into a gainfully employed modern sector; methods to achieve fiscal sustainability and consolidation; infrastructure bottlenecks, especially in terms of finite energy resources; and, given the country’s complex electoral government and global political position, the obstacles toward effecting policy reform.

Saving Kyoto by Graciela Chichilnisky and Kristen A. Sheeran

Saving Kyoto focuses on international efforts to confront the global warming crisis and provides an overview of the history of global climate negotiations, explaining why international cooperation between poor and rich nations has become critical. Detailing how the Kyoto Protocol originated, the debates and conflicts leading up to its signing in 1997, the main protagonists behind its creation and the current issues that threaten to undermine it, the book explains the importance of the carbon market from an insider’s perspective.
What determines human health is known only in part. Even where causal pathways have been identified, great uncertainty frequently exists regarding the strength of the relationship. Compelling and precise estimates of these relationships are needed to inform public policies that will improve population health. This project seeks to improve understanding of these relationships, using natural and quasi-experiments. The project highlights a research design on the use of Ramadan to study the effects of maternal nutrition; the effects of heating subsidies in China to study the effects of pollution on prenatal development; and the impact of obesity report cards on obesity and health in Arkansas.

This proposal argues that refutable research hypotheses can be evaluated in an observational setting where identifying variation is plausibly exogenous. Ideally, the research hypothesis has strong implications which can be evaluated in available (i.e. pre-existing) data. The most compelling empirical comparisons do not require sophisticated econometric fixes. Instead, good natural experiments can identify treatment effects with minimal statistical adjustment. The cleanest of experiments, where the treatment is randomly assigned, requires only the comparison of means to estimate causal effects. This controlled experiment should be emulated wherever possible. Operationally, the proposed approach seeks to unearth comparisons in an observational setting where unadjusted impact estimates are quite similar to regression-adjusted impact estimates.

Inflation is one of the most used concepts by economists, with a search for the term in research databases yielding thousands of matches. Most work in the area of price indices uses static models, e.g., of consumers maximizing one-period utility with no uncertainty, while most modern macroeconomics is explicitly dynamic. The goal of this project is to use dynamic models to construct new measures of inflation. In particular, the PI will try to answer three separate questions.

The first question is how to measure the cost-of-living for an agent that lives for many periods and wants to be in an equally good position to fulfill its goals at the start of each period. Examples are parents planning bequests for different aged children, universities managing endowments, and households managing retirement accounts. It is well-known that price indices that keep the consumption basket fixed suffer from a substitution bias, as an increase in the price of a good leads people to buy less of it. This research will show that there is also an intertemporal substitution bias in static measures like the CPI, since when prices go up, people will borrow from the future in response. A second insight from this work is that intertemporal relative prices, such as asset prices of the price of durables, should be included in measures of cost-of-living inflation because they capture the intertemporal trade-offs facing the agents.

The second question is what measure of inflation to index bonds to in order to provide a riskless asset. The preliminary results show that a static price index like the CPI may be the answer to this dynamic question. An infinitely risk-averse investor wishes to hold a bond that gives the same flow of utility every period, and this is the definition of a static cost-of-living price index.

The third question is how to separate price changes into relative-price changes versus pure inflation. The results indicate that conventional measures of inflation are mostly driven by changes in relative prices, and provide a 2-dimensional index that should be useful in future work that needs to control for them. This separation will also allow one to infer what accounts for the correlation between measures of inflation and real activity. If it is relative prices, then this suggests that explaining the Phillips curve requires models with many goods’ varieties and nominal rigidities, like those that have been prominent in research on monetary policy and inflation in the past decade.
**OCTOBER 26, 2009**
“The Great Indian Health-Care Mess: Problems and Ways Forward”, Lecture by Abhijit Banerjee (MIT)

*Co-sponsored by the South Asia Institute*

**OCTOBER 28, 2009**
“Lehman’s Last Days”, Undergraduate lecture with Kevin Genirs, former Managing Director and General Counsel of Investment Banking at Lehman Brothers

**NOVEMBER 10, 2009**
“Coping with Crisis: Financial Policy in the US and Japan” Conference Panel with Heizō Takenaka, Patrick Bolton, and Takatoshi Ito, moderated by David Weinstein

*Co-sponsored by the Center on Japanese Economy and Business*

**DECEMBER 7, 2009**
“Still More Lessons from the Crisis”, Address by William C. Dudley, President and CEO, Federal Reserve Bank of New York

*Co-sponsored by the World Leaders Forum and the Center on Japanese Economy and Business*

**DECEMBER 11, 2009**

*Co-sponsored by Columbia University Press, Heyman Center for the Humanities and the Committee on Global Thought*