The crisis of 2008 and all that followed woke many people around the world to the importance of finance in a modern economy. At that time, most members of the Columbia community had been aware that over the last twenty years the financial sector had become one of the largest in the U.S. economy, as well as one of the largest employers of Columbia graduates. Yet many would not have predicted that losses in financial companies would cause the largest recession in the post-war United States, an enormous contraction in world trade, and trigger an identity crisis in Europe that threatens the project of European integration.

In the past, when companies like Kodak or Worldcom went bankrupt, their competitors were happy to take over their customers and ended up thriving in the process. But when Bear Stears and Lehman Brothers failed, their competitors themselves were left in need of government assistance. Moreover, debates arose over the merits of each bailout, with companies like AIG having a lot more at stake than a company like GM.

Columbia’s Financial Economics Initiative

BY RICARDO REIS

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Research Spotlight: Prenatal Exposure to Radiation

Almond and Edlund Study Finds Long-term Effects on School Outcomes

After the 2011 tsunami damaged nuclear reactors in Fukushima, Japan, media attention turned to the impact of radiation on nearby inhabitants. Current levels of radiation considered safe have long been established through studies of previous nuclear disasters such as Chernobyl and Three Mile Island. But an article in the New York Times pointed to new research by Columbia Economics Department professors Douglas Almond and Lena Edlund showing that prenatal exposure to doses previously considered acceptable could have cognitive effects for those children later in life.

In their paper, “Chernobyl’s Subclinical Legacy: Prenatal Exposure to Radioactive Fallout and School Outcomes in Sweden,” Almond and Edlund pointed to data collected on the academic performance of stu-
Looking over previous editions of this newsletter, I am struck by the vision that previous chairs had for the future of this department. In 2001, the department and the university began work on an ambitious plan to return Columbia Economics to a top five ranking. We, of course, have made great strides in this area. The size and diversity of the faculty has increased steadily in the last decade, economics plays a larger and more important role in the undergraduate curriculum at Columbia, and our incoming class of graduate students is one of the largest in memory.

We’re remaining focused on our commitment to return Columbia to the top five. We’re doing so through increased initiatives in faculty recruitment, both at the junior and senior level, as well as through visiting faculty. We’re enrolling larger cohorts of graduate students. And we’re taking steps toward initiatives that will place us on the cutting edge of technological research.

This year, we introduce several new faculty members to the department and the university.

- Christoph Rothe comes to us from Toulouse School of Economics. He earned his Ph.D. at the University of Mannheim in 2009, and he works in Econometrics.
- Eduardo Morales comes to us after having completed a one-year fellowship at Princeton. He earned his Ph.D. from Harvard University in 2011. He works on International Trade, Industrial Organization, and Econometrics.
- Supreet Kaur, who has a joint appointment with SIPA, comes to us from Harvard, where she completed her Ph.D. in 2012. Her work is in the area of Developmental Economics and Political Economy.
- Andrea Prat, who has a joint appointment with the Business School, comes to us from LSE. He earned his Ph.D. from Stanford in 1997 and he works on Contracts and Organization, Industrial Organization, Microeconomics, and Political Economy.

At the same time, a few of our colleagues have moved on to other positions and we will sorely miss them: Dennis Kristensen moved to University College London, Till von Wachter to UCLA, Bruce Preston to Monash University in Australia, and Stefania Albanesi remains a neighbor after having moved downtown to work as a Senior Economist at the Federal Reserve Bank of New York.

I should also mention that this year we will host two Wesley Clair Mitchell Research Professors. Giacomo de Giorgi is our Mitchell Visiting Research Professor this fall. He is visiting us from Stanford University, where he has been since he earned his Ph.D. from the University College London in 2007. Olivier Terceux will visit in the spring. He comes to us from the Paris School of Economics, where he has been since 2009. Visiting faculty members make the department more visible in the economics community, and they give us a pool from which to consider future important senior prospective faculty. Thus, we intend to expand the number of visitors we invite to the department each year. Our large number of PER visitors for this semester are introduced later in this newsletter.

An increase in the size, quality, and diversity of our faculty means that we can enroll a larger and more diverse incoming class of graduate students. Of the many hundreds of qualified applicants that we received, we admitted more than 70 students, and enrolled 33. This is the largest incoming class of graduate students in my memory and reflects one of the highest yields ever. Last year’s success in graduate recruitment reflects the tremendous success our students had on the market last year and the enormous innovations we have made to graduate teaching. Dan O’Flaherty, the department’s Director of Graduate Studies, tells me that in the next few years, I should expect many fine dissertations, which means that we will send many fine young economists out into the world to represent their excellent Columbia training.

And we achieved all of these advances in the graduate sphere while maintaining and growing Economics as the largest undergraduate major on campus. We have un-
From the Chair
Continued from Page 2

It’s a very exciting time in the department. We’re expanding our relationship with ISERP by opening the new Columbia Experimental Laboratory for Social Sciences. Please read about this new exciting development in this newsletter. I invite you to visit the Columbia Economics website at http://econ.columbia.edu and read about our research, teaching, and public events. The site announces upcoming public events sponsored by PER, and will keep you up to date on the many accomplishments of the Economics faculty and students. We look forward to maintaining our excellent relationship with our alumni, and invite to become involved in the many talks, workshops, and colloquia that are hosted throughout the year.

David E. Weinstein is the Chair of the Department of Economics and the Carl S. Shoup Professor of the Japanese Economy.

News from the Graduate Program

Michael Mueller-Smith was invited to become a price theory Scholar at the Becker Center in the University of Chicago, Booth School of Business.

At Chicago, Michael will be studying price theory with Gary Becker and Kevin Murphy, and further developing his dissertation under the guidance of Chicago faculty.

This year’s co-winners of the Vickrey Prize for best third year paper were Mike Mueller-Smith for “Program Evaluation with Randomized Screeners: Estimating Heterogenous Instrumental Variables (HRIV) Models” and Joan Monras, for “Low skilled Immigration and labor market outcomes: Evidence from the Mexican Tequila Crisis”.

Mike’s paper considered a growing literature on program evaluation with randomized “administrative screeners” (e.g., court judges). Researchers have recently sought to evaluate social programs through comparing individuals who were randomly assigned to screeners with high versus low overall program assignment propensities. To improve on existing methodologies, he proposed estimating screener-specific decision rules using flexible interactions between individual characteristics and screener assignment. The modified technique can provide an improvement in precision through improved power and a reduction in bias from reducing monotonicity violations. Mike applies these techniques to a new dataset that he collected covering 30 years of criminal court records from Houston, Texas to estimate the impact of type (e.g., probation, incarceration) and intensity (e.g., duration of punishment, amount of fine) of criminal sentencing on future recidivism. Empirical results show that current methods versus the proposed, modified technique yield different conclusions from both an economic and statistical perspective.

Joan’s paper addresses the debate on whether immigration significantly affects labor market outcomes. As a result of the unexpected Mexican economic crisis of 1995, many Mexicans decided to migrate to the US. Those Mexicans tended to be young low skilled workers that migrated to high immigration states. This unexpected shock is used to document the impact that immigration has on host labor markets. A 10% immigration induced supply shock is likely to decrease US wages by around 7-10% on impact. For every 10 Mexicans immigrants, around 7 young low skilled natives reallocated towards low immigration states. This helps to explain why in the third year after the shock the effect is imperceivable. This suggests that: 1) endogeneity might have plagued previous studies relating wages and immigration and 2) the US labor market absorbs shocks quite rapidly.

Monras was also the winner of the Wueller paper prize last year.

Katherine Meckel’s work on the WIC program was accepted to the Fall 2012 APPAM (Association for Public Policy Analysis and Management) Conference this November.

Her paper focuses on the trade-off between cost containment and access in the context of the Special Supplemental Nutrition Program for Women, Infants and Children (WIC), a federally funded, state-run program that contracts with grocery stores to provide nutrition to low-income families. She finds that cost containment initiatives are successful in reducing prices but cause certain types of vendors to leave the program and may reduce access to food as a result.

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Columbia’s Financial Economics Initiative

Continued from Page 1

It has become very clear that any informed citizen who wants to understand the world must have a basic knowledge of financial concepts and of the role that banks and securities markets perform. For students who are in search of this knowledge, majoring in economics has long been the natural route. The core classes in economics at Columbia teach the most important concepts behind financial choices and their regulation. Students learn about how people like higher returns yet dislike risk, and how to think about the demand for insurance and for hedging risks. They learn about the importance of allocating capital to its highest marginal in the process of economic growth, and how banks and financial markets play a role in this process. In other economics classes, students learn that there are governance problems whenever investment decisions are delegated, and that agents with bad incentives can engage in excessively risky activities.

In past years, the Department of Economics offered elective classes in corporate finance and asset pricing. These courses enabled a small number of students to deepen their knowledge of financial economics, and more specifically to apply economic concepts to the financial sector. But the financial crisis led to an increase in student interest in these topics, and these classes typically became over-subscribed. The number of students majoring in economics doubled between 1991 and 2011, and currently more than 4,000 undergraduate students take classes offered by the economics department. A small but significant and rapidly growing share of these students has expressed their desire to learn more about financial decisions and markets.

The department responded to this demand by recently creating a new major in financial economics. It is similar in structure to the successful economics major, but students must take a set of core courses in financial accounting, financial economics and corporate finance. Among the topics that students can now focus on are financial markets, banks and other intermediaries, asset valuation, regulation and corporate governance. Financial economics majors can acquire an academic framework to understand not only what went wrong in 2008, but also what the path forward is. They can intelligently discuss the choices that we must make, both in the public and private sectors. They can do so with the well-known rigor offered by a traditional economics major, and with the focus on understanding and shaping the world that is characteristic of a Columbia education.

In its first two years, the financial economics major was a great success, and it already represents 19% of all majors served by the department. The response from these students provides the clearest argument for the department’s ambition in creating this new major. They see financial economics as an integral part of their economic perspective on the world around them. They engage constructively in the crucial debates about regulating financial markets and institutions while remaining keenly aware of the trade-offs between spurring financial innovation, insuring society against the inherent fragility of financial institutions, and providing proper incentives for managers. They can decode the meaning of CAPM, CDS, or LBOs with the confidence that behind this impressive-looking jargon almost always lie simple ideas that should be questioned. They can provide interpretations for the capital flows from China or the troubles of sovereigns in Europe, and they can understand what the IMF or the FDIC do and do not do.

To continue this effort, the Economics Department has also recently established the Financial Economics Initiative (FEI) as part of its Program for Economic Research (PER). In addition to trying to expand the still very limited offering of senior seminars in financial economics, FEI is taking advantage of the unique opportunities that Columbia’s central location affords. It is working to bring global business and financial leaders to interact with students and to help in the process of their educational enrichment. It has been working with PER to organize stimulating public events, lectures, and conferences on the intersection between financial economics and other fields of economics. It is helping to create the conditions that would allow the department to attract more scholars working in financial economics as well as the necessary funds to support undergraduate research internships in the field. Overall, it is engaged in promoting the active research environment that made Economics at Columbia such a vibrant department.

Some, but not all, top universities have realized that the view of finance as a mere trade, or set of tools, more adequate for professional schools but inconsistent with a high-level liberal arts education is increasingly outdated. Policymakers and the general public need a general understanding of the core concepts of financial economics in order to be able to engage in a world where financial decisions are constantly made, financial markets are an integral part of the economy, and financial policies and regulations have such strong implications for the general well-being. There remains much work to be done to solidify the financial economics major, as well as to integrate financial economics as an active field of research within the department. But by giving its undergraduates the opportunity to learn more about financial economics, Columbia is establishing itself at the forefront of the Ivy League schools.
Phillip Cagan, Emeritus Professor, passed away on June 15th, 2012, in Palo Alto, CA. Professor Cagan was a member of the department from 1966-95, and made significant contributions to the field of economic science, most notably to monetary economics and the study of inflation.

Prof. Cagan published over 100 books, journals, reviews, reports and pamphlets. His Ph.D. dissertation, “The Monetary Dynamics of Hyperinflation,” published as the leading chapter in the volume “Studies in the Quantity Theory of Money” (University of Chicago Press, 1956), was immediately acclaimed as a classic, and has continued to be a staple of reading lists of courses in monetary economics for more than 50 years. It remains the definitive study of the problem of hyperinflation, the definitions and concepts of which provide the starting point for all subsequent work on this problem.

On September 14, 2012, faculty, family and friends gathered at Deutsches Haus to remember Professor Cagan. Professors Michael Woodford and Ronald Findlay spoke of the impact that Professor Cagan’s work is having on today’s economics students.
From the Director of the Program for Economic Research

BY MICHAEL WOODFORD

PER continues its activities to enhance the environment for research in economics at Columbia on several fronts. One of its important functions is assisting faculty with applications for research grants, and managing the grants that are funded. In addition to the direct support provided for faculty research, sponsored research budgets fund places for some of our top graduate students, alleviating pressures on the Graduate School of Arts and Sciences; and indirect costs (or ‘overhead’) generated by sponsored research budgets help Columbia to pay for critical infrastructure needs, such as computing, that support this work. Thanks to our continuing initiatives in this direction, PER currently has grants worth $8.4M under management, and already this fall Columbia faculty and graduate students have submitted 15 new grant proposals through PER. As budgets tighten at some of our department’s traditional sources of research grants, we are working with faculty to identify possible new funding sources, such as smaller foundations.

PER also maintains an active short-term visitors’ program, under which scholars from around the world are able to spend a week at Columbia, presenting their work and engaging in longer discussions with Columbia researchers than are afforded by a single seminar presentation. We have eight visitors coming through during the fall semester and expect to have a similarly active schedule of visitors during the spring.

Among our contributions to research infrastructure in the Department, a recent initiative has been support for the creation of the Columbia Experimental Laboratory for the Social Sciences. Until now, Columbia faculty seeking to conduct laboratory experiments have generally had to use the facilities of other universities, and our PhD students have had little opportunity for involvement in this type of research. The new Columbia lab is expected to be operational this semester, and we expect this to greatly increase the visibility of experimental economics at Columbia, especially as a part of PhD dissertations.

Finally, PER continues its role in sponsoring awareness of economic issues among the broader campus community. Campus events that we have sponsored this fall include a public lecture by Thomas Piketty (Paris School of Economics) on historical trends in income and wealth inequality; a conversation with Sheila Bair (until recently Chairman of the FDIC) about her experiences in Washington; and a debate in Low Library between the chief economic advisors of the two leading candidates for President. These events have each attracted considerable interest, and we hope to organize events of similar interest in the spring. Probably as a result of the continuing turbulence in the global economy, curiosity about economic issues outside our department seems particularly high at present; and PER is happy to play a role in facilitating broader awareness of what economists have to say about topics of widespread concern.

Michael Woodford is the Executive Director of the Program for Economic Research and the John Bates Clark Professor of Political Economy.
Prenatal Exposure to Radiation

Continued from page 1

dents who had been gestating in the womb between eight and twenty-five weeks when the radiation cloud from Chernobyl passed over Sweden. They found that academic performance in their last year of school was significantly lower than those in other age groups, particularly in math. They also found that those in the group performed worse than their siblings did.

“The brain is particularly vulnerable at that early stage of development,” says Edlund. “It grows fast under a compressed period of time and this is when the cells are much more susceptible to radiation.” She adds that this prenatal cell death has been underestimated in follow-up studies which usually pay attention to cancers caused by radiation.

Edlund focused on her native Sweden in order to isolate the effects of radiation on cognitive development. Studying a similar set of Chernobyl residents would have been difficult because they suffered debilitating effects that were caused by the accident continued on page 9

New Faculty in 2012–2013

In the fall of 2012, the Economics Department welcomed four new faculty members to Morningside. Christoph Rothe received his PhD from the University of Mannheim and joins Columbia from the University of Toulouse. He works in the field of econometrics. Eduardo Morales, joining the department after a one-year fellowship at Princeton, received his PhD from Harvard and works in the area of international economics.

Supreet Kaur is a joint appointment with the School of International and Public Affairs. She received her PhD from Harvard and is a development economist.

Andrea Prat is the Richard Paul Richman Professor of Business and Professor of Economics. He joins Columbia from the London School of Economics, where he worked in the fields of industrial organization and microeconomics.
Healthcare differences are pervasive in United States hospitals. This proposal aims to understand why patients with the same underlying health conditions receive different treatments, incur different costs, and experience different outcomes. There are conceivably many factors that affect patient care, but one factor may be the quality of the patient’s attending physician, and another factor may be the patient’s health insurance category.

The first paper in this proposal asks how well physician characteristics explain the variance in patient treatments, costs, and outcomes. It uses the quasi-randomization of emergency room (ER) patients assigned to ER physicians, where the timing of the visit determines the assignment. It uses hospital data on inpatient, outpatient, and ER visits from 2005–2009 in Florida, and matches these records to physician characteristics on the attending physician licenses. It aims to answer questions previously unaddressed in the literature, such as whether physician characteristics explain hospital revisits and whether ER physician referrals for outpatient care affect patient healthcare.

The second paper asks how changes in Medicaid budgets affect program enrollment, spending, and hospital care. It uses the expiration timing of the federal medical assistance percentages (FMAPs) under the American Recovery and Reinvestment Act. The county-level data on Medicaid total enrollments, total payments, managed care enrollments, and managed care payments will be collected from California, Florida, and New York for 2010–2011. They will be used to determine how Medicaid enrollments and spending change in response to changes in the FMAPs. The proposal also uses data on inpatient, outpatient, and emergency room visits in CA, FL, and NY to identify how FMAP changes affect hospital utilization and hospital care. Outcomes of interest include ER visits, likelihood of hospitalization, and hospital revisits.

The ways in which physicians affect hospital healthcare are not entirely clear. The first paper has several advantages over current papers in terms of its data and methodology. The data contain patient revisits and physician referrals for outpatient care, neither of which have been studied. The methodology restricts to ERs to limit selection on the patient-physician assignment.

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Most Medicaid research deals with eligibility expansions. The 2011 expiration of ARRA FMAPs represents one of the first exogenous contractions to Medicaid budgets. In response, states are trying to reduce Medicaid spending by adjusting provider payments. The second paper is the first to address how these contractions affect Medicaid enrollment and hospital care.

The first paper focuses on how emergency room physicians affect patient care. Emergency rooms are meaningful laboratories for analysis, as ER visits have increased over time and ERs provide healthcare to underserved populations (e.g., uninsured). This paper has the ability to advance the field of knowledge on physicians, while also generating implications for how healthcare services are delivered to a large subset of the population. The second paper also focuses on underserved groups (e.g., low-income). It is important to understand how Medicaid policy affects their health insurance status and the quality of healthcare they receive. It is also important to understand the consequences of the FMAP; it will give policy-makers more information about how counties and hospitals might respond to changes going forward.
but were not directly related to radiation: being evacuated and displaced from their homes, becoming stigmatized as victims, suffering from economic setbacks. “It’s hard to disentangle these effects,” she says, “and the literature has been careful to point that out.” Sweden, among other Scandinavian countries, also has a wealth of data that aided in the couple’s research.

Almond had for many years been following the research on radiation fallout in areas of nuclear testing. While his interest in the subject had remained on the backburner, it was brought to the fore when Edlund noticed a map in Nature magazine, published in 2006 on the 20th anniversary of Chernobyl, which traced the effects of the disaster and indicated that Sweden had received significant radiation. They noted that not been much attention had been paid to the less obvious effects of the fallout in the region. Recently, their paper has caught the interest of radiologists and researchers who are conducting their own investigations into the issue to the issue. For example, Kjell Salvanes, a PER visiting fellow for Fall 2012, is studying the effects of prenatal exposure to radiation in Norway.

Almond and Edlund’s work together represents the intersection of their interests. Almond’s research focus has been largely on the subject of fetal origins hypothesis, in tracing fetal conditions to adult successes. Some of his recent research has included the study of birth outcomes of mothers who received food stamps and the study of lingering effects of in utero influenza during the pandemic of 1918. More recently he has been interested in tracing different effects in fetal origins by gender and accordingly has been tracking the gender effects of land reforms in China.

Edlund, whose interests are primarily in the status of women and in sex selection, approaches prenatal studies with a primary interest in the mother of the child. “It’s a long-standing argument that we have to pay attention to women but at the same time there are parts of the world where women eat last and eat the least nutritious food. Feeding the woman is feeding the child which is something that has been underestimated.” Her research together with Almond has also followed the effect of maternal malnutrition and its effect on adult outcomes of the offspring during the famine of the Great Leap Forward in China.

The couple’s latest working paper, “O Sister Where Art Thou? The Role of Son Preference and Sex Choice: Evidence From Immigrants to Canada” studies sex ratios among Asian immigrants and finds them to be “normal at first parity, but rising with parity if there were no previous son.” While a higher than biologically normal sex ratio in Asian countries has been attributed to “poverty and a cultural emphasis on male offspring,” these factors can be eliminated in the case of Asian immigrants in Western countries who tend to be better off, not in need of male sons to support them in old age, and not living in a society which values the birth of males over females. They find that the causes for higher sex ratios can be isolated to a preference for sons stemming from ingrained religious and cultural preferences. The couple had undertaken a previous study of the U.S. census in the year 2000 that showed similar patterns.

Recently, their research has been used by those arguing for greater restrictions on abortions that are carried out on the basis of sex selection. Their papers were cited by an editorial in the Canadian Medical Association Journal arguing for a ban on sex disclosure made by medical professionals in the first thirty weeks of pregnancy. Their U.S. census study which found evidence of sex selection among Asian immigrants was cited in PRENDA, or the Prenatal Non-discrimination Act. The legislation, which also intended to curb sex-selection-based abortions, was presented to Congress this summer for a vote, but it fell short of a two-thirds majority.

The couple intends to continue to work on research together, analyzing sex ratios in immigrant communities as well as doing further research on prenatal radiation exposure.
Visitors to the Program for Economic Research

FALL 2012
Each week, researchers and scholars visit the Columbia Economics Department under the auspices of the Program for Economic Research (PER). Interactions in workshops and seminars advance the body of knowledge and encourage collaboration between economists at Columbia and throughout the world.

PIERRE-OLIVIER GOURINCHAS
(UC Berkeley)
September 10-14, 2012

KALYAN CHATTERJEE
(Pennsylvania State University)
September 24-28, 2012

ANDY SKRZYPACZ
(Stanford University)
October 1-3, 2012

RICHARD VAN WEELDEN
(University of Chicago)
October 8-12, 2012

MARK DEAN
(Brown University)
October 15-19, 2012

GIANCARLO CORSETTI
(Cambridge University)
October 22-26, 2012

JOHANNES HÖRNER
(Yale University)
November 12-16, 2012

JOSÉ TAVARES
(Universidade Nova de Lisboa)
December 3-7, 2012

Recent Faculty Articles

PIERRE-ANDRÉ CHIAPPORI
“Modèles D’Appariement en Économie”
Revue économique. Vol. 63, No. 6, April 2012

GRACIELA CHICHILNISKY
“Sustainable Markets With Short Sales”
Economic Theory Vol. 49, No.2, October 2012

GRACIELA CHICHILNISKY, URS LUTERBACHER
“Climate Change, Security, and Redistribution: How Can Political Dilemmas Linked to the Global Environment Be Solved?”
Brown Journal of World Affairs Vol. 28, No.11, Spring/Summer 2012

R. GLENN HUBBARD, PHILIPPE GRÉGOIRE, MICHAEL F. KOEHN, MARC VAN AUDENRODE, JIMMY ROYER
“Is Backdating Executive Stock Options Always Costly to Shareholders?”
Accounting & Finance, Vol. 52, No. 2, 9 June 2012

ROBERT MUNDELL
“Making Europe Work”
New Perspectives Quarterly, Vol. 29, No. 3, Summer 2012

SURESH NAIDU
“Review of David Graeber’s ‘Debt: The First 5000 Years’”

SURESH NAIDU, LAURENCE WILSE-SAMSON, ETHAN KAPLAN, AND JACOB JENSEN
“The Dynamics of Political Language”
Fall 2012 Brookings Panel on Economic Activity, September 13-14, 2012

EMI NAKAMURA, JÓN STEINSSON
“Measuring Price Rigidity”
Annual Review of Economics Vol. 4, No.1, September 2012

JEFFREY SACHS
“Achieving Universal Health Coverage in Low-Income Settings”
The Lancet, Vol. 380, No. 9845, 8 September 2012

RYAN CHAHROUR, STEPHANIE SCHMITT-GROHÉ, MARTÍN URIBE
“A Model-Based Evaluation of the Debate on the Size of the Tax Multiplier”

MARTIN URIBE, STEPHANIE SCHMITT-GROHÉ, MORTEN O RAVN
“Consumption, Government Spending, and the Real Exchange Rate”
Journal of Monetary Economics, Vol. 59, April 2012

MARTIN URIBE, STEPHANIE SCHMITT-GROHÉ
“An Ols Approach to Computing Ramsey Equilibria in Medium-Scale Macroeconomic Models”
Economics Letters, Vol. 115, No.1, April 2012

ERIC VERHOOGEN, JUDITH A. FRIAS, DAVID S. KAPLAN
“Exports and Within-Plant Wage Distributions: Evidence From Mexico”

ERIC VERHOOGEN, MAURICE KUGLER
“Prices, Plant Size, and Product Quality”

The Fifth Annual Kenneth J. Arrow lecture was held on April 10, 2012, entitled "Moral Hazard in Health Insurance: Developments since Arrow (1963)" and delivered by Amy Finkelstein, Professor of Economics at the Massachusetts Institute of Technology and this year’s recipient of the John Bates Clark Medal. Her lecture focused on Arrow’s seminal 1963 paper on moral hazard in the context of health insurance entitled “Uncertainty and the Welfare Economics of Medical Care,” and traced how his paper and work has influenced the creation and evolution of health economics over the past fifty years. Her lecture was followed by remarks from Jonathan Gruber, Professor of Economics at the Massachusetts Institute of Technology, Kenneth Arrow, Professor Emeritus of Economics at Stanford University, and University Professor Joseph Stiglitz. The annual Arrow Lecture is co-sponsored with the Committee on Global Thought and Columbia University Press.
Work in Progress: The Columbia Experimental Laboratory for the Social Sciences

The Columbia Experimental Laboratory for Social Sciences, or CELSS, was established in the fall of 2012 to help faculty and students acquire data from laboratory experiments when constructing economic models. An interdisciplinary lab for the Social Sciences, it involves not just the Economics Department but also Political Science, Sociology, the Business School, SIPA and ISERP. Professor Alessandra Casella will be the director of CELSS.

"Experimental methods have become standard research tools for the social sciences," she says, along with Professor Navin Kartik who has helped in establishing the laboratory. "An active experimental lab is important not only for the researchers involved but also for students whose graduate training requires at least some exposure to experimental techniques."

Unlike laboratories at other departments in the University that focus on behavioral experiments, CELSS will focus on facilitating experiments uniquely useful to economics such as those designed to control preferences and information, two variables that more than any others are difficult to isolate in non-experimental data. Since every hypothesis in an economic model is conditional on preferences, an ability to test those preferences provides an important contribution to the field. Casella and Kartik underscore the significance of experimental methodology saying, "It offers the exciting possibility of testing assumptions and theories in a discipline long considered unfit for experimental checks. But it is also the necessary gateway to behavioral economics and neuroeconomics, the new frontiers of theoretical research in economics."

The laboratory is an interdisciplinary venture that also involves other departments such as Political Science, Sociology, the School of Business and the School of Business and Public Affairs. Casella hopes that it will open up possibilities for other disciplines to use as well as for cross-disciplinary work.

PICTURED:

CELSS during construction. The facility will open in December 2012.
Two groups of voters of known sizes disagree over a single binary decision to be taken by simple majority. Individuals have different, privately observed intensities of preferences and before voting can buy or sell votes among themselves for money. We study the implication of such trading for outcomes and welfare when trades are coordinated by the two group leaders and when they take place anonymously in a competitive market. The theory has strong predictions. In both cases, trading falls short of full efficiency, but for opposite reasons: with group leaders, the minority wins too rarely; with market trades, the minority wins too often. As a result, with group leaders, vote trading improves over no-trade; with market trades, vote trading can be welfare reducing. Although the experimental data show evidence of overpricing, these predictions are satisfied by all experimental sessions.

We study how inefficiencies of market failure may be further amplified by political choices made by interest groups created in the inefficient market. We take an occupational choice framework, where agents are endowed heterogeneously with wealth and talent. In our model, market failure due to unobservability of talent endogenously creates a class structure that affects voting on institutional reform. In contrast to the world without market failure where the electorate unanimously vote in favour of surplus maximising institutional reform, we find that the preferences of these classes are often aligned in ways that creates a tension between surplus maximising and politically feasible institutional reforms.

We provide a model of conflict and mass killing decisions, to identify the key variables and situations that make mass killings more likely to occur. We predict that mass killings are most likely in countries with large amounts of natural resources, institutional constraints regarding rent sharing, and low productivity of labor in other sectors. The role of resources like oil, gas and diamonds and other key determinants of mass killings is confirmed by our empirical results based on country level as well as ethnic group level analysis.

Differences in electoral rules and/or legislative, executive or legal institutions across countries induce different mappings from election outcomes to distributions of power. We explore how these different mappings affect voters participation in a democracy. Assuming heterogeneity in the cost of voting, the effect of such institutional differences on turnout depends on the distribution of voters preferences for the parties: when the two parties have similar support, turnout is higher in a winner-take-all system than in a power sharing system; the result is reversed when one side has a larger base. The results are robust to a wide range of modeling approaches, including the instrumental voting model, ethical voter models, and voter mobilization models. Findings from laboratory experiments provide empirical support for most of the theoretical predictions.
Recent Discussion Papers

Continued from page 13

FRANCESCO CASELLI, TOM CUNNINGHAM, MASSIMO MORELLI AND INES MORENO DE BARREDA

The Incumbency Effects of Signalling, 1213–05

Much literature on political behavior treats politicians as motivated by reelection, choosing actions to signal their types to voters. We identify a novel implication of incumbent signalling. Because incumbents only care about clearing a reelection hurdle, signals will tend to cluster just above the threshold needed for reelection. This generates a skew distribution of signals leading to an incumbency advantage in the probability of election. We also solve for the optimal threshold when voters have the ability to commit.

RICHARD HOLDEN, NAVIN KARTIK, OLIVIER TERCIEUX

Simple Mechanisms and Preferences for Honesty, 1213–06

We consider full implementation in abstract complete-information environments when agents have an arbitrarily small preference for honesty. We offer a condition called separable punishment and show that when it holds and there are at least two agents, any social choice function can be implemented by a simple mechanism in two rounds of iterated deletion of strictly dominated strategies. We also extend our result to settings of incomplete information so long as there is non-exclusive information.

ERIK EYSTER, ANDREA GALEOTTI, NAVIN KARTIK, MATTHEW RABIN

Congested Observational Learning, 1213–07

We study observational learning in environments with congestion costs: as more of one’s predecessors choose an action, the payoff from choosing that action decreases. Herds cannot occur if congestion on an action can get so large that an agent would prefer to take a different action no matter his beliefs about the state. To the extent that “switching” away from the more popular action also reveals some private information, social learning is improved. The absence of herding does not guarantee complete learning, however, as information cascades can occur through perpetual but uninformative switching between actions. Our main contribution is to provide conditions on the nature of congestion costs that guarantee complete learning and conditions that guarantee bounded learning. We also show that congestion costs have ambiguous effects on the proportion of agents who choose the superior action. We apply our results to markets where congestion costs arise through responsive pricing and to queuing problems where agents dislike waiting for service.

PIERRE-ANDRÉ CHIAPPORI, BERNARD SALANIÉ, FRANÇOIS SALANIÉ

From Aggregate Betting Data to Individual Risk Preferences, 1213–08

As a textbook model of contingent markets, horse races are an attractive environment to study the attitudes towards risk of bettors. We innovate on the literature by explicitly considering heterogeneous bettors and allowing for very general risk preferences, including non-expected utility. We build on a standard single-crossing condition on preferences to derive testable implications; and we show how parimutuel data allow us to uniquely identify the distribution of preferences among the population of bettors. We then estimate the model on data from US races. Within the expected utility class, the most usual specifications (CARA and CRRA) fit the data very badly. Our results show evidence for both heterogeneity and nonlinear probability weighting.

PIERRE-ANDRÉ CHIAPPORI, ALFRED GALICHON, BERNARD SALANIÉ

The Roommate Problem Is More Stable Than You Think, 1213–09

Stable matchings may fail to exist in the roommate matching problem, both when utility is transferable and when it is not. We show that when utility is transferable, the existence of a stable matching is restored when there is an even number of individuals of indistinguishable characteristics and tastes (types.) As a consequence, when the number of individuals of any given type is large enough there always exist “quasi-stable” matchings: a stable matching can be restored with minimal policy intervention. Our results build on an analogy with an associated bipartite problem; it follows that the tools crafted in empirical studies of the marriage problem can easily be adapted to the roommate problem.
The top 1 percent of Americans control 40 percent of the nation’s wealth. And, as Joseph E. Stiglitz explains, while those at the top enjoy the best health care, education, and benefits of wealth, they fail to realize that “their fate is bound up with how the other 99 percent live.”

Stiglitz draws on his deep understanding of economics to show that growing inequality is not inevitable: moneyed interests compound their wealth by stifling true, dynamic capitalism. They have made America the most unequal advanced industrial country while crippling growth, trampling on the rule of law, and undermining democracy. The result: a divided society that cannot tackle its most pressing problems. With characteristic insight, Stiglitz examines our current state, then teases out its implications for democracy, for monetary and budgetary policy, and for globalization. He closes with a plan for a more just and prosperous future.

The global financial crisis has sent shockwaves through the world’s economies, and its effects have been deep and wide-reaching. This book brings together a range of applied studies, covering a range of international and regional experience in the area of finance in the context of the global downturn.

The volume includes an exploration of the impact of the crisis on capital markets, and how corporate stakeholders need to be more aware of the decision-making processes followed by corporate executives, as well as an analysis of the policy changes instituted by the Fed and their effects. Other issues covered include research into the approach of solvent banks to toxic assets, the determinants of US interest rate swap spreads during the crisis, a new approach for estimating Value-at-Risk, how distress and lack of active trading can result in systemic panic attacks, and the dynamic interactions between real house prices, consumption expenditure and output. Highlighting the global reach of the crisis, there is also coverage of recent changes in the cross-currency correlation structure, the costs attached to global banking financial integration, the interrelationships among global stock markets, inter-temporal interactions between stock return differentials relative to the US and real exchange rate in the two most recent financial crises, and research into the recent slowdown in workers’ remittances.

The economy of India is growing at a rate of 8 percent per year, and its exports of goods and services have more than doubled in the past three years. Considering these trends, economists, scholars, and political leaders across the globe are beginning to wonder whether India’s growth can be sustained.
Faculty Books: Fall 2012
Continued from page 15

In this forceful and impassioned book, Jeffrey D. Sachs offers a searing and incisive diagnosis of our country’s economic ills, and an urgent call for Americans to restore the core virtues of fairness, honesty, and foresight as the foundations of national prosperity. Sachs finds that both political parties—and many leading economists—have missed the big picture, profoundly underestimating globalization’s long-term effects and offering shortsighted solutions. He describes a political system that is beholden to big donors and influential lobbyists and a consumption-driven culture that suffers shortfalls of social trust and compassion. He bids readers to reclaim the virtues of good citizenship and mindfulness toward the economy and each one another. Most important, he urges each of us to accept the price of civilization, so that together we restore America to its great promise. The Price of Civilization is a masterly road map for prosperity, founded on America’s deepest values and on a rigorous understanding of the twenty-first-century world economy.

Program for Economic Research
Events Calendar — Fall 2012

SEPTEMBER 27, 2012
Inequality in America: the 1% in International and Historical Perspective
Thomas Piketty, Paris School of Economics
Co-sponsored by the Maison Francaise and the Heyman Center for the Humanities

OCTOBER 4, 2012
A Conversation with the Honorable Sheila C. Bair
With discussant Richard Clarida, Columbia University

OCTOBER 8, 2012
Presidential Economic Advisers Forum 2012
Co-sponsored by the World Leaders Forum, the Committee on Global Thought and the Center on Global Economic Governance