Economic Logic

There is Economics in everything

About Me

ECONOMIC LOGICIAN

I discuss recent research in Economics and various events from an economic perspective, as the name of the blog indicates. I plan on adding posts approximately every workday, with some exceptions, for example when I travel.

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The physicists drew on the economists (Pareto) for power law distributions.

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Nice!anne

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Does anybody know why? Lack of demand? How did CSWEP take it?

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day care stopped a while back

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Good luck with that. I have prepared forecasts for financial institution, complete with error...

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I do not think Economics suffers from Physics envy, as I detailed in an earlier post. An it is not...

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MONDAY, JULY 23, 2012

Do the Greek retire earlier because of their occupations?

A common complaint within the current acrimonious debate about the Greek debt situation is that the Greek retire much earlier than, say, the Germans. This is considered unfair, and the Greek should not enjoy such privileges. It is, however, a fact that people in different occupations retire at different times, and Greece may simply have a labor force with an occupational compositions that yields a lower retirement age. If this were the case in a magnitude corresponding to the observed differences in average retirement ages, the criticism would not be warranted.

Philip Sauré and Hosny Zoabi look at this in the following way. They take the retirement age by occupation for males in the United States, then apply this to the occupational composition of 28 OECD countries. Looking at the effective average retirement age, it turns of occupational differences can explain about 10% of the cross-country variation. Add in another 10 non-OECD countries, and you explain about 16%. Not huge numbers, but occupational composition matters. Transforming the data to account for category mismatches and the impact of state pension plans, one can explain 28% to 39% of the variation, though.

And, by the way, the effective age of retirement of males is higher in Greece than in Germany.

Posted by Economic Logician at 7:43 AM 0 comments Links to this post

Labels: retirement

FRIDAY, JULY 20, 2012

Exchange rates and scapegoats

It is notoriously difficult to understand exchange rate fluctuations, especially in the shorter term. Predicting them is even worse, to the point that a random walk has consistently been shown to be the best predictor (with isolated exceptions). Consistently beating the random walk is seen as the holy grail in international finance.

Philippe Bacchetta and Eric Van Wincoop came up with an intriguing theory: there is no point in trying to relate exchange rate movements to observable fundamentals. Market participants react to rate changes by rationalizing them with some observed fundamental even when the true reason may be unobservable. And market participants keep changing the variables they look at. Everyone has made fun of press reports that explain that the dollar went up because of some event, and then the same event explains why the dollar went down the next day. This is what Bacchetta and Van Wincoop call scapegoating.

This is pretty much all theory. Marcel Fratzscher, Lucio Sarno and

[Gabriele Zinna] have now found a way to test empirically this theory of scapegoats. The reason it took so long is that you need the right data: first a monthly survey of market participants on what they think is driving exchange rate movements, second the order flow data of a major market participant. The data supports remarkably well the scapegoat theory. When there is a large volume of orders, which are not public information and should thus be treated as unobservables that influence market outcomes, and one of the fundamentals moves more than usual in one way or the other, markets participants often link the latter to exchange movements. This is purely after the fact rationalizing, or as used in other contexts, superstition. How this is going to help us in forecasting exchange rate movements is not clear, though.

Posted by Economic Logician at 8:02 AM 0 comments Links to this post
Labels: international markets , rationality

THURSDAY, JULY 19, 2012

Use state banks to stabilize the business cycle

The standard way to think about banking in the business cycle is that financial frictions amplify economic fluctuations. There are various mechanisms that make this happen. For example, the lower value of collateral during a recession makes lending more difficult. Or the value of the bank's assets decreases and it can lend less due to risk regulation. But does this always have to be so?

Ata Can Bertay, Asli Demirgüç-Kunt and Harry Huizinga take the example of state-owned banks. Given their public mission, they may actually try to become more active during recessions, possibly because public guarantees allow them top take on more risk during those times, or because they are more defensive in good times when they are less needed. Whatever the reason, by just looking at the data their study finds that state-owned banks are indeed lending against the cycle, especially in high-income countries with good-governance. Expanding the role of these banks could thus be beneficial, although one has to keep in mind that state banks are not necessarily the most efficient ones or the best at identifying good lending opportunities.

Posted by Economic Logician at 7:18 AM 0 comments Links to this post
Labels: financial markets , recessions

WEDNESDAY, JULY 18, 2012

How to report Fed uncertainty

Any good research reports qualifications and uncertainties about the results. Unfortunately, the non-scientific reader is not interested in those, he wants certainties. A good example is the issue of global climate change. Of course there is some uncertainty about it, but climate scientists did not report it because the public would otherwise discredit their findings. And indeed, once it was "revealed" global climate change is not 100% sure, an uproar resulted. It is not different in Economics.

Recently, the US Federal Reserve started publishing the differences of opinion of its FOMC members regarding its forecasts. There are good reasons for that. The market needs to understand when policy may change course because the data do not tell us enough about the future course. But will the public actually listen to this piece of information?

Economic Logician wrote...
There is now an econophysics tag. By now there is enough material for it.

Ritholtz wrote...
Its not that economics cannot predict this data point or that weekly number -- its that they missed...
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Anonymous wrote...
Hoshi-Kashyap is complete garbage. Read them on banking in Japan -- they don't even know what a...
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Kansan wrote...
We want an econophysics tag!

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Ray Fair does not think so because the wrong information is disseminated. Indeed, the dispersion of median forecasts has rather little information, especially if there is the group think the Board is sometimes accused of, compared to the statistical variance in the forecasts of a single model. Using historical errors as a basis, one could simulate whatever model(s) the Fed uses, draw out for each potential future history policy reactions, and then report the dispersion in future federal fund rates. Much better than the current dispersion of median opinions. And maybe the public will look at it.

Posted by Economic Logician at 7:25 AM 1 comments Links to this post
Labels: macroeconomics , money

TUESDAY, JULY 17, 2012

Family wars

Family feuds can be terrible, and divorce is the worst. That may be because people who trusted each other find themselves victims of treason, and react violently. Does this scale up to relationships between nations?

Enrico Spolaore and Romain Wacziarg find that populations that are genetically closer tend to be more frequently at war, after obviously controlling for geographic distance. They favor the explanation that sharing genes means also sharing preferences over scarce goods. I prefer the family trust story. Seeing how vicious civil wars are does not discredit either theory as well.

Posted by Economic Logician at 7:46 AM 0 comments Links to this post
Labels: economic history

MONDAY, JULY 16, 2012

Econophysics of growth

It is sometimes saddening to see how Economics is currently being criticized for its failure to predict this and that. While at least economists realize that things are not that simple, non-economists have been really silent in offering concrete alternatives, or at least some that would be workable within a decade. Except for the econophysicists, who have no shortage of wacky ideas. They are always good to brighten your days, making you realize that Economics is after all in much better shape than we think.

My latest read was a paper by Hans Danielmeyer and Thomas Martinetz who have come to the realization that Robert Solow's 1956 growth theory is missing leisure and Economics has been in dire straights ever since. Because, you know, there are only 24 hours in a day. How could Macroeconomics have done without labor demand and supply? How could we have missed that long-term per-capita growth depends primarily on labor hours? Actually it does not. Growth accounting reveals that the labor input plays only third fiddle to total factor productivity, physical capital and possibly even human capital. But wait, Danielmeyer and Martinetz are even more innovative than I thought. They discover human capacity, which is general knowledge embodied through education. Quick, someone call Paul Romer.

This is truly path-breaking work we have here. The consequences are immense. As human capacity is limited, after all we are not

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omnipotent, growth will come to a halt. I eagerly await the authors' discovery of computers and technical progress. There is even a quantitative evaluation of the theory, which has much broader scope than you would expect. Indeed, it can explain the over-valuation of real estate in Japan, the 2008 banking crash can be traced back to policy makers neglecting the trade-off between growth and national wealth, and we face a "convergence crisis" in the 2040's because of stagnant human capacity. Fascinating.

Posted by Economic Logician at 6:32 AM 8 comments Links to this post
Labels: bad research , development , econophysics

FRIDAY, JULY 13, 2012

Is a lost decade ahead?

It is quite obvious that the current economic situation in both Europe and the United States is not healthy. It has been argued that in both cases policy uncertainty or the inability of authorities to take decisions are detrimental to economic activity, and private investment in particular. It is not difficult to rationalize this with simple theory. The question is whether this could have some longer term consequences.

Kenza Benhima and Baptiste Massenot find that yes, we could be ahead of a lost decade like the one that Japan experienced in the 1990's. They take a simple real business cycle model, a model that is the least likely to produce very persistent deviations from trend or permanent departures from the growth path. They only amend the model in two ways: investors have a decreasing relative risk aversion, instead of constant, and they can choose between two technologies, a risky one with higher returns and a safe one with low returns. The model then exhibits two equilibria: the standard RBC one, and a second, self-fulfilling one, a trap where capital is mis-allocated into overly safe assets, there is little growth if any, and interest rates keep getting lower thereby reinforcing the trap.

These results are consistent with Japan during its lost decade. Total factor productivity decreases, essentially because of a mis-allocation of resources. Assets are mostly safe ones in the trap, compared to risky ones before. And the interest rate keeps declining. Interestingly, the resulting economy in the bad equilibrium looks like it had a bad technology shock, even though technology is just fine. This makes it consistent with the Hayashi-Prescott claim that Japan's lost decade was due to bad total factor productivity draws. The same applies to the Caballero-Hoshi-Kashyap claim that banks in Japan kept lending to unproductive firms, preventing better ones to enter and raise total factor productivity. Even Krugman's liquidity trap fits in the story because interest rates are very low in the trap as well.

And recent data in Europe and the US seems to be consistent with this trap as well. The only way out is a coordinated action of all market participants. The only ones that could make this happen are the authorities. Unfortunately, they seem to be quite far from that.

Posted by Economic Logician at 6:56 AM 2 comments Links to this post
Labels: Japan , recessions

THURSDAY, JULY 12, 2012

Useful blogs

- **Calculated Risk**
  Zillow: "Housing Market Turns Corner"
- **VoxEU.org: Recent Articles**
  Club Med and the Sun Belt: Lessons from adjustment within a monetary union
- **Paul Krugman**
  Free Money
- **Econbrowser**
  The Path Not Taken ... Thus Far: Debt Deleveraging by Inflation
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  Sicily fact of the day
- **Angry Bear**
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  Is Banking Unusually Corrupt, and If So, Why? Posner
- **Greg Mankiw's Blog**
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- **Economists Do It With Models**
  Fun with Purchasing-Power Parity: The Big Mac Index
- **The RePEc Blog**
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- **Against Monopoly**
  Copyright: Would books be published without copyright?
- **Freakonomics**
  Homeownership and Suburban Sprawl
- **Dani Rodrik's weblog**
  What Next at the World Bank?

Corruption and wages of public officials

In some countries, especially in Eastern Europe, corruption in educational institutions is a serious issue, to the point that diplomas do not mean anything. One potential reason for this high level of corruption is that educators and administrators are very poorly paid, and thus are more than willing to accept bribes to let students in, to let them pass exams and graduate. While the practice is well known and even accepted, how prevalent it is is obviously difficult to figure out.

Oana Borcan, Mikael Lindahl and Andreea Mitrut look at an interesting natural experiment in Romania: the wage of all public sector workers, including education, were cut by 25% in May 2010. The cut was unexpected and happened just before exams. They study the Baccalaureate exam, which is the exam at the end of high school, is the entrance ticket to university and is actually rather difficult. Comparing results in public vs. private schools (which where not affected by wage cuts) and 2009 vs. 2010, they find that public schools had suddenly a much higher grades (by one fourth of the standard deviation) and 10-12% more students passed the exams. And this despite the fact that students of all schools were mixed in exam rooms. This could only have happened if the public students knew beforehand what the questions or answers were. And indeed, this exam has the nickname of "Xeroxed exam" in Romania. And who gave them these copies? Well, consumption expenditures of teachers seem to have been unaffected by the wage cuts, according to the Romanian Household Budget Survey...

Posted by Economic Logician at 7:15 AM 3 comments Links to this post
Labels: education , ethics

WEDNESDAY, JULY 11, 2012

The under-representation of women at the AEA meetings

There is no secret that women are under-represented in the Economics profession. Things have improved over time, though, but the proportion of women thins considerably as you look further up in the academics ranks. And this is not just a cohort effect coming from the increased proportion of women taking up Economics compared to previous years. Is there still a glass ceiling, despite the huge pressures on departments to hire and promote women?

Rosemary Cunningham and Madeline Zavodny show that one way to look at this is how well women are represented on the program of the annual meeting of the American Economic Association. Again, things have improved over time, but they are still under-represented compared to their numbers in the profession. And this despite the fact that there are sessions essentially reserved for them organized by CSWEP (Committee on the Status of Women in the Economics Profession) and IAFE (International Association of Feminist Economists). The classic argument is that women do not come to the meeting because it is held during a school holiday (very early January), but there is daycare. I would rather argue that it has to do with how the program is put together. As in much of what is going on at the AEA, being part of the old boys network is essential. Very few people from outside are lucky to break through. Women simply do not like taking part in such professional shmoozing, and they are not that welcome either. The fact that it is old people doing the program does not help either.

Posted by Economic Logician at 7:01 AM 3 comments Links to this post
Labels: Economics profession

TUESDAY, JULY 10, 2012

Avoiding sovereign debt dilution with debt seniority

There is a natural tendency for firms to borrow too much. This is known as the debt dilution problem. It occurs because the borrower does not factor in the impact on old debt of borrowing more. Indeed, it makes old more risky, and hence increases borrowing costs. The market response to this problem was to introduce debt seniority, wherein some debt classes have priority over others in liquidation. For example, primary mortgages have priority over secondary mortgages, and the latter carry higher interest rates. The fact that one has a secondary mortgage has then no bearing on the riskiness and cost of the primary mortgage.

Satyajit Chatterjee and Burcu Eyigungor point out that there is not such concept in sovereign debt, but it should. Indeed, debt dilution happens at a massive scale in sovereign debt, and the market response when debt dilution happens such as now in many countries is to have shorter terms. This increases costs significantly, as Southern European countries have recently witnessed. Chatterjee and Eyigungor show that if sovereign debt also had a seniority structure, the frequency of default would be significantly reduced, by 40% taking the example of Argentina. It also reduces the volatility of spreads by two thirds. That seems very interesting.

Posted by Economic Logician at 7:04 AM 1 comments Links to this post
Labels: credit markets , financial markets , international markets

MONDAY, JULY 9, 2012

School subsidies may increase school attendance and child labor

Child labor is widely recognized as a poverty trap problem. Parents know their child should go to school, but they cannot afford missing out on supplemental income or domestic help. And in cases where there is actually no good reason to send the child to school, it is because the economy does not have jobs for people with more education, because no one has more education. This is why several programs have been very successful in getting children into school as long as they provided the right incentives for parents: cash transfers and free lunches that provide the economic replacement of the income the child would have generated. The success is usually measured by looking at school attendance or outcomes.

Jacobus de Hoop and Furio Rosati point out that the impact on child labor is not so clear, especially as it is difficult to measure. Indeed, most of child labor is inside the household or in informal markets. Using data from Burkina Faso, they find that recipients from the BRIGHT program both increased school attendance and child labor. The BRIGHT program also includes the construction of school and provides for take-home food rations for girls.

De Hoop and Rosati show that these disheartening results can be consistent with altruistic parents when there are some non-convexities. The latter stem from the fact that there are substantial commuting times for school attendance. As the program built new schools, it reduced those commuting times. This in itself makes school attendance more likely, but at the cost of providing more time for work for those who were already going to school. This does not mean one should not build schools, though, rather one should find some other intervention that counteracts this perverse effect.

Posted by Economic Logician at 8:28 AM 0 comments Links to this post
Labels: Africa , development , education , labor market

FRIDAY, JULY 6, 2012

What should a country do with a windfall?

You live in a country with a poor population and little infrastructure. Assume you are benevolent and the country gets a sudden, but temporary, windfall, say from the discovery of some natural resources. How should you allocate this windfall? The simple growth model with subsistence consumption would tell you to put as much as possible into capital. This would get the country above the unstable equilibrium and out of the development trap. But if you are already above, you can put some income towards current consumption, taking time preference into account.

Frederick van der Ploeg refines this on several dimensions. First, the efficiency of investment is not that high in a country that is not used to it, and there are decreasing returns. This would call to put more into consumption and especially into debt reduction. This is reinforced by the Dutch disease, which is the tendency of a country with abundant resources to turn into an economy that all revolves around these resources. It is very difficult to invest in anything else. It may thus be good to put some money into a sovereign wealth fund until the non-traded sector is ready to accept more investment. Also, additional consumption should be concentrated towards the poorest.

As some would say, this is very nice in theory, but practice should that resource-rich economies have a dismal growth record, largely due to mis-allocation. But it is worth thinking how this could be done better

Posted by Economic Logician at 7:07 AM 0 comments Links to this post
Labels: development

THURSDAY, JULY 5, 2012

Why are Olympic Games always more expensive than planned?

Rare are the big sports events that stay within budget, and those that do are criticized as being too "commercial." I would suspect this is because organizers try to submit a budget that seems appealing, knowing that it is the lower end. Of course, by now everyone should realize this, especially legislators, but they may like the idea and care less about the cost and thus may be willing to go along with the mis-representation. Once additional funds are needed, legislators are either to go along anyway or they are forced to accept given all the money that was sunk into the project. And they think about the benefits that come with such events, which is actually not true

(previous posts: 1, 2)

Wladimir Andreff has a better take at this than my random thoughts. In the case of the Olympic Games, he notes that the only recent games that did not suffer from a "winner's curse" by overbidding was Los Angeles 1984, which was the only candidate at the time (there was a big financial mess for Montreal 1976 that discouraged other candidates). So it would look like having competition drives candidates to pretending they need too low budgets. The recommended solution is to get rid of candidates altogether: have the games at fixed locations (one for Summer and one for Winter), as I have called for before.

Posted by Economic Logician at 6:36 AM 2 comments Links to this post
Labels: petition , sports

WEDNESDAY, JULY 4, 2012

How effective is a moral appeal in discouraging exam cheating

Several programs have introduced honor codes, especially MBA programs. Students promise not too copy, plagiarize or otherwise cheat, and in response the program administration does not put much in place in terms of surveillance. Simple game theory tells you that if there are few controls, this cannot work. And given that students try to cheat even when they are checked on, imagine what happens when there is no one to watch them. By the way, what influences cheating?

Michał Krawczyk looks at an experiment where students were told cheating was wrong and then took at test. Statistical analysis is then used to figure out who still cheated, which is preferable to notoriously unreliable self-reports. It turns out that a one-time appeal to moral values is not a good deterrent. Also, self-reports of cheating, about the current experiment or in the past, are highly unreliable. Finally, the boys cheat more. No surprise here.

Posted by Economic Logician at 7:07 AM 0 comments Links to this post
Labels: ethics , students

TUESDAY, JULY 3, 2012

Does it help to search for a job?

Getting unemployed workers to search with sufficient intensity has been for a long time an important aspect of active and passive labor market policies. For example, unemployment insurance benefits decrease over an unemployment spell or expire exactly for this reason. But for it to make sense, it would need to be established that search intensity actually matters for the probability of finding a job. It seems obvious, but there are so many different ways to do this that some may turn out not to be that good and should thus not be required for eligibility to some programs.

Javier Vázquez-Grenno tries this for Spain, a country with an unusually high unemployment rate. He finds that immigrants have a higher search success, at least before the current crisis. Search intensity as measured by the number of search methods matters, and all methods improve the chances of employment, except one. Registering at the public employment office. That must be a big disappointment for all those who have maintained that these offices were the center part of lowering the unemployment rate. It does not seem to work at the microeconomic level, although it may still work at the macroeconomic one: after all, the office employees would probably be unemployed without that job.

Posted by Economic Logician at 7:28 AM 1 comments Links to this post
Labels: labor market , Spain

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