

Abstracts of Articles Accepted in Journals, Books, and Conference Volumes*

Premiums and Penalties for Surplus and Deficit Education: Evidence from the United States and Germany

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An intriguing finding in the literature on the role of education in the labor market concerns workers who have acquired either more or less education than they say their jobs require. Contrary to predictions from a rigid, structural view of jobs, several authors have found that the labor market rewards workers for having completed more schooling than their jobs require and penalizes workers who have “too little” schooling. We investigate whether the structural changes in the labor market in the United States over the 1970s and 1980s (see Levy, F., and Murnane, R. 1992. “U.S. Earnings Levels and Earnings Inequality: A Review of Recent Trends and Proposed Explanations.” *Journal of Economic Literature* 30, pp. 1,333–1,381) affected the rewards and penalties associated with having too much or too little schooling for a job. We then examine whether the same rewards and penalties for surplus and deficit education observed in the United States apply in Germany, a country with a much more structured educational system and labor market. We test explicitly for differences over time in the United States and at a point in time between the United States and Germany. We find, consistent with a universalistic view of labor markets, more similarities across countries than over time.

Testing the Significance of Income Distribution Changes over the 1980s Business Cycle: A Cross-National Comparison

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Econometrics* 14(3) (1999) pp. 253–272.

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Using kernel density estimation we describe the distribution of household size-adjusted real income and how it changed over the business cycle of the 1980s in the United States and the United Kingdom. We confirm previous studies that show income inequality increased in the two countries and the middle of the distribution was squashed down. Using a series of statistical tests, however, we find that while the mass in both tails of the distribution increased significantly in both countries over the period, by far the greatest gains were in the upper tail.

*The abstracts are arranged alphabetically by FRB San Francisco authors, whose names are in boldface.

Time? Money? Both? The Allocation of Resources to Older Parents

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Published in *Demography*
36(2) (May 1999) pp. 219–232.

We provide estimates of a reduced-form model of the allocation of household time and money resources. We consider four demands for these resources: time spent working, time spent providing care for nonco-resident elderly parents, time spent performing housework, and monetary transfers to noncoresident elderly parents. We focus on the effects of wage rates and parental characteristics on the allocation decisions of adult children and their households concerning these four demands. We find that households with individuals earning high wages rely relatively more on cash transfers and relatively less on time transfers than do lower-wage households. We also find evidence consistent with an unmeasured tendency of some families to provide multiple sources of support.

Financial Modernization and Regulation

Frederick T. Furlong
Simon Kwan

Published in *Journal
of Financial Services Research*
16(2–3) December 1999.

Financial systems worldwide have been marked by a push toward financial modernization and rolling financial crises over the past several years. These developments have put pressure on financial supervision and regulation to adapt. While some changes in regulatory oversight have taken place, adaptation of financial supervision and regulation can be expected to continue into the 21st century. In the Financial Modernization and Regulation Conference cosponsored by the Federal Reserve Banks of Atlanta and San Francisco, a number of papers dealing with financial supervision and regulation in the changing environment were presented. This article highlights the contributions of the conference papers in the following six areas: financial modernization, market discipline and financial regulation, systemic risk, corporate structure, pricing deposit insurance, and conflicts of interest.

Origins of the Asian Financial Crisis: Impulses and Propagation Mechanisms

Reuven Glick

Published in
*The Asian Financial Crisis:
Origins, Implications, and Solutions*,
eds. William C. Hunter, et al. 1999.
Boston: Kluwer Academic Press,
pp. 33–64.

The traditional fundamentals suggested by first- and second-generation crisis models did not provide much indication of an impending crisis in Asia. Growing current account deficits and somewhat overvalued real exchange rates suggested some need to curtail domestic demand and/or engineer nominal currency depreciation but did not suggest a crisis of the magnitude that has occurred.

Nevertheless, to a large extent, the Asian crisis can be explained in terms of impulses and propagation mechanisms related to fundamentals, specifically general weaknesses and distortions in the financial sector. These include relationship lending practices, excessive risk-taking, and inadequate financial supervision and regulation. The effect of these factors was cumulative and increased the vulnerability of Asia to bad shocks.

Once the crisis hit, various mechanisms magnified its initial impact. These included the effects of excessive leverage, collateralized lending, competitive devaluations, and exposure of unhedged foreign liabilities. Elements of illiquidity-based financial panic also may have played a role. It is important to emphasize, however, the difficulty in identifying whether the motivation for the panic was based on a spontaneous shift in creditor confidence or on changing fundamentals.

Foreign Reserve and Money Dynamics with Asset Portfolio Adjustment: International Evidence

Reuven Glick, with Michael M. Hutchison, *University of California, Santa Cruz*

Forthcoming in *Journal of International Financial Markets, Institutions, and Money*.

Central bank intervention in foreign exchange markets to achieve exchange rate objectives poses a potential conflict with the desire for domestic monetary control. Central banks often resolve this conflict, at least in the short run, by sterilizing or insulating the domestic monetary base from the foreign reserve flows due to foreign exchange market intervention operations. Empirical work in this area typically estimates central bank reaction functions and sterilization coefficients that take account only of the contemporaneous impact of foreign asset changes on domestic credit. However, complete modeling of intervention and sterilization dynamics needs to be considered when central banks' short- and longer-term behavior and objectives differ and when there are adjustment costs to re-balancing private portfolios. This paper analyzes the dynamics of intervention and sterilization operations in Japan and Germany during the post-Bretton Woods period by using a vector error correction model to separate out the short- from the long-term effects of foreign exchange market operations on domestic credit and the monetary base.

Money and Credit, Competitiveness, and Currency Crises in Asia and Latin America

Reuven Glick
Ramon Moreno

Published in *Monetary Policy and the Structure of the Capital Account, Proceedings of the 13th Pacific Basin Central Bank Conference*. 1999. Mexico City, Mexico: Banco de Mexico.

This paper analyzes the role of money, credit, trade, and competitiveness variables in signaling currency crises in a sample of East Asian and Latin American countries over the period 1972:01–1997:10. Bivariate tests suggest that money and credit, as well as trade and competitiveness variables, appear to behave differently around crisis episodes than they do during periods of tranquility, suggesting that they may help signal currency crises. In multivariate probit regressions, which allow for the identification of marginal contributions of individual variables, reductions in real domestic credit and in foreign reserves as well as appreciation in the real exchange rate imply increases in the probability of a crisis. Real exchange rate appreciation appears to play a greater role in predicting currency crises in East Asia, while foreign reserve losses play a greater role in Latin America.

Is Pegging the Exchange Rate a Cure for Inflation? East Asian Experiences

Reuven Glick
Ramon Moreno, with Michael Hutchison, *University of California, Santa Cruz*

Published in *Exchange Rate Policies for Emerging Market Economies*, eds. Richard J. Sweeney, et al. 1999. Boulder, CO: Westview Press, pp. 165–192.

A popular argument for pegging the exchange rate is that linking to a stable foreign currency enforces discipline on monetary and fiscal policy and helps limit inflation. To varying degrees, East Asian economies have pegged their currencies to the U.S. dollar. Most also achieved relatively low inflation, certainly by the standards of developing countries. However, as we argue in this paper, the exchange rate pegging policies of East Asian economies were not the explanation for their historically low inflation. To the contrary, in most cases pegging prevented necessary adjustment of the real exchange rate in response to external shocks. Between 1985 and 1995, those Asian economies that allowed their currencies to appreciate against the U.S. dollar experienced relatively less inflation than their neighbors in the region. Asia's low inflation bias is attributable mainly to relatively stable domestic political institutions and limited budget deficits.

Contagion and Trade: Explaining the Incidence and Intensity of Currency Crises

Reuven Glick, with
Andrew K. Rose,
University of California, Berkeley

Published in *The Asian Financial
Crises: Causes, Contagion, and
Consequences*, eds. Pierre-Richard
Agenor, et al. 1999. Cambridge:
Cambridge University Press,
pp. 284–306.

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In this paper, we demonstrate that trade links help explain the intensity as well as the incidence of contagion across countries for different currency crisis episodes. We show that the magnitude of exchange rate pressure experienced by a country's currency during these episodes rises with the extent of its trade linkage with "ground zero" of the crisis. Trade is an important channel for contagion empirically, even after accounting for the effects of macroeconomic and financial factors.

Contagion and Trade: Why Are Currency Crises Regional?

Reuven Glick, with
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University of California, Berkeley

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of International Money and Finance*
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Currency crises tend to be regional; they affect countries in geographic proximity. Since macroeconomic and financial phenomena are not regional, these phenomena are unimportant in understanding why crises spread. But international trade is regional, as countries tend to trade with their neighbors. This suggests that patterns of international trade are important in understanding how currency crises spread, above and beyond any macroeconomic phenomena. This paper provides empirical support for this hypothesis. Using data for five different currency crises (in 1971, 1973, 1992, 1994, and 1997), it is shown that currency crises affect clusters of countries tied together by international trade. By way of contrast, macroeconomic and financial influences are not closely associated with the cross-country incidence of speculative attacks.

A Dynamic Model of Export Competition, Policy Coordination, and Simultaneous Currency Collapse

Chan G. Huh
Kenneth Kasa

Forthcoming in
Review of International Economics.

This paper shows that the "price wars during booms" logic of Rotemberg and Saloner (1986) provides an explanation of contagious currency crises. The idea is as follows. When a group of countries relies on exports to a common foreign market, pressures for competitive devaluations arise. In response, competing exporters find it optimal to peg their exchange rates to the currency of their export market. However, it must be in each country's self-interest to adhere to its peg, and we show that a common adverse external shock can make an existing (implicitly) cooperative arrangement unenforceable. Maintenance of the arrangement requires a collective devaluation that reduces the unilateral incentive to devalue.

Expectations, Credibility, and Disinflation in a Small Macroeconomic Model

Chan G. Huh
Kevin J. Lansing

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and Business* 2000(51) pp. 51–86.

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We used a version of the Fuhrer-Moore model to study the effects of expectations and central bank credibility on the economy's dynamic transition path during a disinflation. Simulations were compared under four different specifications of the model which vary according to the way that expectations are formed (rational versus adaptive) and the degree of central bank credibility (full versus partial). The various specifications exhibited qualitatively similar behavior and were able to reasonably approximate the trend movements in U.S. macro variables during the Volcker disinflation of the early 1980s. However, the specification with adaptive expectations/partial credibility was the only one to capture the temporary rise in long-term nominal interest rates observed in U.S. data at the start of the disinflation. We also found that incremental reductions in the output sacrifice ratio were largest at the low end of the credibility range, suggesting that a central bank may face diminishing returns in its efforts to enhance credibility.

Forecasting the Forecasts of Others in the Frequency Domain

Kenneth Kasa

Forthcoming in
Review of Economic Dynamics.

This paper studies a class of models developed by Townsend (1983) and Sargent (1991). These models feature dynamic signal extraction problems and an infinite regress in expectations. Frequency domain methods are used to compute an analytical solution to the fixed-point problem posed by the infinite regress in expectations. The advantage of a frequency-domain approach vis-à-vis a time-domain approach derives from the fact that these models produce equilibria with nonfundamental moving average representations, in which market observations do not reveal the underlying shocks to agents' information sets. As a result, decision rules contain moving average components that are more easily handled in the frequency domain than in the time domain.

Model Uncertainty, Robust Policies, and the Value of Commitment

Kenneth Kasa

Forthcoming in
Macroeconomic Dynamics.

Using results from the literature on H^∞ -control, this paper incorporates model uncertainty into Whiteman's (1986) frequency domain approach to stabilization policy. The derived policies guarantee a minimum performance level even in the worst of (a bounded set of) circumstances. Robust H^∞ policies are shown to be more "activist" than Whiteman's H^2 policies in the sense that their impulse responses are larger. Robust policies also tend to be more autocorrelated. Consequently, the premium associated with being able to commit is greater under model uncertainty. Without commitment, the policymaker isn't able to (credibly) smooth his response to the degree that he would like.

From a technical standpoint, a contribution of this paper is its analysis of robust control in a model featuring a forward-looking state transition equation, which arises from the fact that the private sector bases its decisions on expectations of future government policy. Existing applications of H^∞ -control in economics follow the engineering literature and only consider backward-looking state transition equations.

An Observational Equivalence among H^∞ -control Policies

Kenneth Kasa

Published in *Economics Letters* 64(2) (August 1999) pp. 173–180.

This paper constructs an equivalence class of objective functions that produce the same linear state-feedback decision rule. Members of this class are distinguished by the relative weight placed on state variability and the minimized H^∞ norm of the system's transfer function. This result is used to show that in models of dynamic policy formation a concern for robustness in the presence of model uncertainty can substitute for the ad hoc incorporation of adjustment costs.

Will the Fed Ever Learn?

Kenneth Kasa

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This paper studies optimal learning by a central bank that is unsure about the natural rate of unemployment and the slope of the Phillips curve. Given its objective of stabilizing output and inflation, the central bank must balance the short-term benefits of behaving optimally given its current beliefs, or taking actions that are currently sub-optimal but which yield new information and hence improve future performance. Using dynamic programming results from Easley and Kiefer (1988), this paper shows that the central bank may come to believe that there is an exploitable relationship between inflation and output, even when no such relationship exists. Thus, this paper provides another reason why monetary policy may be subject to a persistent inflation bias.

A Theory of Liquidity in Residential Real Estate Markets

John Krainer

Forthcoming in *Journal of Urban Economics*.

A “hot” real estate market is one where prices are rising, average selling times are short, and the volume of transactions is higher than the norm. “Cold” markets have the opposite characteristics—prices are falling, liquidity is poor, and volume is low. This paper provides a theory to match these observed correlations. I show that liquidity can be good while prices are high because the opportunity cost of failing to complete a transaction is high for both buyers and sellers. I also show how state varying liquidity depends on the absence of smoothly functioning rental markets.

Mergers of Publicly Traded Banking Organizations Revisited

Simon Kwan, with Robert A. Eisenbeis, *FRB Atlanta*

Published in *Federal Reserve Bank of Atlanta Economic Review* 84(4) (1999) pp. 26–37.

In more than 3,844 mergers and acquisitions between 1989 and 1999, acquiring institutions purchased more than \$3 trillion in assets. A number of reasons have been advanced for such a surge in acquisitions, including the need to consolidate to achieve cost savings and operational efficiencies, the need to be better able to compete in the global marketplace, and the need to provide for the controlled exit of inefficient firms from the financial services industry.

This article explores the question of whether the various expected performance and earning benefits of mergers are in fact realized. It adds to the limited existing research on the effects of bank mergers by analyzing consolidations between 1989 and 1996, a period of almost unprecedented banking consolidation. Specifically, examining recent data allows us to consider evidence of efficiency or other gains from the wave of acquisitions flowing from the erosion and final elimination of the McFadden Act.

Mergers (*continued*)

Consistent with the findings of earlier studies, the results point to mixed efficiency and performance effects. For example, evidence suggests that even though the better-performing institutions tended to target the higher-performing targets, the resulting mergers did not significantly improve profit performance or efficiency. In addition, we find only weak evidence that the market viewed acquisitions favorably. The overall conclusion is that the widely touted earnings, efficiency, and other performance and earnings benefits of mergers of large banks still remain in doubt.

**The Role of Specialized
Lenders in Extending
Mortgages to Lower-Income
and Minority Homebuyers**

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of the Federal Reserve System*
Wayne Passmore, *Board of Governors
of the Federal Reserve System*

Published in *Federal Reserve Bulletin*
85 (November 1999) pp. 709–723.

Home-purchase lending to lower-income and minority households and neighborhoods has expanded significantly and at a faster rate than lending to other borrowers in recent years. Over the same period, however, an increasing proportion of applicants for conventional home-purchase mortgages, including lower-income and minority applicants, has had applications denied. The first trend often has been taken as evidence that lenders' efforts to expand credit availability have been successful, whereas the second trend has contributed to concerns about access to credit and the fairness of the lending process. An important but little recognized force behind the shift of credit toward lower-income and minority borrowers has been a rapid expansion of activity by subprime and manufactured-home lenders, lenders who are oriented toward lower-income and minority households. Using data collected under the Home Mortgage Disclosure Act (HMDA) from 1993 to 1998, this article finds that part of the growth in mortgage lending and most of the increase in denial rates are associated with the substantial and growing share of mortgage activity of institutions that specialize in subprime and manufactured-home lending.

**Do Savings Associations Have
a Special Commitment
to Housing?**

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Wayne Passmore, *Board of Governors
of the Federal Reserve System*

Forthcoming in
Journal of Financial Services Research.

In this paper, we investigate whether elimination of the savings association charter might reduce lending to nontraditional mortgage borrowers. We present a theoretical model of lender portfolio choice in which nontraditional lenders have some market power and traditional lenders are price takers in the mortgage market. The comparative statics indicate differences between nontraditional and traditional lenders in terms of their asset allocation responses to changes in borrower income and house prices. Empirical tests indicate the absence of such differences between savings associations and commercial banks, suggesting that elimination of the savings association charter would not impair lending to non-traditional mortgage borrowers.

Optimal Redistributive Capital Taxation in a Neoclassical Growth Model

Kevin J. Lansing

Published in *Journal of Public Economics* 73 (September 1999) pp. 423–453.

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This paper provides a counterexample to the simplest version of the redistribution models considered by Judd (1985) in which the government chooses an optimal distortionary tax on capitalists to finance a lump-sum payment to workers. I show that the steady-state optimal tax on capital income is generally non-zero when the capitalists' utility is logarithmic and the government faces a balanced-budget constraint. With log utility, agents' optimal decisions depend solely on the current rate of return, not any future rates of return or tax rates. This feature of the economy effectively deprives the government of a useful policy instrument because promises about future tax rates can no longer influence current allocations. When combined with a lack of other suitable policy instruments (such as government bonds), the result is an inability to decentralize the allocations that are consistent with a zero limiting capital tax. I show that the standard approach to solving the dynamic optimal tax problem yields the wrong answer in this (knife-edge) case because it fails to properly enforce the constraints associated with the competitive equilibrium. Specifically, the standard approach lets in an additional policy instrument through the back door.

Fiscal Policy and Productivity Growth in the OECD

Kevin J. Lansing, with
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Published in *Canadian Journal of Economics* 32(5) (November 1999) pp. 1,215–1,226.

We use a simple endogenous growth model with productive public capital to investigate the degree to which observed fiscal policies in eight OECD countries can account for slowdowns in the growth rates of aggregate labor productivity since 1970. In model simulations, we find that none of the observed public capital policies can generate slowdowns of sufficient magnitude to match those in the data. For most countries in our sample, a simulation that combines the observed public capital policy with the observed tax policy does a better job of accounting for the slowdown than either policy in isolation.

Optimal Taxation of Capital Income with Imperfectly Competitive Product Markets

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We show that the steady-state optimal tax on capital income can be negative, positive, or zero in a neoclassical growth model that allows for imperfectly competitive product markets. The sign of the optimal tax rate depends crucially on (1) the degree of monopoly power, (2) the extent to which monopoly profits can be taxed, (3) the size of the depreciation allowance, and (4) the magnitude of government expenditures. For an empirically plausible set of parameters, we find that the steady-state optimal capital tax can range between –10% and 22%.

Regulatory Evaluation of Value-at-Risk Models

Jose A. Lopez

Forthcoming in *Journal of Risk*.

Beginning in 1998, U.S. commercial banks may determine their regulatory capital requirements for financial market risk exposure using Value-at-Risk (VaR) models. Currently, regulators have available three hypothesis-testing methods for evaluating the accuracy of VaR models: the binomial, interval forecast, and distribution forecast methods. Given the low power often exhibited by their corresponding hypothesis tests, these methods can often misclassify forecasts from inaccurate models as acceptably accurate. An alternative evaluation method using loss functions based on probability forecasts is proposed. Simulation results indicate that this method is only as capable of differentiating between forecasts from accurate and inaccurate models as the other methods. However, its ability to incorporate regulatory loss functions directly into model evaluations makes it a useful complement to the current regulatory evaluation of VaR models.

Supervisory Information and the Frequency of Bank Examinations

Jose A. Lopez, with
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Published in Federal Reserve Bank of New York's *Economic Policy Review* 5(1) (April 1999) pp. 1–19.

Bank supervisors need timely and reliable information about the financial condition and risk profile of banks. A key source of this information is the on-site, full-scope bank examination. This article evaluates the frequency with which supervisors examine banks by assessing the decay rate of the private supervisory information gathered during examinations. The analysis suggests that this information ceases to provide a useful picture of a bank's current condition after six to twelve quarters. The decay rate appears to be faster in years when the banking industry experiences financial difficulties, and it is significantly faster for troubled banks than for healthy ones. Thus, the analysis suggests that the annual examination frequency currently mandated by law is reasonable, particularly during times of financial stress for the banking industry.

Evaluating Credit Risk Models

Jose A. Lopez, with
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Forthcoming in *Journal of Banking and Finance*; a summary of this paper is forthcoming in the Bank of England's *Financial Stability Review*.

Over the past decade, commercial banks have devoted many resources to developing internal models to better quantify their financial risks and assign economic capital. These efforts have been recognized and encouraged by bank regulators. Recently, banks have extended these efforts into the field of credit risk modeling. However, an important question for both banks and their regulators is evaluating the accuracy of a model's forecasts of credit losses, especially given the small number of available forecasts due to their typically long planning horizons. Using a panel data approach, we propose evaluation methods for credit risk models based on cross-sectional simulation. Specifically, models are evaluated not only on their forecasts over time, but also on their forecasts at a given point in time for simulated credit portfolios. Once the forecasts corresponding to these portfolios are generated, they can be evaluated using various statistical methods.

Is Implied Correlation
Worth Calculating?
Evidence from Foreign
Exchange Options
and Historical Data

Jose A. Lopez, with
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Forthcoming in *Journal of Derivatives*.

Implied volatilities, as derived from option prices, have been shown to be useful in forecasting the subsequently observed volatility of the underlying financial variables. In this paper, we address the question of whether implied correlations, derived from options on the exchange rates in a currency trio, are useful in forecasting the observed correlations. We compare the forecast performance of the implied correlations from two currency trios with markedly different characteristics against correlation forecasts based on historical time-series data. For the correlations in the USD/DEM/JPY currency trio, we find that implied correlations are useful in forecasting observed correlations, but they do not fully incorporate all the information in the historical data. For the correlations in the USD/DEM/CHF currency trio, implied correlations are much less useful. In general, since the performance of implied correlations varies across currency trios, implied correlations may not be worth calculating in all instances.

Will the New Information
Economy Cure the
Cost Disease in the U.S.?

Joe Matthey

Forthcoming in
*The Growth of Service Industries:
The Paradox of Exploding Costs and
Persistent Demand*. Northampton, MA:
Edward Elgar Publishing.

This paper is one of several selected for publication from an international conference on “Structural Change and Employment” and the “Cost Disease,” a concept formed by William Baumol and various of his co-authors. Baumol noted that services that are stagnant, in the sense that labor productivity is stable, are likely to suffer from an increase in relative costs if labor productivity in other sectors of the economy is rising. This increase in relative costs has come to be known as Baumol’s “Cost Disease,” reflecting the possibility that the large relative cost shifts could lead to various social and economic problems. Matthey describes the U.S. experience for comparison with other authors’ discussions of how service-sector relative productivity trends have been affecting the economic structure of their own countries. The paper notes that, as in other countries, the service sector in the U.S. has remained quite viable in terms of output shares—despite rapid increases in relative prices. Various possible resolutions of the paradox of exploding costs and persistent demand are discussed. The paper reviews explanations relating to the commodity composition of final demand, the strength of the income effect, and possible mismeasurement. Some of the largest contributions to unbalanced growth are traced to industries and occupations where use of information technology has been most intensive. In the most recent period, this has come in the form of the rapid growth of a New Information Economy, the use of the Internet to conduct business and personal activities. The paper concludes that the review of historical trends in the United States offers grounds for optimism that the New Information Economy will allow society to deal well with unbalanced growth. The increases in overall societal income levels that are accompanying rapid technological change may themselves contain the medicine needed to cure the “Cost Disease.”

The Effects of General Inflation and Idiosyncratic Cost Shocks on Within-Commodity Price Dispersion: Evidence from Microdata

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of Economics and Statistics* 81(2)
(May 1999) pp. 205–216.

Asia's Financial Crisis: Implications and Lessons for Vietnam

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Published in *Vietnam and the Region:
Asia Pacific Experiences and Vietnam's
Economic Policy Directions*,
ed. Suiwah Leung. 1999.
Northampton, MA: Edmund Elgar.

Opportunistic and Deliberate Disinflation under Imperfect Credibility

Glenn Rudebusch, with
Antulio M. Bomfim, *Board of Governors
of the Federal Reserve System*

Forthcoming in
Journal of Money, Credit and Banking.

This study investigates the dispersion of price levels within highly disaggregated markets by examining plant-level product records from the U.S. Census of Manufactures. The paper estimates the effects of inflation on price dispersion through cross-sectional variation in the drift rate of average input costs within a market, arguing that, in several models that relate inflation to price dispersion, the effects of cost increases on dispersion is similar to the effects of general inflation. We also disentangle the effects of aggregate and idiosyncratic shocks on price dispersion. In general, we find that the higher the drift rate of input costs of a given commodity, the larger the amount of price dispersion. The standard deviation of idiosyncratic shocks also is positively correlated with the degree of price dispersion.

This paper analyzes the sources of East Asia's recent financial crisis and notes that Vietnam's financial system shares a number of vulnerabilities with its neighbors, resulting from impediments to using business criteria in credit allocation or risk management. While the socialization of risk in its domestic financial system and limited openness to international capital flow movements have insulated Vietnam from financial crises in recent years, financial sector weaknesses still may impose significant costs. The recent experience of East Asia suggests that Vietnam would benefit from economic reforms to strengthen the financial sector.

One strategy for disinflation prescribes a deliberate path towards low inflation. A contrasting opportunistic approach eschews deliberate action and instead waits for unforeseen shocks to reduce inflation. This paper compares the ability of these two approaches to achieve disinflation—and at what cost. We analyze these issues using the Federal Reserve's FRB/US model, which allows alternative assumptions to be made about expectations held by agents in the economy; hence, the credibility of the central bank can be considered in assessing the cost of deliberate and opportunistic disinflations.

Policy Rules for Inflation Targeting

Glenn D. Rudebusch, with
Lars E.O. Svensson,
Stockholm University

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ed. J. Taylor. 1999. Chicago:
University of Chicago Press,
pp. 203–246.

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In this paper, we use a small empirical model of the U.S. economy to examine the performance of policy rules that are consistent with a monetary policy regime of inflation targeting. In the real world, explicit inflation targeting is currently pursued in many countries and is characterized by (1) a publicly-announced numerical inflation target (either in the form of a target range, a point target, or a point target with a tolerance interval), (2) a framework for policy decisions which involves comparing an inflation forecast to the announced target, thus, providing an “inflation-forecast targeting” regime for policy where the forecast serves as an intermediate target, and (3) a higher-than-average degree of transparency and accountability.

We compare the properties and outcomes of two kinds of policy rules: explicit “instrument rules” and “targeting rules.” The latter may be closer to actual operating procedures of inflation-targeting central banks. We find that inflation forecasts are central for good policy rules under inflation targeting. Some simple instrument and targeting rules do remarkably well relative to the optimal rule; others, including some that are often used as representing inflation targeting, do less well.

Declining Job Security

Rob Valletta

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Economics* 17(4, part 2)
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Also forthcoming in
*On the Job: Is Long-Term
Employment a Thing of the Past?*
ed. David Neumark. 2000.
New York: Russell Sage Foundation.

This paper defines and analyzes job security in the context of implicit contracts designed to overcome incentive problems in the employment relationship. Contracts of this nature generate predictions concerning the relationship between job security parameters—such as worker seniority and sectoral economic conditions—and the probability of separations. To test these predictions, I estimate binomial and multinomial models of job separations using Panel Study of Income Dynamics (PSID) data for the period 1976–1993. The results are consistent with a decline over time in the incentives to maintain existing employment relationships for male workers and for skilled white-collar women.

The Effect of Health Insurance on Married Female Labor Supply

Rob Valletta, with
Thomas Buchmueller,
University of California, Irvine

Published in *Journal
of Human Resources* 34(1), pp. 42–70.

We investigate the effects of employer-provided health insurance on the labor supply of married women. Because health benefits commonly are restricted to full-time workers, wives who prefer to work short hours but have no alternate source of insurance may work long hours in order to acquire coverage for their families. We use data from the April 1993 Current Population Survey Benefits Supplement, and we exploit variation in coverage under husbands’ health plans to estimate the magnitude of this effect. Our reduced-form labor supply models indicate a strong negative effect of husbands’ health insurance on wives’ work hours, particularly in families with children. This effect persists when we replace husbands’ insurance coverage with husbands’ offered insurance and when we use a multinomial logit model that accounts for unobserved heterogeneity in family labor supply preferences.