# Publications and Other Research

Federal Reserve Bank of New York
Research and Market Analysis Group
www.newyorkfed.org/research

2003

# Contents


| | |
|---|---|
| 1 | Introduction |
| 2 | Economic Policy Review |
| 6 | EPR Executive Summaries |
| 7 | Current Issues in Economics and Finance |
| 10 | Research Update |
| 11 | Staff Reports |
| 16 | Outside Journals |
| 22 | Order Form |



Federal Reserve Bank of New York
Research and Market Analysis Group
www.newyorkfed.org/research

January 2004

# Introduction

The Federal Reserve Bank of New York's Research and Market Analysis Group produces a wide variety of publications and discussion papers of interest to business and banking professionals, policymakers, academics, and the general public.

This catalogue lists recent issues in our research series:

- the *Economic Policy Review*
  a policy-oriented journal focusing on economic and financial market issues
- *Current Issues in Economics and Finance*
  concise studies of topical economic and financial issues
- *Second District Highlights*
  a regional supplement to *Current Issues*
- *Staff Reports*
  technical papers intended for publication in leading economic and finance journals.

The Research Group also offers two other publications of interest to readers:

- *EPR Executive Summaries*
  online versions of selected *Economic Policy Review* articles, in abridged form
- *Research Update*
  a quarterly newsletter providing summaries of studies and listings of recent publications in our research series.

Members of the Group also publish papers in many economic and finance journals, conference volumes, and scholarly books. A list of these publications begins on page 16.

# Economic Policy Review

The *Economic Policy Review* is a policy-oriented research journal that focuses on macroeconomic, banking, and financial market topics.

***EPR*** articles are available at **www.newyorkfed.org/research/epr**.

## Volume 9

### Number 1, April 2003

Special issue: "Corporate Governance: What Do We Know, and What Is Different about Banks?"

#### Introduction
*Hamid Mehran*

#### Boards of Directors as an Endogenously Determined Institution: A Survey of the Economic Literature
*Benjamin E. Hermalin and Michael S. Weisbach*

The authors identify the primary findings of the empirical literature on boards of directors. Typically, these studies have sought to answer one of the following questions: How are the characteristics of the board related to profitability? How do these characteristics affect boards' observable actions? What factors affect board makeup and evolution? Across these studies, a number of regularities have emerged—notably, the fact that board composition does not seem to predict corporate performance, while board size has a negative relationship to performance. The authors note, however, that because there has been little theory to accompany these studies, it is difficult to interpret the empirical results, particularly with respect to possible policy prescriptions.

#### Executive Equity Compensation and Incentives: A Survey
*John E. Core, Wayne R. Guay, and David F. Larcker*

Stock and option compensation and the level of managerial equity incentives are aspects of corporate governance that are especially controversial to shareholders, institutional activists, and government regulators. Similar to much of the corporate finance and corporate governance literature, research on stock-based compensation and incentives has not only generated useful insights, but also produced many contradictory findings. Not surprisingly, many fundamental questions remain unanswered. In this study, the authors synthesize the broad literature on equity-based compensation and executive incentives and highlight topics that seem especially appropriate for future research.

#### A Survey of Blockholders and Corporate Control
*Clifford G. Holderness*

The author surveys the empirical literature on large-percentage shareholders in public corporations, focusing on four key issues: the prevalence of blockholders; the motivation for block ownership; the effect of blockholders on executive compensation, leverage, the incidence of takeovers, and a wide range of corporate decisions; and the effect of blockholders on firm value. A central finding of this study is that there is little reason for policymakers or small investors to fear large-percentage shareholders in general, especially when the blockholders are active in firm management.

## Transparency, Financial Accounting Information, and Corporate Governance

*Robert M. Bushman and Abbie J. Smith*

Audited financial statements along with supporting disclosures form the foundation of the firm-specific information set available to investors and regulators. In this article, the authors discuss economics-based research focused on the properties of accounting systems and the surrounding institutional environment important to effective governance of firms. They provide a framework for understanding the operation of accounting information in an economy, discuss a broad range of important research findings, present a conceptual framework for characterizing and measuring corporate transparency at the country level, and isolate a number of future research possibilities.

## The Corporate Governance of Banks

*Jonathan R. Macey and Maureen O'Hara*

The study argues that commercial banks pose unique corporate governance problems for managers and regulators as well as for claimants on the banks' cash flows, such as investors and depositors. The authors support the general principle that fiduciary duties should be owed exclusively to shareholders. However, in the special case of banks, they contend that the scope of the fiduciary duties and obligations of officers and directors should be broadened to include creditors. In particular, the authors call on bank directors to take solvency risk explicitly and systematically into account when making decisions or else face personal liability for failure to do so.

## Incentive Features in CEO Compensation in the Banking Industry

*Kose John and Yiming Qian*

This article examines the incentive features of top-management compensation in the banking industry. Economic theory suggests that the compensation structures for bank management should have low pay-performance sensitivity because of the high leverage of banks and the fact that banks are regulated institutions. In accordance with this school of thought, the authors find that the pay-performance sensitivity for bank CEOs is lower than it is for CEOs of manufacturing firms. This difference is attributable largely to the difference in debt ratios. The authors also find that banks' pay-performance sensitivity declines with bank size.

## Is Corporate Governance Different for Bank Holding Companies?

*Renée Adams and Hamid Mehran*

The authors analyze a range of corporate governance variables as they pertain to a sample of bank holding companies (BHCs) and manufacturing firms. They find that BHCs have larger boards and that the percentage of outside directors on these boards is significantly higher; also, BHC boards have more committees and meet slightly more frequently. Conversely, the proportion of CEO stock option pay to salary plus bonuses as well as the percentage and market value of direct equity holdings are smaller for bank holding companies. Furthermore, fewer institutions hold shares of BHCs relative to shares of manufacturing firms, and the institutions hold a smaller percentage of a BHC's equity. These observed differences in variables suggest that governance structures are industry-specific. The differences, the authors argue, might be due to differences in the investment opportunities of the firms in the two industries as well as to the presence of regulation in the banking industry.

**EPR Executive Summary available**

**Number 2, June 2003**

"Policies to Promote Affordable Housing." Selected papers from a conference cosponsored by the Federal Reserve Bank of New York and New York University's Furman Center for Real Estate and Urban Policy, February 7, 2002.

Opening Remarks
*William J. McDonough*

State of New York City's Housing and Neighborhoods: An Overview of Recent Trends
*Michael H. Schill and Glynis Daniels*

The Impact of Building Restrictions on Housing Affordability
*Edward L. Glaeser and Joseph Gyourko*

Government Regulation and Changes in the Affordable Housing Stock
*C. Tsuriel Somerville and Christopher J. Mayer*

Housing Production Subsidies and Neighborhood Revitalization: New York City's Ten-Year Capital Plan for Housing
*Ingrid Gould Ellen, Michael H. Schill, Amy Ellen Schwartz, and Ioan Voicu*

Effects of Homeownership on Children: The Role of Neighborhood Characteristics and Family Income
*Joseph M. Harkness and Sandra J. Newman*

The Impacts of New Neighborhoods on Poor Families: Evaluating the Policy Implications of the Moving to Opportunity Demonstration
*John Goering*

Comparing the Costs of Federal Housing Assistance Programs
*Denise DiPasquale, Dennis Fricke, and Daniel Garcia-Diaz*

The Twenty-Fifth Anniversary of the Community Reinvestment Act: Past Accomplishments and Future Regulatory Challenges
*William C. Apgar and Mark Duda*

Preservation First
*Ronay Menschel*

The Building Blocks for Private Investment in New York City's Underserved Communities
*Richard Roberts*

**Number 3, September 2003**

**Part 1**

"Economic Statistics: New Needs for the Twenty-First Century." Selected papers from a conference cosponsored by the Federal Reserve Bank of New York, the Conference on Research in Income and Wealth, and the National Association for Business Economics, July 11, 2002.

Opening Remarks
*Jamie B. Stewart, Jr.*

Price Hedonics: A Critical Review
*Charles R. Hulten*

Remarks on the Measurement, Valuation, and Reporting of Intangible Assets
*Baruch Lev*

Productivity Measurement Issues in Services Industries: "Baumol's Disease" Has Been Cured
*Jack E. Triplett and Barry P. Bosworth*

**Part 2**

**Articles**

### What Market Risk Capital Reporting Tells Us about Bank Risk

*Beverly J. Hirtle*

In recent years, financial market supervisors and the financial services industry have increasingly emphasized the role of public disclosure in ensuring the efficient and prudent operation of financial institutions. This article examines the market risk capital figures reported to bank regulators by U.S. bank holding companies with large trading operations to assess the extent to which such disclosure provides market participants with meaningful information about risk. It argues that when one looks across banks, market risk capital figures provide little additional information about the extent of an institution's market risk exposure beyond what is conveyed by simply knowing the relative size of its trading account. In contrast, when one examines individual banks over time, these figures appear to provide information not available from other data in regulatory reports. These findings suggest that market risk capital figures are most useful for tracking changes in individual banks' market risk exposures over time.

**EPR Executive Summary available**

### Formulating the Imputed Cost of Equity Capital for Priced Services at Federal Reserve Banks

*Edward J. Green, Jose A. Lopez, and Zhenyu Wang*

According to the 1980 Monetary Control Act, the Federal Reserve Banks must establish fees for their priced services to recover all operating costs as well as the imputed costs of capital and taxes that would be incurred by a profit-making firm. Since 2002, the Federal Reserve has made fundamental changes to the calculations used to set the imputed costs. This article describes and analyzes the current approach, which is based on a simple average of three methods as applied to a peer group of bank holding companies. The methods estimate the cost of equity capital from three perspectives—the historical average of comparable accounting earnings, the discounted value of expected future cash flows, and the equilibrium price of investment risk as per the capital asset pricing model. The authors show that the current approach also provides stable and sensible estimates of the cost of equity capital over the past twenty years.

## Measuring Treasury Market Liquidity

*Michael J. Fleming*

Securities liquidity is important to those who transact in markets, those who monitor market conditions, and those who analyze market developments. This article estimates and evaluates a comprehensive set of liquidity measures for the U.S. Treasury securities market. The author finds that the commonly used bid-ask spread—the difference between bid and offer prices—is a useful measure for assessing and tracking liquidity. The spread is highly correlated with a more sophisticated price impact measure and is correlated with episodes of reported poor liquidity in the expected manner. The author also finds that other measures correlate less strongly with episodes of poor liquidity and with the bid-ask spread and price impact measures, indicating that they are only modest proxies for market liquidity. Trading volume and trading frequency, in particular, are found to be weak proxies for market liquidity, as both high and low levels of trading activity are associated with periods of poor liquidity.

**EPR Executive Summary available**

## EPR Executive Summaries

Visit our website for concise summaries of *Economic Policy Review* articles.

Our online publication—*EPR Executive Summaries*—condenses many of the articles published in the *Review*. Readers of the summaries will find timely, policy-oriented studies that are easy to absorb, with links to key charts, related articles, and other resources.

The summaries make the technical research of New York Fed economists more accessible to policymakers, educators, business and financial leaders, and others. The series is designed to foster a fuller understanding of our research among those who are in a position to put our ideas and findings to work.

Summaries, in html format, are available for various articles published in 2003 and 2002.

**www.newyorkfed.org/research/epr/executive_summary.html**

# Current Issues in Economics and Finance

*Current Issues in Economics and Finance* offers concise studies of topical economic and financial issues.

*Second District Highlights*—a regional supplement to *Current Issues*—covers important financial and economic developments in the Federal Reserve System's Second District.

Both series are available in html and pdf formats at **www.newyorkfed.org/research/current_issues**.

## Volume 9

No. 1, January 2003

### The Impact of Exchange Rate Movements on U.S. Foreign Debt

*Cédric Tille*

In 2001, the United States' net debt to the rest of the world jumped to $2.3 trillion, a level double that recorded in 1999. Much of the increase reflects the new borrowing undertaken by the country to finance its mounting current account deficit. A third of the change, however, can be traced to a simple accounting effect—the impact of a rising dollar on the value of U.S. assets held abroad.

No. 2, February 2003

### New York City's Economy before and after September 11

*Jason Bram*

An analysis of employment and income trends suggests that the economic impact of the September 11 attack on New York City was somewhat less severe than originally thought. The attack created sizable job and income losses, but the city's current downturn appears to stem largely from other, cyclical factors—namely, the national economy and the financial markets.
*Second District Highlights*

No. 3, March 2003

### Governing the Financial or Bank Holding Company: How Legal Infrastructure Can Facilitate Consolidated Risk Management

*Thomas C. Baxter, Jr.*

On October 25, 2002, Thomas C. Baxter, Jr., General Counsel and Executive Vice President of the Federal Reserve Bank of New York, presented these remarks at the Puerto Rico Bankers Association conference "Financial Transparency and Corporate Governance of Financial Institutions after the Sarbanes-Oxley Act of 2002" in San Juan, Puerto Rico.

No. 4, April 2003

### Now and Then: The Evolution of Loan Quality for U.S. Banks

*Kevin J. Stiroh and Christopher Metli*

Although loan quality in the U.S. banking industry deteriorated in recent years, a comparison with the banking crisis of the late 1980s and early 1990s suggests that the industry is in a far better position today than it was a decade ago. The percentage of troubled loans is lower, loan quality problems are confined principally to large-bank commercial and industrial lending, and credit weakness is concentrated in a small number of borrower industries.

No. 5, May 2003

### Social Security and the Consumer Price Index for the Elderly

*Bart Hobijn and David Lagakos*

Some argue that social security benefits should be adjusted using a price index that reflects the spending habits of the elderly rather than those of workers. This study suggests that if such an index were adopted today, over the next forty years benefit levels would increase and the social security trust fund could become insolvent up to five years sooner than projected.

No. 6, June 2003

### The Repurchase Agreement Refined: GCF Repo

*Michael J. Fleming and Kenneth D. Garbade*

One of the largest and most important of the money markets is the market for repurchase agreements. In a repurchase agreement, a borrower of money effectively agrees to provide securities as collateral to the lender to mitigate credit risk. GCF Repo is a recent innovation in this market that reduces transaction costs, enhances liquidity, and facilitates the efficient use of collateral.

No. 7, July 2003

### Job Declines in New York–New Jersey Region to Slow in 2003; Modest Growth Seen for 2004

*James Orr and Rae Rosen*

Employment in the New York–New Jersey region will decline in 2003—but only slightly—and the region's economy is poised to rebound in 2004 with 1 percent growth, or a gain of 128,000 jobs. Continued expansion in the national economy and sustained vigor in the financial markets, however, will be essential to a favorable employment outlook.
*Second District Highlights*

No. 8, August 2003

### Has Structural Change Contributed to a Jobless Recovery?

*Erica L. Groshen and Simon Potter*

The current recovery has seen steady growth in output but no corresponding rise in employment. A look at layoff trends and industry job gains and losses in 2001-03 suggests that structural change—the permanent relocation of workers from some industries to others—may help explain the stalled growth in jobs.

No. 9, September 2003

### What Moves Sovereign Bond Markets? The Effects of Economic News on U.S. and German Yields

*Linda Goldberg and Deborah Leonard*

Economic announcements are an important source of information, containing news that spills over internationally across markets, affecting yields. An analysis of the U.S. and German sovereign bond markets finds that the largest moves in yields are associated with U.S. announcements on labor market conditions, real GDP growth, and consumer sentiment.

No. 10, October 2003

### Taking the Pulse of the Tech Sector: A Coincident Index of High-Tech Activity

*Bart Hobijn, Kevin J. Stiroh, and Alexis Antoniades*

A new index of the U.S. high-tech sector—drawing upon a range of technology-specific data—has the potential to offer a more timely assessment of economic activity than has been possible to date. The index suggests that while the tech sector has rebounded from its poor performance in the 2000-01 "tech bust," it has not resumed its rapid expansion of the late 1990s.

No. 11, November 2003

### Coping with Terms-of-Trade Shocks in Developing Countries

*Christian Broda and Cédric Tille*

Sharp swings in a developing country's terms of trade—the price of its exports relative to the price of its imports—can seriously disrupt output growth. An analysis of the effects of a decline in export prices in seventy-five developing economies suggests that countries with a flexible exchange rate will experience a much milder contraction in output than their counterparts with fixed exchange rate regimes.

No. 12, December 2003

### After the Refinancing Boom: Will Consumers Scale Back Their Spending?

*Margaret M. McConnell, Richard W. Peach, and Alex Al-Haschimi*

Concerns are rising that the recent surge in home equity withdrawal has left consumers in a weakened financial position that will, over time, prompt a retrenchment in spending. However, a look at household assets and liabilities suggests that consumers have used the withdrawn funds to restructure their balance sheets and reduce their debt service burden. As a result, households may be in a better position to spend in the years ahead.

# Research Update

*Research Update* is a quarterly newsletter designed to keep you informed about the Research Group's current work. The newsletter—which complements this catalogue—offers summaries of selected studies and listings of recent articles and papers in our research series.

*Research Update* also reports on other news within the Group, including:

- staff publication in outside journals,
- upcoming conferences at the Federal Reserve Bank of New York,
- calls for papers, and
- new publications and services.

You can subscribe to *Research Update* by using the enclosed order form. The publication is also available in html and pdf formats at **www.newyorkfed.org/research/research_update**.

# Staff Reports

The *Staff Reports* series features technical research papers designed to stimulate discussion and elicit comments. These papers are intended for eventual publication in leading economic and finance journals.

The series is available only at **www.newyorkfed.org/research/staff_reports**.

## Macroeconomics and Growth

No. 159, January 2003

### Tracking the New Economy: Using Growth Theory to Detect Changes in Trend Productivity

*James A. Kahn and Robert Rich*

The authors propose a methodology that draws on growth theory to identify variables other than productivity—namely, consumption and labor compensation—to estimate trend productivity growth. They treat that trend as a common factor with two "regimes," high- and low-growth. The authors find evidence of a switch in the mid-1990s to a higher long-term growth regime, as well as a switch in the early 1970s in the other direction. In addition, the study finds that productivity data alone provide insufficient evidence of regime changes; corroborating evidence from other data is crucial in identifying changes in trend growth. The authors argue that their methodology would also detect trend changes in real time: For the 1990s, it would have detected a switch within two years of its occurrence, according to subsequent data.

No. 169, June 2003

### Cross-Country Technology Adoption: Making the Theories Face the Facts

*Diego Comin and Bart Hobijn*

The authors document the common patterns observed in the diffusion of more than twenty technologies across twenty-three of the world's leading industrial economies from 1788 to 2001. Their results suggest a pattern of trickle-down diffusion that is remarkably robust across technologies. Most of the technologies considered originate in advanced economies and are adopted there first; they then trickle down to countries that lag economically. The study also shows that the most important determinants of a country's speed in adopting technologies are its human capital endowment, type of government, degree of openness to trade, and adoption of predecessor technologies. The overall rate of diffusion has increased markedly since World War II because of the convergence of these variables across countries.

No. 171, August 2003

### An Investigation of the Gains from Commitment in Monetary Policy

*Ernst Schaumburg and Andrea Tambalotti*

This study proposes a simple framework for analyzing a continuum of monetary policy rules characterized by differing degrees of credibility, in which commitment and discretion become special cases of what the authors call quasi commitment. The monetary policy authority is assumed to formulate optimal commitment plans, to be tempted to renege on them, and to succumb to this temptation with a constant exogenous probability known to the private sector. By interpreting this probability as a continuous measure of the (lack of) credibility of the monetary policy authority, the authors investigate the welfare effect of a marginal increase in credibility. Their main finding is that in a simple model of the monetary transmission mechanism, most of the gains from commitment accrue at relatively low levels of credibility.

No. 174, October 2003

### What Explains the Stock Market's Reaction to Federal Reserve Policy?

*Ben S. Bernanke and Kenneth N. Kuttner*

This paper analyzes the impact of changes in the federal funds rate target on equity prices, with the aim of both estimating the size of the typical reaction and understanding the reasons for the reaction. On average, a typical unanticipated 25-basis-point rate cut is associated with a roughly 1 percent increase in broad stock market indexes. The response varies across industries in a pattern consistent with the capital asset pricing model. Policy's impact on expected future stock returns accounts for the largest share of the stock price response, while the direct effect of the real risk-free interest rate is small.

## Microeconomics

No. 168, May 2003

### Using Home Maintenance and Repairs to Smooth Variable Earnings

*Joseph Gyourko and Joseph Tracy*

Recent research indicates that the marked increase in U.S. income inequality over the past twenty-five years has not been matched by a similar increase in consumption inequality. This paper examines the role of saving/dissaving in a house as a vehicle for consumption smoothing. Data from the American Housing Survey show that expenditures on home maintenance and repairs are economically significant, amounting to roughly $1,750 per household each year. This figure is comparable to the labor literature estimates that put households' average annual transitory income variance at about $2,200. The authors' calculations show a significant elasticity of maintenance and repair expenditures to transitory income shocks. The elasticities are higher for less well educated households, which are more likely to be liquidity constrained than their better educated counterparts.

No. 173, October 2003

### Inflation Inequality in the United States

*Bart Hobijn and David Lagakos*

Inflation is often assumed to affect everyone the same way. However, differences in spending patterns across households and differences in price increases across goods and services lead to unequal levels of inflation. This paper measures the degree of inflation inequality across U.S. households from 1987 to 2001. Its results suggest that inflation experiences vary significantly, with most of the differences traceable to changes in the relative prices of education, health care, and gasoline. Cost-of-living increases are found to be generally higher for the elderly, largely because of their health care expenditures, and the cost of living for poor households is most sensitive to fluctuations in gasoline prices. It also finds that households experiencing high inflation in one year do not generally do so in the next year.

## International

No. 172, September 2003

### Tariffs and the Great Depression Revisited

*Mario J. Crucini and James Kahn*

Drawing on recent business cycle research on the Great Depression, the authors return to an argument they advanced in a 1996 *Journal of Monetary Economics* article: Features of the Hawley-Smoot tariffs could have done more to decrease economic activity than is customarily believed, although not enough to account for the severe decline of the early 1930s. In this study, the authors reformulate their argument in a business cycle accounting framework that apportions fluctuations between three types of "wedges": (productive) inefficiency, the consumption-leisure margin, and intertemporal inefficiency. Tariff increases in their model correspond primarily to productive inefficiency in a prototype one-sector model. Moreover, the wedge implied by tariffs during the Depression correlates well with the overall measure of productive inefficiency. By failing to produce a labor wedge of any consequence, their model offers persuasive evidence that factors other than tariffs also contributed significantly to the severity of the Depression.

## Banking and Finance

No. 158, January 2003

### Fifteen Minutes of Fame? The Market Impact of Internet Stock Picks

*Peter Antunovich and Asani Sarkar*

The authors examine 120 Nasdaq and over-the-counter "buy" recommendations by Internet sites from April 1999 to June 2001. The stock picks show substantial short- and long-run price and liquidity gains, although no new information is revealed about them. For example, liquidity one year after the pick day remains higher for these stocks than for a sample matched according to size, book-to-market value, and liquidity in the preceding year. After controlling for fundamental and microstructure factors, the study also finds that stocks with lower initial liquidity have greater improvements in liquidity on the pick day, while stocks with lower initial liquidity and higher pick-day liquidity have higher pick-day excess returns. These results suggest that stocks have multiple liquidity equilibria, and that the stock picks, by coordinating uninformed trading activity, push initially illiquid stocks to a higher liquidity equilibrium.

No. 160, February 2003

### Endogenous Deposit Dollarization

*Christian Broda and Eduardo Levy Yeyati*

This paper explores sources of deposit dollarization unrelated to standard moral hazard arguments. The authors develop a model in which banks choose the optimal currency composition of their liabilities. They argue that the equal treatment of peso and dollar claims in the event of bank default can induce banks to attract dollar deposits above the socially desirable level. The distortion arises because dollar deposits are the only source of default risk in the model, but dollar depositors share the burden of the default with peso depositors. The incentive to dollarize is reinforced by common banking system safety nets, such as deposit and bank insurance. These findings suggest that regulators in bicurrency economies would potentially benefit by departing from the currency-blind benchmark and differentiating among currencies in a way that prevents undesirable currency mismatches.

No. 164, March 2003

### An Empirical Analysis of Stock and Bond Market Liquidity

*Tarun Chordia, Asani Sarkar, and Avanidhar Subrahmanyam*

This paper explores liquidity movements in stock and Treasury bond markets over more than 1,800 trading days. Cross-market dynamics in liquidity are estimated using a vector autoregressive model for liquidity, returns, volatility, and order flow. The paper finds that a shock to quoted spreads in one market affects spreads in both markets, and that return volatility is an important driver of liquidity. Innovations to stock and bond market liquidity and volatility prove to be significantly correlated, suggesting that common factors drive liquidity and volatility in both markets. Monetary expansion increases equity market liquidity during financial crises, and unexpected increases (decreases) in the federal funds rate lead to decreases (increases) in liquidity and increases (decreases) in stock and bond volatility. Finally, flows to the stock and government bond sectors play an important role in forecasting stock and bond liquidity.

No. 165, April 2003

### The Execution of Monetary Policy: A Tale of Two Central Banks

*Leonardo Bartolini and Alessandro Prati*

The Eurosystem and the Federal Reserve follow different approaches to the execution of monetary policy. The Eurosystem largely delegates to depository institutions the task of stabilizing their liquidity at high frequency, while the Federal Reserve intervenes daily to fine-tune banking system liquidity. The authors review the effect of these approaches on the high-frequency behavior of very short-term interest rates. They also examine interest rate behavior after the Y2K date change and September 11—events requiring the two central banks to deviate from their styles of liquidity management. They find that, despite differences in operational frameworks, certain elements of the central banks' daily intervention have caused very short-term interest rates to behave similarly in the euro area and the United States. Significantly, during periods of anticipated or actual crisis, the two banks have acted very much alike in managing interbank market liquidity in response to shocks.

No. 166, May 2003

### The Impact of CEO Turnover on Equity Volatility

*Matthew J. Clayton, Jay C. Hartzell, and Joshua V. Rosenberg*

The authors develop three hypotheses about how changes in CEOs affect stock price volatility and test them using a sample of 872 turnovers over the 1979-95 period. They find that volatility increases following turnover, even when the CEO leaves voluntarily and is replaced internally. In addition, forced turnovers increase volatility more than voluntary turnovers do, a finding consistent with the view that forced departures imply a higher probability of large strategy changes. For voluntary departures, external successions increase volatility more than internal successions do. The authors attribute this volatility difference to increased uncertainty over the successor CEO's managerial skills. They also document a greater stock price response to earnings announcements following chief executive officer turnover, consistent with more informative signals of value driving the increased volatility.

No. 167, May 2003

### Evaluating the Riskiness of Initial Public Offerings: 1980-2000

*Stavros Peristiani*

This paper considers whether IPOs have become more perilous to investors over time. The author employs two approaches to investigate the post-issuance riskiness of IPOs over the 1980-2000 period. First, he compares the stock price volatility for issuing and nonissuing firms. Second, he uses a qualitative model to estimate the likelihood that new issues will survive in the aftermarket. Both methodologies show that the riskiness of IPOs relative to a nonissuing peer group has increased roughly 30 percent in the 1990s. Although the proliferation of Internet companies in this period helps account for the increased risk, the study reveals a more gradual shift in risk that cannot be fully explained by the high-tech bubble. Specifically, companies taken public by top-tier underwriters or funded by venture capital exhibit higher relative volatility and a lower likelihood of survival.

No. 170, July 2003

### Stock Market Reaction to Financial Statement Certification by Bank Holding Company CEOs

*Beverly J. Hirtle*

In 2002, the Securities and Exchange Commission (SEC) mandated that CEOs of large, publicly traded firms certify the accuracy of their financial statements. This paper investigates whether certification has had a measurable effect on the stock market valuation of the forty-two bank holding companies (BHCs) subject to the order. It finds that the firms had a positive average abnormal return of 30 to 60 basis points on certification day—a result driven primarily by BHCs that certified in advance of the SEC's deadline. Characteristics associated with greater opaqueness are systematically associated with these certification-day abnormal returns. In addition, average abnormal returns for not-yet-certifying BHCs were positive, though not statistically significant, on the day the first two BHCs certified, lending weak support to the idea that early certification may have signaled to investors that other BHCs were likely to certify. These results suggest that the certification requirement provided relevant information to investors and was thus an effective public policy tool, at least in the banking sector.

No. 175, October 2003

### Cross-Country Differences in Monetary Policy Execution and Money Market Rates' Volatility

*Leonardo Bartolini and Alessandro Prati*

The volatility patterns of overnight interest rates differ across industrial countries in ways that existing models, designed to replicate the features of the U.S. federal funds market, cannot explain. The authors present an equilibrium model of the overnight interbank market that matches these different patterns by incorporating differences in policy execution by the world's main central banks, including differences in central banks' management of marginal lending and deposit facilities in response to shocks. Their model is consistent with central banks' observed practice of rationing access to marginal facilities when the objective of stabilizing short-term interest rates conflicts with another high-frequency objective, such as targeting exchange rates.

No. 176, December 2003

### Are Banks Really Special? New Evidence from the FDIC-Induced Failure of Healthy Banks

*Adam B. Ashcraft*

The Federal Deposit Insurance Corporation (FDIC) used cross-guarantees to close thirty-eight subsidiaries of First RepublicBank Corporation in 1988 and eighteen subsidiaries of First City Bancorporation in 1992 when lead banks from each of these Texas-based bank holding companies were declared insolvent. The author uses this exogenous failure of otherwise healthy subsidiary banks as a natural experiment for studying the impact of bank failure on local-area real economic activity. He finds that the closings of the subsidiaries were associated with a significant decline in bank lending that led to a permanent reduction in real county income of about 3 percent.

## Quantitative Methods

No. 161, February 2003

### Modeling Uncertainty: Predictive Accuracy as a Proxy for Predictive Confidence

*Robert Rich and Joseph Tracy*

The authors evaluate current strategies for the empirical modeling of forecast behavior. They focus on the reliability of using proxies from time series models of heteroskedasticity to describe changes in predictive confidence. To do so, they examine the relationship between ex-post inflation forecast errors and ex-ante measures of inflation uncertainty using data from the Survey of Professional Forecasters. The results provide little evidence of a strong link between observed heteroskedasticity in the consensus forecast errors and forecast uncertainty. Instead, they indicate a significant link between observed heteroskedasticity in the consensus forecast errors and forecast dispersion. The authors conclude that conventional model-based measures of uncertainty may be capturing not the degree of confidence that individuals attach to their forecasts, but the degree of disagreement across individuals.

No. 162, March 2003

### Nonparametric Pricing of Multivariate Contingent Claims

*Joshua V. Rosenberg*

The author derives and implements a nonparametric, arbitrage-free technique for multivariate contingent claim pricing. Using results from the method of copulas, he shows that the multivariate risk-neutral density can be written as a product of marginal risk-neutral densities and a risk-neutral dependence function. He then develops a pricing technique using nonparametrically estimated marginal risk-neutral densities and a nonparametric dependence function to estimate the joint risk-neutral density of euro-dollar and yen-dollar returns. The study compares the nonparametric risk-neutral density with density based on a lognormal dependence function and nonparametric marginals. The nonparametric euro-yen density has greater volatility, skewness, and kurtosis than the density based on a lognormal function. For euro-yen futures options, the nonparametric model's pricing accuracy is superior to that of the lognormal model.

No. 163, March 2003

### Forecasting in Large Macroeconomic Panels Using Bayesian Model Averaging

*Gary Koop and Simon Potter*

This paper considers the problem of forecasting in large macroeconomic panels using Bayesian model averaging. It describes practical methods for implementing Bayesian model averaging with factor models; the methods involve algorithms that simulate from the space defined by all possible models. The authors explain how these algorithms can be used to select the model with the highest marginal likelihood (or highest value of an information criterion). They use these methods to forecast GDP and inflation, relying on quarterly U.S. data on 162 time series. Models containing factors outperform autoregressive models in forecasting GDP and inflation, but only narrowly and at short horizons. The authors attribute this finding to the presence of structural instability and the fact that lags of the dependent variable seem to contain most of the information relevant for forecasting.

# Outside Journals

Members of the Research and Market Analysis Group publish in a wide range of economic and finance journals, conference volumes, and scholarly books.

## Published in 2003

### Macroeconomics and Growth

Arturo Estrella

"Monetary Policy Shifts and the Stability of Monetary Policy Models," with Jeffrey Fuhrer. *Review of Economics and Statistics* 85, no. 1 (February): 94-104.

Arturo Estrella and Anthony Rodrigues

"How Stable Is the Predictive Power of the Yield Curve? Evidence from Germany and the United States," with Sebastian Schich. *Review of Economics and Statistics* 85, no. 3 (August): 629-44.

Bart Hobijn

"Another View of Investment: Forty Years Later," with Jess Benhabib. In Philippe Aghion, Roman Frydman, Joseph Stiglitz, and Michael Woodford, eds., *Knowledge, Information, and Expectations in Modern Macroeconomics: In Honor of Edmund S. Phelps*, 522-45. Princeton, N.J.: Princeton University Press.

James Kahn and Robert Rich

"Distinguishing Trends from Cycles in Productivity." *Monetary Policy in a Changing Environment*, BIS Papers no. 19, October: 443-61.

James McAndrews

"Settlement Risk under Gross and Net Settlement," with Charles Kahn and William Roberds. *Journal of Money, Credit, and Banking* 35, no. 4 (August): 591-608.

Jonathan McCarthy

"Capital Overhangs: Has Investment Spending Suffered from a Hangover?" *Business Economics* 38, no. 4 (October): 20-7.

Paolo Pesenti

"Monetary Rules for Small, Open, Emerging Economies," with Douglas Laxton. *Journal of Monetary Economics* 50, no. 5 (July): 1109-46.

Til Schuermann

"Risk Measurement, Risk Management, and Capital Adequacy of Financial Conglomerates," with Andrew Kuritzkes and Scott Weiner. In Richard Herring and Robert Litan, eds., *Brookings-Wharton Papers on Financial Services 2003*, 141-93.

Kevin Stiroh

"Growth and Innovation in the New Economy." In Derek C. Jones, ed., *New Economy Handbook*, 723-51. San Diego, Calif.: Academic Press.

"Lessons for Canada from the U.S. Growth Resurgence," with Dale W. Jorgenson and Mun S. Ho. *International Productivity Monitor*, no. 6 (spring): 3-18.

"Lessons from the U.S. Growth Resurgence," with Dale W. Jorgenson and Mun S. Ho. *Journal of Policy Modeling* 25, no. 5 (July): 453-70.

Review of *Technological Innovation and Economic Performance*, edited by Benn Steil, David G. Victor, and Richard G. Nelson. *Journal of Economics* 79, no. 1 (May): 100-4.

### Kei-Mu Yi

Review of *Barriers to Riches*, by Stephen L. Parente and Edward C. Prescott. *Journal of International Economics* 60, no. 1 (May): 223-8.

## International

### Leonardo Bartolini

"The Overnight Interbank Market: Evidence from the G-7 and the Euro Zone," with Alessandro Prati and Giuseppe Bertola. *Journal of Banking and Finance* 27, no. 10 (October): 2045-83.

### James Harrigan

"Is Japan's Trade (Still) Different?" with Rohit Vanjani. *Journal of the Japanese and International Economies* 17, no. 4 (December): 507-19.

"Specialization and the Volume of Trade: Do the Data Obey the Laws?" In E. Kwan Choi and James Harrigan, eds., *Handbook of International Trade*, 85-118. Oxford: Blackwell.

### Amartya Lahiri

"Delaying the Inevitable: Interest Rate Defense and Balance of Payments Crises," with Carlos Végh. *Journal of Political Economy* 111, no. 2 (April): 404-24.

### Paolo Pesenti

"The Global Economy Model," with Tamim Bayoumi. In *World Economic Outlook: Growth and Institutions*, 145. Washington, D.C.: International Monetary Fund.

### Cédric Tille

"Exchange Rate Pass-Through and the Welfare Effects of the Euro," with Michael B. Devereux and Charles Engel. *International Economic Review* 44, no. 1 (February): 223-42.

### Kei-Mu Yi

"Can Vertical Specialization Explain the Growth of World Trade?" *Journal of Political Economy* 111, no. 1 (February): 52-102.

## Microeconomics

### James McAndrews

"ATM Network Pricing: A Review of the Literature." *Review of Network Economics* 2, no. 2 (spring): 146-58.

### Chris Stefanadis

"Self-Regulation, Innovation, and the Financial Industry." *Journal of Regulatory Economics* 23, no. 1 (January): 5-25.

"Sunk Costs, Contestability, and the Latent Contract Market." *Journal of Economics and Management Strategy* 12, no. 1 (spring): 119-38.

### George Zanjani

"The Production and Regulation of Insurance: Limiting Opportunism in Proprietary and Nonproprietary Organizations," with Tomas Philipson. In Bjorn Lindgren, ed., *Individual Decisions for Health*, 194-206. London: Routledge.

## Banking and Finance

### Adam Ashcraft and Donald Morgan

"Using Loan Rates to Measure and Regulate Bank Risk: Findings and an Immodest Proposal." *Journal of Financial Services Research* 24, no. 2-3 (October/December): 181-200.

### Leonardo Bartolini

"The Execution of Monetary Policy: A Tale of Two Central Banks," with Alessandro Prati. *Economic Policy* 18, no. 37 (October): 435-67.

### Morten Bech

"The Intraday Liquidity Management Game," with Rod Garratt. *Journal of Economic Theory* 109, no. 2 (April): 198-219.

### João Santos

"Alternative Forms of Mixing Banking with Commerce: Evidence from American History," with Joseph Haubrich. *Financial Markets, Institutions, and Instruments* 12, no. 2 (May): 121-64.

"The Paradox of Priority," with Stanley Longhofer. *Financial Management* 32, no. 1 (spring): 69-81.

### Asani Sarkar

"A Comparison of Trading Costs in U.S. Corporate, Municipal, and Treasury Bond Markets," with Sugato Chakravarty. *Journal of Fixed Income* 13, no. 1 (June): 39-48.

"Diversification Benefits of Emerging Markets Subject to Portfolio Constraints," with Kai Li and Zhenyu Wang. *Journal of Empirical Finance* 10, no. 1-2 (February): 57-80.

### Kevin Stiroh

"Competitive Dynamics of Deregulation: Evidence from U.S. Banking," with Philip E. Strahan. *Journal of Money, Credit, and Banking* 35, no. 5 (October): 801-28.

"Efficiency and Scale Economies in Universal Banks: Evidence from Switzerland," with Bertrand Rime. *Journal of Banking and Finance* 27, no. 11 (November): 2121-50.

## Quantitative Methods

### Arturo Estrella

"Critical Values and P-Values of Bessel Process Distributions: Computation and Application to Structural Break Tests." *Econometric Theory* 19, no. 6 (December): 1128-43.

### Simon Potter

"Bayesian Analysis of Endogenous Delay Threshold Models," with Gary Koop. *Journal of Business and Economic Statistics* 21, no. 1 (January): 93-103.

### Joshua Rosenberg

"Nonparametric Pricing of Multivariate Contingent Claims." *Journal of Derivatives* 10, no. 3 (spring): 9-26.

## Forthcoming

## Macroeconomics and Growth

### Adam Ashcraft

"New Evidence on the Lending Channel." *Journal of Money, Credit, and Banking.*

### Bart Hobijn

"Cross-Country Technology Adoption: Making the Theories Face the Facts," with Diego Comin. *Journal of Monetary Economics.*

Robert Rich and Joseph Tracy

"Uncertainty and Labor Contract Durations." *Review of Economics and Statistics.*

## International

Tobias Adrian

"The Degree of Openness and the Costs of Fixing the Exchange Rate," with Daniel Gros. *Economic Letters.*

Christian Broda

"Terms of Trade and Exchange Rate Regimes in Developing Countries." *Journal of International Economics.*

Cédric Tille

"The Welfare Effect of International Asset Markets Integration under Nominal Rigidities." *Journal of International Economics.*

## Microeconomics

Andrew Haughwout

"Land Taxation in New York City: A General Equilibrium Analysis." In Amy Schwartz, ed., *City Taxes, City Spending: Essays in Honor of Dick Netzer.* London: Edward Elgar.

"Local Revenue Hills: Evidence from Four U.S. Cities," with Robert Inman, Steven Craig, and Thomas Luce. *Review of Economics and Statistics.*

"Trade and Tax Policy: Lessons from American Regions." In *Tax Policy*. Proceedings of a Bank of Italy Public Finance Workshop.

Giorgio Topa

"Religious Intermarriage and Socialization in the United States," with Alberto Bisin and Thierry Verdier. *Journal of Political Economy*.

Joseph Tracy

"Unions, Bargaining, and Strikes," with Peter Cramton. In John T. Addison and Claus Schnabel, eds., *International Handbook of Trade Unions*. Cheltenham, England: Edward Elgar.

## Banking and Finance

Arturo Estrella

"The Cyclical Behavior of Optimal Bank Capital." *Journal of Banking and Finance.*

Beverly Hirtle

"Stock Repurchases and Bank Holding Company Performance." *Journal of Financial Intermediation.*

James McAndrews

"To Surcharge or Not to Surcharge: An Empirical Investigation of ATM Pricing," with Timothy Hannan, Elizabeth Kiser, and Robin Prager. *Review of Economics and Statistics.*

Hamid Mehran

"Organizational Form, Taxes, Ownership, and CEO Compensation: Evidence from Small Businesses," with Rebel Cole. *Journal of Financial Economics.*

Donald Morgan

"The Credit Cycle and the Business Cycle: New Findings from the Senior Loan Officer Opinion Survey," with Cara Lown. *Journal of Money, Credit, and Banking.*

Stavros Peristiani

"Modeling the Instability of Mortgage-Backed Prepayments." *Journal of Fixed Income.*

"The Role of Bank Advisors in Mergers and Acquisitions," with Linda Allen, Julapa Jagtiani, and Anthony Saunders. *Journal of Money, Credit, and Banking.*

Joshua Rosenberg

"The Impact of CEO Turnover on Equity Volatility," with Matthew J. Clayton and Jay C. Hartzell. *Journal of Business.*

João Santos

"Allocating Lending of Last Resort and Supervision in the Euro Area," with Charles Kahn. In Volbert Alexander, Jacques Mélitz, and George M. von Furstenberg, eds., *Monetary Union: Why, How, and What Follows?* Oxford: Oxford University Press.

"Banking and Commerce: A Liquidity Approach," with Joseph Haubrich. *Journal of Banking and Finance.*

Til Schuermann

"Capital Regulation for Position Risk in Banks, Securities Firms, and Insurance Companies," with Richard Herring. In Hal Scott, ed., *Capital Adequacy: Law, Regulation, and Implementation.* Oxford: Oxford University Press.

"The New Basel Accord and Questions for Research," with Marc Saidenberg. In Benton Gup, ed., *The New Capital Basel Accord.* Cincinnati, Ohio: South-Western.

Kevin Stiroh

"Diversification in Banking: Is Noninterest Income the Answer?" *Journal of Money, Credit, and Banking.*

"Do Community Banks Benefit from Diversification?" *Journal of Financial Services Research.*

## Quantitative Methods

Simon Potter

"Forecasting Recessions Using the Yield Curve," with Marcelle Chauvet. *Journal of Forecasting.*

Til Schuermann

"Modeling Regional Interdependencies Using a Global Vector Error-Correcting Macroeconometric Model," with M. Hashem Pesaran and Scott Weiner. *Journal of Business and Economic Statistics.*

# Publications and Other Research–2003 Order Form

**Please send me the following at no cost:**

**ECONOMIC POLICY REVIEW, VOL. 9**

____ No. 1 ____ No. 2 ____ No. 3

**CURRENT ISSUES IN ECONOMICS AND FINANCE, VOL. 9**

| | | | |
|---|---|---|---|
| ____ No. 1 | ____ No. 4 | ____ No. 7 | ____ No. 10 |
| ____ No. 2 | ____ No. 5 | ____ No. 8 | ____ No. 11 |
| ____ No. 3 | ____ No. 6 | ____ No. 9 | ____ No. 12 |

**EPR EXECUTIVE SUMMARIES AND STAFF REPORTS**

These series are available only on our website.

**Please add me to the mailing lists for these free publications:**

❑ *Economic Policy Review* ❑ *Current Issues in Economics and Finance*

❑ *Research Update* ❑ *Publications and Other Research*

Name ______________________________

Address ______________________________

City ______________________________

State ______________________ ZIP Code __________

Country ______________________________

Order forms can be faxed to 212-720-1216.
Publications are also available at **www.newyorkfed.org/research/publication_annuals**.

03BB

# Join Our Free E-Alert Service

Readers interested in learning of our new research quickly and conveniently are encouraged to join our free Electronic Alert notification service.

As a subscriber to Electronic Alert, you receive an e-mail as soon as new research publications are posted on our website—enabling you to access research well before print copies are available.

The e-mails also offer you:

- full abstracts of the new publications,
- links to the publications, their press releases, author home pages, and research on similar topics,
- access to a range of data and charts on economic and financial conditions,
- information on upcoming conferences and calls for papers.

**www.newyorkfed.org/alertservices**