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Research Update

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New Study Estimates U.S. Welfare Gains from the Increased Variety of Imported Goods

The growth of international trade in recent decades has greatly expanded U.S. consumers' choice of goods. While the benefits of trade have traditionally been associated with declines in the price of existing products, economists now recognize that the availability of new imported goods and varieties constitutes another important gain from trade.

In "Are We Underestimating the Gains from Globalization for the United States?" (*Current Issues in Economics and Finance*, vol. 11, no. 4), authors Christian Broda and David Weinstein break new ground by providing a measure of the gains from variety growth. Their estimates put the value to U.S. consumers of global variety growth in the 1972-2001 period at roughly $260 billion.

The authors begin their analysis by calculating the increase in global varieties from 1972 to 2001. They find that over this period, the number of product varieties more than tripled. This increase reflects a sharp rise in both the number of goods available and the number of countries supplying each good.

To measure the degree to which this increase in available varieties enhances consumer well-being, the authors recalculate the U.S. import price index for 1972-2001 taking variety growth into account. By comparing their variety-adjusted estimate of the rate of change in import prices over the sample period with the conventional estimate that does not include variety growth, they obtain a measure of the nation's welfare gains from variety growth.

The authors' calculations show that between 1972 and 2001, the variety-adjusted price of imports fell about 1.2 percentage points per year faster than the unadjusted price. Thus, the real cost of imports was almost 30 percent lower at the end of the period than the conventional price index would suggest. Reasoning that imports account for about 10 percent of U.S. GDP, Broda and Weinstein then estimate that the value to consumers of this drop in import prices is about 3 percent of GDP in 2001, or approximately $260 billion. ■

Premier Issue of *International Journal of Central Banking* Is Published

In May, the Federal Reserve Board, along with the twenty-four other sponsoring institutions of the *International Journal of Central Banking* (*IJCB*), announced the publication of the journal's first issue and the launch of a website hosted by the Bank for International Settlements.

The *IJCB*, a quarterly publication, is an initiative of the central banking community. It features articles on central bank theory and practice, with a special emphasis on research relating to monetary and financial stability. The journal's main objectives are to disseminate widely the best policy-relevant and applied research that reflects the missions of central banks around the world across a range of disciplines, and to promote communication among researchers both inside and outside central banks.

The *IJCB*'s first issue contains the following articles:

- Monetary Policy with Judgment: Forecast Targeting
  Lars E. O. Svensson
- Do Actions Speak Louder Than Words? The Response of Asset Prices to Monetary Policy Actions and Statements
  Refet S. Gürkaynak, Brian Sack, and Eric T. Swanson
- The Performance and Robustness of Interest-Rate Rules in Models of the Euro Area
  Ramón Adalid, Günter Coenen, Peter McAdam, and Stefano Siviero
- Monetary Policy Neglect and the Great Inflation in Canada, Australia, and New Zealand
  Edward Nelson
- Committees versus Individuals: An Experimental Analysis of Monetary Policy Decision Making
  Clare Lombardelli, James Proudman, and James Talbot
- Exchange Rate Volatility and the Credit Channel in Emerging Markets: A Vertical Perspective
  Ricardo Caballero and Arvind Krishnamurthy

Detailed information on the *International Journal of Central Banking* can be found at **www.ijcb.org**.

Publications and Papers

The Research and Statistics Group produces a wide range of publications:

- ***The Economic Policy Review***—a policy-oriented journal focusing on economic and financial market issues.
- ***EPR Executive Summaries***—online versions of selected ***Economic Policy Review*** articles in abridged form.
- ***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, available only online.
- ***Publications and Other Research***—an annual catalogue of our research output.

New Titles in the *Staff Reports* Series

The following new ***Staff Reports*** are available at **www.newyorkfed.org/research/staff_reports**.

MACROECONOMICS AND GROWTH

No. 206, April 2005
Shock Identification of Macroeconomic Forecasts Based on Daily Panels
Marlene Amstad and Andreas M. Fischer

This paper proposes a new procedure for shock identification of macroeconomic forecasts based on factor analysis. The authors' identification scheme for information shocks relies on data reduction techniques for daily panels and the recognition that macroeconomic releases exhibit a high level of clustering. This information clustering facilitates the interpretation of forecast innovations as real or nominal information shocks. An empirical application is provided for Swiss inflation. Amstad and Fischer show that the monetary policy shocks generate an asymmetric response to inflation, that the pass-through for consumer price index inflation is weak, and that the information shocks to inflation are not synchronized.

No. 208, May 2005
Who Is Afraid of the Friedman Rule?
Joydeep Bhattacharya, Joseph Haslag, Antoine Martin, and Rajesh Singh

The authors explore the connection between optimal monetary policy and heterogeneity among agents. They utilize a standard monetary economy with two types of agents that differ in the marginal utility they derive from real money balances—a framework that produces a nondegenerate stationary distribution of money holdings. Without type-specific fiscal policy, the authors show that the zero-nominal-interest-rate policy (the Friedman rule) does not maximize type-specific welfare; further, it may not maximize aggregate ex ante social welfare. Indeed, one or, more surprisingly, *both* types of agents may benefit if the central bank deviates from the Friedman rule.

INTERNATIONAL

No. 209, May 2005
The Simple Geometry of Transmission and Stabilization in Closed and Open Economies
Giancarlo Corsetti and Paolo Pesenti

This paper provides an introduction to the recent literature on macroeconomic stabilization in closed and open economies. Corsetti and Pesenti present a stylized theoretical framework, illustrating its main properties with the help of an intuitive graphical apparatus. Among the issues discussed are optimal monetary policy and the welfare gains from macroeconomic stabilization, the international transmission of real and monetary shocks and the role of exchange rate pass-through, and the design of optimal exchange rate regimes and monetary coordination among interdependent economies.

MICROECONOMICS

No. 212, June 2005
Propensity Score Matching, a Distance-Based Measure of Migration, and the Wage Growth of Young Men
John C. Ham, Xianghong Li, and Patricia B. Reagan

This paper estimates the effect of U.S. internal migration on real wage growth between the movers' first and second jobs. Ham, Li, and Reagan develop an economic model to 1) assess the appropriateness of matching as an econometric method for studying migration and 2) choose the conditioning variables used in the matching procedure. The authors find a significant effect of migration on the wage growth of college graduates of 10 percent and a marginally significant effect for high-school dropouts of -12 percent. If the authors use a measure of migration based on moving across either county lines or state lines, the significant effects of migration for college graduates and dropouts disappear.

No. 213, June 2005
Selection Bias, Demographic Effects, and Ability Effects in Common Value Auction Experiments
Marco Casari, John C. Ham, and John H. Kagel

The authors find clear demographic and ability effects on bidding in common value auctions: inexperienced women are much more susceptible to the winner's curse than are men, but they catch up quickly; economics and business majors substantially overbid relative to other majors; and those with superior SAT/ACT scores are much less susceptible to the winner's curse. There are strong selection effects in bid estimates for both inexperienced and experienced subjects that are not identified using standard econometric techniques, but rather through the authors' experimental design effects. Ignoring these selection effects is most misleading for inexperienced bidders, because the unbiased estimates of the bid function indicate much faster learning and adjustment to the winner's curse for individual bidders than do the biased estimates.

BANKING AND FINANCE

No. 207, April 2005
The Joint Dynamics of Liquidity, Returns, and Volatility across Small and Large Firms
Tarun Chordia, Asani Sarkar, and Avanidhar Subrahmanyam

This paper explores liquidity spillovers in market-capitalization-based portfolios of NYSE stocks. Return, volatility, and liquidity dynamics across the small- and large-cap sectors are modeled by way of a vector autoregression model, using data that span more than 3,000 trading days. The authors find that volatility and liquidity innovations in one sector are informative in predicting liquidity shifts in the other. Impulse responses indicate the existence of persistent liquidity, return, and volatility spillovers across the small- and large-cap sectors. Lead and lag patterns across small- and large-cap stocks are stronger when spreads in the large-cap sector are wider. Consistent with the notion that private informational trading in large-cap stocks is transmitted to other stocks with a lag, order flows in the large-cap decile predict both transaction-price-based and mid-quote returns of small-cap deciles when large-cap spreads are high.

No. 210, June 2005
Banking, Markets, and Efficiency
Falko Fecht and Antoine Martin

This paper addresses the question whether the increased financial market access of households improves welfare in a financial system where there is intense bank competition for private households' funds. The authors use a model in which the degree of liquidity insurance offered to households through banks' deposit contracts is restrained by household financial market access; however, they also assume spatial monopolistic competition among banks. Fecht and Martin's results suggest that in Germany's bank-dominated financial system, characterized by intense competition for households' deposits, improved financial market access might reduce welfare because it only reduces risk sharing. In contrast, in the U.S. banking system, where there is less competition for households' deposits, a high level of household financial market participation might be beneficial.

No. 211, June 2005
The Impact of Network Size on Bank Branch Performance
Beverly Hirtle

Despite recent innovations that might have reduced banks' reliance on brick-and-mortar branches for distributing retail financial services, the number of U.S. bank branches has continued to increase steadily over time. Further, an increasing percentage of these branches are held by banks with large branch networks. This paper assesses the implications of these developments by examining a series of simple branch performance measures and asking how these measures vary, on average, across institutions with different branch network sizes. Based on bank-average deposits per branch, small business loans per branch, and net deposit funding costs, mid-sized branch networks may be at a competitive disadvantage relative to both larger and smaller branch networks. ■

Recently Published

Stefano Eusepi. 2005. **"Did the Great Inflation Occur despite Policymaker Commitment to a Taylor Rule?"** with James Bullard. *Review of Economic Dynamics* 8, no. 2 (April): 324-59.

Michael J. Fleming. 2005. **"U.S. Treasury and Agency Securities,"** with Frank J. Fabozzi. In Frank J. Fabozzi, ed., *The Handbook of Fixed Income Securities*, 7th ed., 229-50. New York: McGraw-Hill.

Michael J. Fleming and Kenneth D. Garbade. 2005. **"Anomalous Bidding in Short-Term Treasury Bill Auctions,"** with Frank Keane. *Journal of Financial Research* 28, no. 2 (summer): 165-76.

Charles Himmelberg. 2005. **"Do Stock Price Bubbles Influence Corporate Investment?"** with Simon Gilchrist and Gur Huberman. *Journal of Monetary Economics* 52, no. 4 (May): 805-27.

Amartya Lahiri. 2005. **"A Two-Country Model of Endogenous Growth,"** with Roger E. Farmer. *Review of Economic Dynamics* 8, no. 1 (January): 68-88.

Antoine Martin. 2005. **"Recent Evolution of Large-Value Payment Systems: Balancing Liquidity and Risk."** Federal Reserve Bank of Kansas City *Economic Review* 90, no. 1 (first quarter): 33-57.

Hamid Mehran. 2005. **"Regulatory Incentives and Consolidation: The Case of Commercial Bank Mergers and the Community Reinvestment Act,"** with Raphael Bostic, Anna L. Paulson, and Marc Saidenberg. *B. E. Journals in Economic Analysis and Policy* 5, no. 1 (March):1-27.

Simon Potter. 2005. **"Predicting Recessions Using the Yield Curve,"** with Marcelle Chauvet. *Journal of Forecasting* 24, no. 2 (March): 77-103.

Charles Steindel. 2005. **"Future Public Debt Accumulation and Saving in the United States."** In Daniele Franco, ed., *Public Debt*. Rome: Bank of Italy. ■

Papers Presented by Economists in the Research and Statistics Group

"Does the Time Inconsistency Problem Make Flexible Exchange Rates Look Worse Than You Think?" Roc Armenter. Centre de Recerca en Economia Internacional macroeconomics workshop, Universitat Pompeu Fabra, Barcelona, Spain, June 21. With Martin Bodenstein.

"Corporate Payments Services Survey Results," Michele Braun. National Automated Clearing House Association conference, San Antonio, Texas, April 11. With Sandy Krieger.

"Trade Invoicing in the Accession Countries: Are They Suited to the Euro?" Linda Goldberg. NBER conference, Budapest, Hungary, June 18.

"Vehicle Currency Use in International Trade," Linda Goldberg. NBER conference, Cambridge, Massachusetts, April 1. With Cédric Tille. Also presented at a University of Houston Department of Economics seminar, Houston, Texas, May 2, and a conference cosponsored by Northwestern University and the European University Institute, Florence, Italy, June 14.

"Vertical Contracts as a Source of Incomplete Cross-Border Transmission: The Case of Autos," Rebecca Hellerstein. Workshop on Globalization and Contracts, cosponsored by the Centre for Economic Policy Research and the Department and Laboratory of Theoretical and Applied Economics at the École Normale Supérieure, Paris, France, April 28. With Sofia Berto Villas-Boas.

"Unemployment Insurance and the Diminished Importance of Temporary Layoffs over the Business Cycle," Margaret McConnell. Society of Labor Economics meetings, San Francisco, California, June 2. With Joseph Tracy.

"Board Committee Structures, Incentives, and Firm Performance," Hamid Mehran. Rutgers University seminar, New Brunswick, New Jersey, June 10. With Rachel Hayes and Scott Schaefer.

"Predatory Lending?" Donald Morgan. Federal Reserve Bank of Chicago Bank Structure Conference, Chicago, Illinois, May 4. With Samuel Hanson.

"Current Accounts and Global Rebalancing in a Multi-Country Simulation Model," Paolo Pesenti. NBER conference on G7 Current Account Imbalances, Newport, Rhode Island, June 1. With Hamid Faruqee, Douglas Laxton, and Dirk Muir.

"The Global Economy Model (GEM): Design and Applications," Paolo Pesenti. Bank of Canada International Department seminar, Ottawa, Canada, May 10.

"Productivity Spillovers, Terms of Trade, and the 'Home Market Effect,'" Paolo Pesenti. Centre for Economic Policy Research and Central Bank of Cyprus European Summer Symposium in International Macroeconomics, Limassol, Cyprus, May 28. With Giancarlo Corsetti and Philippe Martin.

"The Simple Geometry of Transmission and Stabilization in Closed and Open Economies," Paolo Pesenti. Harvard University Department of Economics lecture, Cambridge, Massachusetts, May 9. With Giancarlo Corsetti.

"Welfare-Based Monetary Policy Rules in an Estimated Model of the U.S. Economy," Paolo Pesenti. International Research Forum on Monetary Policy, European Central Bank, Frankfurt, Germany, May 21. With Michel Juillard, Philippe Karam, and Douglas Laxton.

"Bank Loans, Bonds, and Informational Monopolies across the Business Cycle," João Santos. Federal Reserve Bank of Chicago Bank Structure Conference, Chicago, Illinois, May 4. With Andrew Winton.

"The Joint Dynamics of Liquidity, Returns, and Volatility across Large and Small Firms," Asani Sarkar. International Conference on New Financial Market Structures, held at HEC Montréal, Montreal, Canada, April 8. With Tarun Chordia and Avanidhar Subrahmanyam.

"A Search for a Structural Phillips Curve," Argia Sbordone. Columbia Business School seminar, New York City, March 15. With Timothy Cogley.

"A General Approach to Integrated Risk Management with Skewed, Fat-Tailed Distributions," Til Schuermann. Georgia Tech University, Atlanta, Georgia, April 1. With Joshua Rosenberg. Also presented at the *Journal of Applied Econometrics* Annual Lecture Series and Conference, Venice, Italy, June 2.

"Scope for Credit Risk Diversification," Til Schuermann. University of Massachusetts Department of Finance seminar, Amherst, Massachusetts, March 11. With M. Hashem Pesaran and Samuel Hanson. Also presented at the Rutgers University Conference on Pacific Basin Finance, Economics, and Accounting, New Brunswick, New Jersey, June 11.

"Bank Risk and Revenue Diversification: An Assessment Using Equity Returns," Kevin Stiroh. Basel Committee on Banking Supervision, Oesterreichische Nationalbank, Vienna, Austria, April 22.

"Financial Integration and the Wealth Effect of Exchange Rate Fluctuations," Cédric Tille. Cornell University seminar, Ithaca, New York, April 13. Also presented at the Society for Economic Dynamics annual meeting, Budapest, Hungary, June 23.

Research and Statistics Group Publications and Papers: April-June 2005

CURRENT ISSUES IN ECONOMICS AND FINANCE, VOL. 11

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Are We Underestimating the Gains from Globalization for the United States?
Christian Broda and David Weinstein

No. 5, May 2005
Improving Business Payments by Asking What Corporations *Really* Want
Sandy Krieger and Michele Braun

No. 6, June 2005
New York City Immigrants: The 1990s Wave
Rae Rosen, Susan Wieler, and Joseph Pereira
Second District Highlights

STAFF REPORTS

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