Findings: A Daily Roundup of Academic Studies
Serious, Sublime, Surreal, and Otherwise
Compiled by Kevin Lewis

Friday, November 26, 2010

Past Due

Do Expiring Budgets Lead to Wasteful Year-End Spending? Evidence from Federal Procurement

Jeffrey Liebman & Neale Mahoney
Harvard Working Paper, November 2010

Abstract:
Many organizations fund their spending out of a fixed budget that expires at year's end. Faced with uncertainty over future spending demands, these organizations have an incentive to build a buffer stock of funds over the front end of the budget cycle. When demand does not materialize, they then rush to spend these funds on lower quality projects at the end of the year. We test these predictions using data on procurement spending by the U.S. federal government. Using data on all federal contracts from 2004 through 2009, we document that spending spikes in all major federal agencies during the 52nd week of the year as the agencies rush to exhaust expiring budget authority. Spending in the last week of the year is 4.9 times higher than the rest-of-the-year weekly average. We examine the relative quality of year-end spending using a newly available dataset that tracks the quality of $130 billion in information technology (I.T.) projects made by federal agencies. Consistent with the model, average project quality falls at the end of the year. Quality scores in the last week of the year are 2.2 to 5.6 times more likely to be below the central value. To explore the impact of allowing agencies to roll unused spending over into subsequent fiscal years, we study the I.T. contracts of an agency with special authority to roll over unused funding. We show that there is only a small end-of-year I.T. spending spike in this agency and that the one major I.T. contract this agency issued in the 52nd week of the year has a quality rating that is well above average.

Bankruptcy as Implicit Health Insurance

Neale Mahoney
Stanford Working Paper, November 2010

Abstract:
This paper examines the interaction between health insurance and the implicit insurance that people have because they can file (or threaten to file) for bankruptcy. With a simple model that captures key institutional features, I demonstrate that the financial risk from medical shocks is capped by the assets that could be seized in bankruptcy. For households with modest seizable assets, this implicit "bankruptcy insurance" can crowd out conventional health insurance. I test these predictions using variation in the state laws that specify the type and level of assets that can be seized in bankruptcy. Because of the differing laws, people who have the same assets and receive the same medical care face different losses in bankruptcy. Exploiting the variation in seizable assets that is orthogonal to wealth and other household characteristics, I show that households with fewer seizable assets are more likely to be uninsured. This finding is consistent with another: uninsured households with fewer seizable assets end up making lower out-of-pocket medical payments. The estimates suggest that if medical costs could not be discharged in bankruptcy, 15.4 percent of the uninsured would buy health insurance. Achieving the

About the Author

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same increase in coverage would require a premium subsidy of approximately 44.8 percent. To shed light on puzzles in the literature and examine policy counterfactuals, I calibrate a utility-based, micro-simulation model of insurance choice. Among other things, simulations show that "bankruptcy insurance" explains the low take-up of high-deductible health insurance.

The Ticket to Easy Street? The Financial Consequences of Winning the Lottery

Scott Hankins, Mark Hoekstra & Paige Marta Skiba
Review of Economics and Statistics, forthcoming

Abstract:
This paper examines whether giving large cash transfers to financially distressed people causes them to avoid bankruptcy. A comparison of Florida Lottery winners who randomly received $50,000 to $150,000 to small winners indicates that such transfers only postpone bankruptcy rather than prevent it, a result inconsistent with the negative shock model of bankruptcy. Furthermore, the large winners who subsequently filed for bankruptcy had similar net assets and unsecured debt as small winners. Thus, our findings suggest that skepticism regarding the long-term impact of cash transfers may be warranted.

Regulating for Legitimacy: Consumer Credit Access in France and America

Gunnar Trumbull
Harvard Working Paper, November 2010

Abstract:
Theories of legitimate regulation have emphasized the role of governments either in fixing market failures to promote greater efficiency, or in restricting the efficient functioning of markets in order to pursue public welfare goals. In either case, features of markets serve to justify regulatory intervention. I argue that this causal logic must sometimes be reversed. For certain areas of regulation, its function must be understood as making markets legitimate. Based on a comparative historical analysis of consumer lending in the United States and France, I argue that national differences in the regulation of consumer credit had their roots in the historical conditions by which the small loan sector came to be legitimized. Americans have supported a liberal regulation of credit because they have been taught that access to credit is welfare promoting. This perception emerged from an historical coalition between commercial banks and NGOs that promoted credit as the solution to a range of social ills. The French regulate credit tightly because they came to see credit as both economically risky and a source of reduced purchasing power. This attitude has its roots in the early postwar lending environment, in which loans were seen to be beneficial only if they were accompanied by strong government protections. These cases suggest that national differences in regulation may trace to historically contingent conditions under which markets are constructed as legitimate.

Willpower Taxes

Lee Anne Fennell
Georgetown Law Journal, forthcoming

Abstract:
Self-control and related concepts appear regularly in tax discussions, but often they are invoked hazily or blurred together with other aspects of choice over time. Despite the evident relevance of willpower to consumption patterns, wealth accumulation, and, ultimately, well-being, there is no consensus about whether and how heterogeneity along this dimension should factor into tax policy. There is support in the tax literature for such divergent responses as funneling more resources to low-willpower people, penalizing them for their lapses, and limiting their choices. Whether we should follow one of these approaches, or some other approach entirely, requires a careful analysis of willpower's workings and its connections to well-being. To begin such an analysis, I focus on three categories of costs associated with willpower problems: the failure costs of suboptimal choices, exercise costs stemming from the willpower exertion itself, and erosion costs that relate to changes over time in willpower levels as a result of patterns of exertions and outcomes. With this framework in mind, I consider the effects of existing and proposed tax policy measures on people with different self-control levels. I then consider some alternatives that would address heterogeneity in willpower through a menu of regulatory bundles designed to induce self-sorting.

The President and the Distribution of Federal Spending

Christopher Berry, Barry Burden & William Howell
American Political Science Review, forthcoming

Abstract:
Scholarship on distributive politics focuses almost exclusively on the internal operations of Congress, paying particular attention to committees and majority parties. This article highlights the president, who has extensive opportunities, both ex ante and ex post, to influence the distribution of federal outlays. We analyze two databases that track the geographic spending of nearly every domestic program over a 24-year period - the largest and most comprehensive panels of federal spending patterns ever assembled. Using district and county fixed-effects estimation strategies, we find no evidence of committee influence and mixed evidence that majority party members receive larger shares of federal outlays. We find that districts and counties receive systematically more federal outlays when legislators in the president's party represent them.

Barriers to Investment in Polarized Societies

Marina Azzimonti
American Economic Review, forthcoming

Abstract:
I present a tractable dynamic model of political economy where disagreements about the composition of public spending result in implementation of short-sighted policies. Excessive taxation reduces the return to physical capital and hence investment rates, which slows down growth along the transition. In the long run, output, consumption and welfare are inefficiently low. The larger is the degree of polarization, the greater is the inefficiency. Political stability mitigates the effects of polarization by making the incumbent internalize the dynamic inefficiencies introduced by the choice of growth-retarding policies.

Government Spending Composition, Technical Change, and Wage Inequality

Guido Cozzi & Giammario Impullitti
Journal of the European Economic Association, December 2010, Pages 1325-1358

Abstract:
In this paper we argue that government spending played a significant role in stimulating the wave of innovation that hit the U.S. economy in the late 1970s and in the 1980s, as well as the simultaneous increase in inequality and in education attainments. Since the late 1970s U.S. policymakers began targeting commercial innovations more directly and explicitly. We focus on the shift in the composition of public demand toward high-tech goods, which, by increasing the market-size of innovative firms, functions as a de facto innovation policy tool. We build a quality-ladders non-scale growth model with heterogeneous industries and endogenous supply of skills, and show that an increase in the technological content of public spending stimulates R&D, raises the wage of skilled workers, and, at the same time, stimulates human capital accumulation. A calibrated version of the model suggests that government policy explains between 12% and 15% of the observed increase in wage inequality in the period 1976-1991.

Industry Evidence on the Effects of Government Spending

Christopher Nekarda & Valerie Ramey
American Economic Journal: Macroeconomics, forthcoming

Abstract:
This paper investigates the effects of government purchases at the industry level in order to shed light on the transmission mechanism for government spending on the aggregate economy. We begin by highlighting the different theoretical predictions concerning the effects of government spending on industry output and labor market variables. We create a new panel data set that matches output and labor variables to industry-specific shifts in government demand. We find that an increase in government demand raises output and hours, but lowers real product wages and labor productivity slightly in the short-run; the markup does not respond. Our estimates also imply roughly constant returns to scale. The findings are consistent with the neoclassical model of government spending, but they are not consistent with the key mechanism of textbook New Keynesian models of the effects of government spending.

Deficit reduction: Short-term pain for long-term gain

Kevin Clinton, Michael Kumhof, Douglas Laxton & Susanna Mursula

European Economic Review, forthcoming

Abstract:
The paper evaluates the costs and benefits of fiscal consolidation using simulations based on the IMFs global dynamic general equilibrium model GIMF. Over the longer run, well-targeted permanent reductions in budget deficits can lead to a considerable increase in both the growth rate and the level of output. The gains may be enhanced by shifting some of the tax burden from incomes to consumption. In the short run, credibility plays a crucial role in determining the size of initial output losses. Global current account imbalances would be significantly reduced if budget consolidation was larger in countries with current account deficits.

Ideology and the Growth of Government

Andrew Pickering & James Rockey
Review of Economics and Statistics, forthcoming

Abstract:
We analyze the impact of ideology on the size of government. In a simple model the government sets redistribution and provision of public services according to the preferences of the median voter. Ideology is defined in terms of preferences for public services and the impact of ideology upon the size of government is shown to increase with mean income. This idea is tested using measures of ideology based on party manifestos. We show that the interaction of ideology and mean income has a major role in explaining the increase and divergence in government size observed across OECD countries.

Understanding policy in the great recession: Some unpleasant fiscal arithmetic

John Cochrane
European Economic Review, forthcoming

Abstract:
I use the valuation equation of government debt to understand fiscal and monetary policy in and following the great recession of 2008-2009. I also examine policy alternatives to avoid deflation, and how fiscal pressures might lead to inflation. I conclude that the central bank may be almost powerless to avoid deflation or inflation; that an eventual fiscal inflation can come well before large deficits or monetization are realized, and that it is likely to come with stagnation rather than a boom.

Exploiting Naivete about Self-Control in the Credit Market

Paul Heidhues & Botond Koszegi
American Economic Review, forthcoming

Abstract:
We analyze contract choices, loan-repayment behavior, and welfare in a model of a competitive credit market when borrowers have a taste for immediate gratification. Consistent with many credit cards and subprime mortgages, for most types of non-sophisticated borrowers the baseline repayment terms are cheap, but they are also inefficiently front-loaded and delays require paying large penalties. Although credit is for future consumption, non-sophisticated consumers overborrow, pay the penalties, and back-load repayment, suffering large welfare losses. Prohibiting large penalties for deferring small amounts of repayment -- akin to recent regulations in the US credit-card and mortgage markets -- can raise welfare.

Chapter 7 or 13: Are Client or Lawyer Interests Paramount?

Lars Lefgren, Frank McIntyre & Michelle Miller
B.E. Journal of Economic Analysis & Policy, 2010

Abstract
Households often rely on professionals with specialized knowledge to make important financial decisions. In many cases, the professional's financial interests are at odds with those of the client. We explore this problem in the context of personal bankruptcy. OLS, fixed effects, and IV estimates all show that attorneys play a central role in determining whether households file under Chapter 7 or Chapter 13 of the bankruptcy code. We present evidence suggesting that some attorneys maximize profits by steering households into Chapter 13 bankruptcy even when the households' objective financial benefits are low and

the probability of case dismissal is high. An attorney-induced Chapter 13 filing increases household legal fees and reduces the probability of long-term debt relief.

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