VI. Winter Workshop in Economics

Friday, December 28, 2012
Koç University

Program

9:00-9:30   **Coffee & Tea**

9:30-10:30   Geographical Reallocation and Unemployment during the Great
Recession: The Role of the Housing Bust
Fatih Karahan – NY Federal Reserve Bank   (joint with Serena Rhee)
Discussant: Erem Ateşağaoğlu – SUNY-Stony Brook

10:30-11:30   Self-control Preferences and Taxation: A Quantitative Analysis in a Life-cycle
Model
Athanasios C. Thanopoulos – University of Athens (joint with Çağrı S. Kumru)
Discussant: Yusuf Soner Başkaya - CBRT

11:30-11:45   **Coffee Break**

11:45-12:45   Trend Shocks, Risk Sharing and Cross-Country Portfolio Holdings
Mustafa Kılınç - CBRT (joint with Yavuz Arslan and Gürsu Keleş)
Discussant: Asli Leblebicioğlu – North Carolina State University

12:45-13:45   **Lunch at Faculty Club**

13:45-14:45   When the Floodgates Open: "Northern" Firms' Response to Removal of Trade
Quotas on Chinese Goods
Hale Utar – University Colorado, Boulder
Discussant: Murat Üngör - CBRT

14:45-15:45   Auction Pricing under State Uncertainty
Mehmet Oğuz Karahan – Boğaziçi University (Joint with Tolga Umut Kuzubaş)
Discussant: Okan Yılankaya – Koç University

15:45-16:00   **Coffee Break**

16:00-17:00   Aging and Monetary Policy
Zeynep Kantur – Bilkent University
Discussant: Gönül Şengül - CBRT

17:00-18:00   Analyzing Fiscal policy news from a cross-country perspective
Ceyhun Elgin – Boğaziçi University (Joint with Mario Solis-Garciay)
Discussant: Hande Küçük - CBRT

Abstracts

Geographical Reallocation and Unemployment during the Great Recession: The Role of the Housing Bust

Fatih Karahan − NY Federal Reserve Bank (joint with Serena Rhee)

Abstract: This paper quantitatively evaluates the hypothesis that the housing bust in 2007 decreased the geographical mobility of workers and exacerbated unemployment during the Great Recession. We document the following facts regarding this episode: i) ceteris paribus, unemployment increased more in metropolitan statistical areas (MSAs) with larger housing busts, and ii) controlling for local labor productivity, out-migration rates were lower in MSAs with larger housing busts. We construct and calibrate a directed search model of local housing and labor markets and migration. The model is quantitatively consistent with the volatilities of unemployment and vacancies, gross and net flows across MSAs, and the correlation between net flows and local unemployment prior to the Great Recession. A housing bust decreases the amount of home equity and makes it harder to afford a new house after moving due to a down payment requirement. Some households in low productivity regions that would have moved absent the housing bust decide to stay and look for jobs in their local labor market. The model accounts for 88% of the increase in the dispersion of unemployment across MSAs and the entire decline in net migration during the 2007-2009 recession. We find that this mechanism explains around 17% of the rise in unemployment after accounting for the fall in labor productivity.

Self-control Preferences and Taxation: A Quantitative Analysis in a Life-cycle Model

Athanasios C. Thanopoulos − University of Athens (joint with Çağrı S. Kumru)

Abstract: This paper examines the impact of various Öscal policies, namely, taxes on consumption, labor and capital when agents have self-control preferences. Agents trade in a stochastic overlapping generations economy while facing borrowing constraints. We quantitatively es- tablish that the existence of temptation in preferences may function as an opposing mechan- ism to modelling choices, such as, liquidity constraints, life-cycle structure and idiosyncratic earnings risks, that are critical in delivering a positive capital income tax rate. We argue and quantitatively show that for a su¢ ciently large measure of individuals having self-control preferences instead of CRRA preferences, or alternatively, for a su¢ ciently high cost of exercising self control when all individuals are self-control types, the optimal capital in- come tax rate is zero. Given there is strong empirical and experimental evidence regarding the existence of self-control problems, our model provides quite an interesting insight: as agentsíself-control costs rise, the optimal capital income tax rate will converge to Chamley and Judd value.

Trend Shocks, Risk Sharing and Cross-Country Portfolio Holdings

Mustafa Kılınç − CBRT (joint with Yavuz Arslan and Gürsu Keleş)

Abstract: This paper analyzes the dynamics of risk premia, real exchange rates and portfolio movements in a two-country, two-good, two-bond model. We use an asymmetric set-up in the model, where one of the countries is emerging and the other one is developed and both countries issue bonds in domestic currency. The emerging country di§ers from the developed country in that it is subject to trend shocks and it is more risk averse. We Önd that the trend shocks produce strong wealth e§ects for the emerging country, and as a result, the terms of trade and the real exchange rate appreciate. Appreciation of the terms of trade breaks the hedging opportunities coming from international trade in goods. In contrast, the appreciation of the real exchange rate generates new hedging opportunities in international Önancial markets for both countries. Therefore, our model can endogenously generate large portfolio holdings. And di§erences in the risk aversion across countries lead to net positive foreign asset positions and signiÖcant risk premia in the emerging country. Moreover, the relative volatilities and cyclicalities of risk premia and real exchange rates improve signiÖcantly and move closer to the observed values in the data and our model can account for the lack of international risk sharing.

When the Floodgates Open: "Northern" Firms' Response to Removal of Trade Quotas on Chinese Goods
Hale Utar

Abstract: Using the dismantling of the Multi-fibre Arrangement quotas on Chinese textile and clothing products in conjunction with China's accession to WTO, within firms adjustments to intensified low-wage competition is analyzed. Employing Danish employer-employee matched data supplemented with transaction-level data from between 1995 and 2007, the analysis shows a significant increase in skill and capital intensity associated with down- sizing in response to heightened competition. Competition is found to negatively affect employment, value-added and intangible assets of the Danish firms, and firms are found to refocus their innovative efforts away from goods where China's competitive advantage be- comes higher. The results show an important role of the distributional impact of low-wage competition within firms in restructuring the industry and support theories that indicate compositional changes in the scopes and operations of "Northern" firms in response to competition from "South".

Mehmet Oguz Karahan − Bogazici University
Auction Pricing under State Uncertainty (joint with Tolga Umut Kuzubaş)

Abstract: In this paper we study the equilibria of second price auctions with resale when the value of the object is subject to future state uncertainty and bidders have state-dependent values. In our model, bidders differ on their exposure towards state risk, such as high or low leverage in the acquisition of the object. Our model implies that bidders who have the highest and lowest exposures to the future state uncertainty have higher willingness to pay for a given object. When bids reveal prior to the resale stage, individuals with a higher exposure to state uncertainty, i.e. when their values are more biased towards one of the states, bid more aggressively compared to the type with a mild exposure. Bids are increasing when individual types move away from the median type. We no longer have the result that biding behaviour is monotonically increasing in types, which yields semi-pooling equilibria under incomplete information because information conveyed by the bids is insufficient to fully identify the type of the losing bidder in our environment.

Aging and Monetary Policy
Zeynep Kantur − Bilkent University

Abstract: As the baby-boom generation retires and fertility rate declines, the population in industrialized countries will age rapidly over the next several decades. This paper studies the monetary policy in the context of aging societies through its macroeconomic effects by adopting a New Keynesian model with heterogenous agents. The aim of this paper is to propose a model which examines the impact and the transmission mechanism of monetary policy in economies with different demographic profiles. On the theoretical side, this paper contributes to the literature by providing a model where supply side of the economy follows a New Keynesian setup and demand side is represented by a two period overlapping generations framework. Main results of the study can be described as follows: First, as the population ages, effectiveness of the monetary policy on output gap and inflation decreases due to decreasing interest rate sensitivity of the society. Second, monetary policy should be more aggressive to control the inflation and output gap in an aging society.

Analyzing Fiscal Policy News from a Cross-country Perspective
Ceyhun Elgin− Boğaziçi University (joint with Mario Solis-Garciay)

Abstract: Economic agents' expectations about future tax policy are not constant over time. News about changes in future fiscal plans ("news shocks," see ? or ?) can influence the behavior of economic agents even though these plans may never materialize. Understanding how news about future tax policy—and government policy in general—affect the business cycle is essential for policy- makers and government officials. This paper takes a novel approach to measure the extent to which news shocks to fiscal policy affect the business cycle. Using a DSGE model where agents receive news about changes in future policy every period and data from a cross-section of 45 countries we identify the effect of news shocks to capital and labor income taxes, as well as gov- ernment consumption. Using the cross-country data generated from the model we empirically analyze what factors play a role in determining the relative performance of the model with news shock compared to the one without. Empirical analysis highlights a couple of economic and political factors in this regard.