

Research Update

Federal Reserve Bank of New York

Research and Market Analysis Group

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EPR Volumes Focus on Corporate Governance, Affordable Housing

Two distinct but vital themes—corporate governance and affordable housing—are the subjects of two recent volumes of the Bank’s *Economic Policy Review*.

“Corporate Governance: What Do We Know, and What Is Different about Banks?” (April 2003) aims to broaden understanding of corporate governance issues while identifying areas of future research. The papers—by specialists in law, financial accounting, and financial economics—offer insight into corporate governance generally and as it applies to banking.

The first half of the volume reviews the literature on governance by considering the role of the board of directors, compensation, monitoring by holders of large blocks of stock, and corporate disclosure in miti-

gating conflicts of interest between managers and shareholders. The second half sheds light on why banks differ from unregulated firms with regard to governance issues and describes the challenges that the differences present for regulators, bank managers, investors, and depositors.

“Policies to Promote Affordable Housing” (June 2003) examines public and private sector strategies to ease the housing problems of low- and moderate-income families.

The contributors to the volume—academics, practitioners, and policy specialists—analyze affordable housing from a national perspective as well as focus on the unique conditions of the New York City area. Key themes include the cost burdens that housing places on low- and moderate-income families, the policies designed to

lower housing costs for these families, and the policies that may have exacerbated the shortage of affordable housing.

All papers are available at www.newyorkfed.org/rmaghome/econ_pol/2003/.

New Research: April-June 2003

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Basing Social Security Benefits on a CPI for Seniors Suggests an Important Policy Trade-Off

Each year, social security benefits are automatically adjusted for inflation to prevent a decline in the purchasing power of benefits. The adjustments are based on the CPI-W, a Bureau of Labor Statistics (BLS) measure of price changes in the average set of goods purchased by workers. Yet the spending habits of the typical worker differ from those of the typical retiree. For example, medical care represents a much larger share of seniors' income.

In "Social Security and the Consumer Price Index for the Elderly" (*Current Issues in Economics and Finance*, vol. 9, no. 5), Bart Hobijn and David Lagakos consider how the use of a different price index to adjust social security benefits—one reflecting the spending patterns of seniors—could affect the level of benefits paid and the future resources of the social security trust fund.

The authors note that since the early 1980s, the BLS has calculated an experimental price index for elderly consumers: the CPI-E. Significantly, between 1984 and 2001, inflation as measured by the CPI-E has been consistently higher than CPI-W inflation, with a 0.38 percent average annual difference. Accordingly, they estimate that if the CPI-E had been adopted in 1984, the average social security benefit in 2001 would be 3.84 percent higher, or roughly \$408 more per year per recipient.

However, the authors also estimate that introduction of the CPI-E now could accelerate the trust fund's insolvency by as many as five years relative to the currently projected 2043. "The trade-off facing policymakers, therefore, is between prolonging the solvency of the social security trust fund and maintaining the purchasing power of seniors over time," conclude Hobijn and Lagakos.

Publications and Papers

The Research and Market Analysis 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*—a newsletter-style publication offering concise and timely analyses of economic and financial topics.
- *Second District Highlights*—a regional supplement to *Current Issues* covering financial and economic developments in the Federal Reserve's Second District.
- *Staff Reports*—technical papers intended for publication in leading economic and finance journals, available only online.
- *Publications and Other Research*—an annual catalogue of the Group's research output.

New Titles in the Staff Reports Series

The following new *Staff Reports* are available at www.newyorkfed.org/rmaghome/staff_rp/2003/2003.html.

Macroeconomics and Growth

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.

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 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.

Banking and Finance

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.

João Santos. 2003. "The Paradox of Priority," with Stanley Longhofer. *Financial Management* 32, no. 1 (spring): 69-81.

Asani Sarkar. 2003. "Assessing the Impact of Short-Sale Constraints on the Gains from International Diversification," with Zhenyu Wang and Kai Li. *Journal of Empirical Finance* 10, no. 1-2 (February): 57-80.

Kevin Stiroh. 2003. "Lessons for Canada from the U.S. Growth Resurgence," with Dale Jorgenson and Mun Ho. *International Productivity Monitor* 6 (spring): 3-18.

George Zanjani. 2003. "The Production and Regulation of Insurance: Limiting Opportunism in Proprietary and Nonproprietary Organizations," with Tomas Philipson. In Bjorn Lindgren, ed., *Individual Decisions for Health*. London: Routledge.

Recently Published

Morten Bech. 2003. "The Intraday Liquidity Management Game," with Rod Garratt. *Journal of Economic Theory* 109, no. 2 (April): 198-219.

Arturo Estrella. 2003. "Monetary Policy Shifts and the Stability of Monetary Policy Models," with Jeffrey Fuhrer. *Review of Economics and Statistics* 85, no. 1 (February): 94-104.

Paolo Pesenti. 2003. "The Global Economy Model," with Tamim Bayoumi. In *World Economic Outlook: Growth and Institutions*. Washington, D.C.: International Monetary Fund.

João Santos. 2003. "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.

Papers Presented by Economists in the Research and Market Analysis Group

“Board Structure and Banking Firm Performance,” *Renée Adams and Hamid Mehran*. Princeton University Economics Department seminar, Princeton, New Jersey, April 16.

“The Volatility of Short-Term Interest Rates,” *Leonardo Bartolini*. University of Piraeus Banking and Finance Department seminar, Athens, Greece, April 9. Also presented at the Helsinki School of Economics, Helsinki, Finland, June 12.

“The Execution of Monetary Policy: A Tale of Two Central Banks,” *Leonardo Bartolini*. Centre for Economic Policy Research, Athens, Greece, April 10.

“Diffusion of Technology within Central Banking: The Case of Real Time Gross Settlement,” *Morten Bech*. Danmarks Nationalbank seminar, Copenhagen, Denmark, May 21.

“Liquidity, Gridlock, and Bank Failures in Large Value Payment Systems,” *Morten Bech*. Bank of Finland seminar, Helsinki, Finland, May 28. With Kimmo Soramaki.

“The Intraday Liquidity Management Game,” *Morten Bech*. European Central Bank conference, Frankfurt, Germany, June 10. With Rod Garratt.

“Decomposing the Exchange Rate Disconnect Puzzle,” *Linda Goldberg*. American Economic Association 2003 Annual Meeting, Washington, D.C., January 5. With José Campa.

“Lending Cycles of Banks in Emerging Markets,” *Linda Goldberg*. North American Economics and Finance Association 2003 Annual Meeting, Washington, D.C., May 16.

“Exchange Rates and Prices,” *Linda Goldberg*. Syracuse University Graduate School of Business seminar, Syracuse, New York, May 28.

“Has September 11 Affected New York City’s Growth Potential?” *Andrew Haughwout*. Russell Sage Foundation, New York City, May 9.

“The Difficulty of Discerning What’s Too Tight: Taylor Rules and Japanese Monetary Policy,” *Kenneth Kuttner*. Claremont McKenna College, Lowe Institute of Political Economy Workshop on the Macroeconomics of Low Inflation and the Prospects for Global Deflation, Claremont, California, April 25. With Adam Posen.

“Measuring Housing Costs in the CPI,” *Jonathan McCarthy and Richard Peach*. Brookings Institution Workshop on Economic Measurement, Washington, D.C., May 23.

“Monetary Rules for Small, Open, Emerging Economies,” *Paolo Pesenti*. Princeton University International Economics Department seminar, Princeton, New Jersey, April 16.

“Three Lectures on Monetary Models in an Open Economy,” *Paolo Pesenti*. Bank of Finland Macro Models Workshop, Helsinki, Finland, June 9-11.

“The Cost of Large Equity Trades,” *Asani Sarkar*. Baruch College conference, New York City, April 29. With Robert Schwartz and Avner Wolf.

“Capital Regulation for Position Risk in Banks, Securities Firms, and Insurance Companies,” *Til Schuermann*. Harvard Law School, Program on International Financial Systems Conference, Cambridge, Massachusetts, June 10. With Richard Herring.

“A Simple Explanation of the Border Effect,” *Kei-Mu Yi*. University of Pittsburgh Department of Economics seminar, Pittsburgh, Pennsylvania, April 14.

“The Chinese Juggernaut: How Has It Affected the World Economy?” *Kei-Mu Yi*. World Trade Center Buffalo Niagara conference, Buffalo, New York, May 21. With Hunter Clark and Matthew Higgins.

Publications and Papers: April-June 2003

Publications are available at
www.newyorkfed.org/rmaghome.

Economic Policy Review, Vol. 9

No. 1, April 2003

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

Boards of Directors as an Endogenously
Determined Institution: A Survey of the
Economic Literature

*Benjamin E. Hermalin
and Michael S. Weisbach*

Executive Equity Compensation and
Incentives: A Survey

*John E. Core, Wayne R. Guay,
and David F. Larcker*

A Survey of Blockholders and
Corporate Control

Clifford G. Holderness

Transparency, Financial Accounting
Information, and Corporate
Governance

Robert M. Bushman and Abbie J. Smith

The Corporate Governance of Banks

Jonathan R. Macey and Maureen O’Hara

Incentive Features in CEO Compensation
in the Banking Industry

Kose John and Yiming Qian

Is Corporate Governance Different for Bank
Holding Companies?

Renée Adams and Hamid Mehran

No. 2, June 2003

Special issue, “Policies to Promote
Affordable Housing”

Contents include:

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

Current Issues in Economics and Finance, Vol. 9

No. 4, April 2003

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

Kevin J. Stiroh and Christopher Metli

No. 5, May 2003

Social Security and the Consumer Price Index for the Elderly

Bart Hobijn and David Lagakos

No. 6, June 2003

The Repurchase Agreement Refined: GCF Repo

Michael J. Fleming and Kenneth D. Garbade

Staff Reports

Available only online.

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