Interest Bearing Notes **Vol. 21 No. 6**

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The next issue of Interest Bearing Notes will appear in January 2019 so please send comments, suggestions (such as your own or others' interesting research), and requests to be added to our distribution list, to Bob Cull (mailto: rcull@worldbank.org) by January 7th.

IBN is a product of the Finance and Private Sector Development Team in the World Bank's Development Research Group. Our working papers and descriptions of research projects in progress can be found, along with a list of forthcoming seminars and conferences, on our web page (http://www.worldbank.org/en/research/brief/finance-private-sector)

I What's new on our website

Ten years after Lehman: Where are we now?
In a recent blog post, **Asli Demirgüç-Kunt** reflects on regulation after the global financial crisis. Her post highlights areas where progress has been made, such as banks having stronger capital positions, but it also cautions that much has remained unchanged in terms of providing banks with the right incentives for less risk-taking.
http://blogs.worldbank.org/allaboutfinance/ten-years-after-lehman-where-are-we-now

II World Bank research

Courts and business registration: Evidence from Serbia

IBN co-editor **Miriam Bruhn**, together with **Caleb Cho**, **Andreja Marusic**, **Ha Nguyen**, **José-Daniel Reyes** and **Trang Tran**, study the effects of a reform in Serbia that transferred business registration from regional courts to a centralized agency in 2005. The authors obtained administrative data on the number of new firms for all years from 2003 to 2011. With these data, they employ a difference-in-difference strategy that compares the number of new firms before and after the reform across regions based on the level of distrust in regional courts (as measured in the 2006 Life in Transition Survey). The results suggest that the reform increased the number of new firms more in regions with higher initial levels of distrust, by up to 34 percent. This effect is large compared to the previous literature that has typically studied the introduction of one-stop shops. Studies of one-stop shops also tend to find that these lead to registration of lower-quality firms, for example firms with lower survival rates, in line with the argument that less productive firms are deterred by high registration costs. The Serbia paper instead finds that the reform increased the survival rates of new firms. The reason could be that registration at courts represented not only an administrative burden and fixed costs but was also often discretionary and may have prevented some high-quality firms from registering at all.
http://documents.worldbank.org/curated/en/834991539264667624/Courts-and-Business-Registration-Evidence-from-Serbia

The causal mechanism of financial education: Evidence from mediation analysis

IBN co-editor **Bilal Zia**, together with **Fenella Carpena** apply formal causal mediation analysis to unpack the causal mechanism of financial education in India. The authors use a field experiment with multiple financial education treatments to investigate the mechanisms between financial education and financial behavior. Focusing on the mediating role of financial literacy, the authors start with a broader definition of financial knowledge that includes three dimensions: numeracy skills, financial awareness, and attitudes towards personal finance. Each of these dimensions are then tested for their contribution to changing financial behavior. The results are quite striking. Numeracy does not mediate any effects of financial education on household outcomes. However, for simple financial actions such as budgeting, both awareness and attitudes serve as critical pathways, while for more complex financial activities such as opening a savings account, attitudes play a more prominent role. Hence, financial attitudes appear to be the most robust channel for affecting financial behaviors through financial education. These findings underscore the importance of changing perceptions about financial products and services as a vital mechanism for the success of financial education.
http://documents.worldbank.org/curated/en/472901540223638588/The-Causal-Mechanism-of-Financial-Education-Evidence-from-Mediation-Analysis?

Endowment effects and usage of financial products: Field evidence from Malawi

Our very own **Xavier Gine** along with **Jessica Goldberg** conduct a field experiment with savings accounts in Malawi to identify the endowment effect – the gap between consumers' willingness-to-accept and their willingness-to-pay. Moreover, the effect embodies the psychological cost of switching between savings products and can be explained by loss aversion. In their field experiment, the authors study the propensity of account holders to switch to a different, cheaper savings account once fees are introduced in their previously free account, compared to a sample of new subjects without a prior account who are presented with the same choice between the two accounts. They find that prior account holders are significantly less

likely to switch to the cheaper account, compared with new subjects without a prior account. While 49 percent of account holders retained their original, expensive accounts, none of the new subjects who opened an account chose the expensive one. This finding is consistent with the endowment effect. Exploiting previous experimental variation in account usage among prior account holders, the paper finds that the endowment effect disappears among those with higher induced usage. This finding suggests that familiarity with the account can mitigate behavioral anomalies and improve financial decision-making.
http://documents.worldbank.org/curated/en/815821536173881140/Endowment-Effects-and-Usage-of-Financial-Products-Field-Evidence-from-Malawi

Bank runs and moral hazard: A review of deposit insurance
Our own **Deniz Anginer** and **Asli Demirguc-Kunt** offer a clear, easy-to-read summary of research findings on the relationship between deposit insurance and moral hazard. Regular IBN readers will not be surprised to learn that the empirical literature continues to show that deposit insurance can ensure depositor confidence and prevent bank runs, but that it often comes with the unintended consequence of incentivizing banks to take on excessive risk. Thus, the design features of deposit insurance schemes are critical for understanding when they lead to excessive risk taking, instability, and ultimately, banking crises. For example, assessing premia for deposit insurance that reflects the riskiness of a bank's assets can be helpful, though the literature also indicates that this can be tricky to implement. Deniz and Asli also emphasize the interplay between deposit insurance and capital regulation, noting that more stringent capital regulation can help offset risk-taking incentives stemming from deposit insurance. Supervisors must act when capital standards aren't met, and thus the downsides of deposit insurance are less likely to rear their heads when supervisors are empowered to take prompt corrective action. Private monitoring also plays an important role in disciplining banks, so having large, sophisticated uninsured depositors, as well as shareholders and other unsecured creditors that have an incentive to monitor a bank is also important. Finally, and more generally, both private and public monitoring can only be effective in countries with strong institutions and well-established rule of law, and thus long-term institutional development remains an important priority, especially for developing countries.
http://documents.worldbank.org/curated/en/548031537377082747/Bank-Runs-and-Moral-Hazard-A-Review-of-Deposit-Insurance

III "FYI": Our eclectic guide to recent research of interest

The employment effects of faster payment: Evidence from the federal Quickpay reform
Jean-Noel Barrot and **Ramana Nanda** study the employment effects of Quickpay, a 2011 federal reform that accelerated payments to small business contractors of the U.S. government. For eligible small businesses, Quickpay cut the time of payment in half, from 30 to 15 days. Some small businesses were not eligible for Quickpay since they were selling to government departments that were already paying within 15 days. Using an identification strategy that compares employment growth in eligible firms, before and after Quickpay, the authors find that the reform significantly increased employment growth at the firm level. A falsification test shows no such effect in non-eligible firms. To examine the general equilibrium effects of Quickpay, the authors then aggregate the results up to the level of local labor markets, using as a treatment variable the average amount of eligible government contracts to be performed in a

given county and sector between 2009 and 2011, normalized by 2011 payroll. The results show that aggregate employment growth increased, but only in areas where unemployment was high relative to the number of vacancies in 2010. In tight labor markets, Quickpay had no effect on aggregate employment growth.
https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2808666

Roots and consequences of masculinity norms
Victoria Baranov, **Ralph De Haas**, and **Pauline Grosjean** use a natural historical experiment based on transporting convicts to Australia in the 18th and 19th centuries to study the effects traditional masculinity norms on modern-day outcomes. Between 1787 and 1868, Great Britain transported 132,308 male convicts to Australia compared with 29,640 female convicts. Voluntary migration was quite limited until the discovery of gold in the 1850s, though that too was heavily biased toward males. Because convicts were allocated across geographic areas (rather than put in prisons), the authors argue that a quasi-exogenous pattern of historical sex ratios emerged. They conjecture that the pattern of local male-to-male competition shaped masculinity norms, and they then show that in areas with high historical (though not necessarily present-day) male sex ratios, Australians were more likely to vote against same-sex marriage, an institution perceived to be at odds with traditional masculinity norms. They also use survey data to confirm that this pattern was driven primarily by male voting. They go on to show that historically male-biased areas remain characterized by more violence, excessive alcohol consumption, and greater occupational gender segregation, behaviors which they argue stem from masculinity norms that were driven by intense local competition between males.
https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3185694

The medieval roots of inclusive institutions
Inclusive institutions, those where the people are broadly represented, are increasingly viewed as a key to long-term development. But what are their roots and how are they nurtured? **Charles Angelucci**, **Simone Meraglia**, and **Nico Voigtlander** have collected a novel dataset from 549 medieval English towns (boroughs) to help answer this question. They start with the Norman Conquest in 1066, which resulted in largely homogeneous institutions across England. In the early sample years, due to monitoring difficulties and information asymmetries, Kings faced inefficiencies in tax collection. This inefficiency became more severe with the onset of the Commercial Revolution in the 12th century because the tax base tilted increasingly toward movable goods on which it was harder to ascertain taxes. This then led to mutually beneficial agreements called Farm Grants, whereby medieval merchant towns obtained the right of self-administered tax collection and law enforcement with little intervention from the King or his officials. In return, the self-administered towns voluntarily agreed to pay higher taxes to the benefit of the King. The authors then offer evidence that Farm Grants had long-term implications for the inclusiveness of institutions. Kings began using the parliament in 1295 to raise extra-ordinary taxes (to fight wars) to reduce negotiation costs with the self-governed towns and to improve efficiency of tax collection. Royal boroughs (those directly under the King's oversight instead of local lords) with trade-favoring geography were much more likely to be represented in the parliament, and this relationship worked mainly through Farm Grants. The authors show that this local empowerment had long-term consequences for national institutions. Boroughs with medieval Farm Grants had persistently more inclusive local elections of public officials and MPs, they raised troops to back the parliamentarians during the Civil War in 1642, and they

supported the Great Reform Act of 1832, which resulted in the extension of the franchise.
http://www.nber.org/papers/w23606

Government R&D subsidies and innovation: Evidence from China
How are government subsidies for R&D activities affected by corruption? And how do government R&D subsidies affect innovation efficiency? To address these questions, **Lily Fang**, **Josh Lerner**, **Chaopeng Wu**, and **Qi Zhang** take advantage of a natural experiment, the 2012 anti-corruption campaign in China, and the fact that Chinese firms must report their entertainment and traveling costs to the government. IBN co-editor Colin Xu and coauthors have shown that this category of expenses has been linked to higher levels of corruption (Cai, Fang and Xu 2011). After the 2012 anti-corruption campaign, government R&D subsidies became more closely related to a firm's historical innovation efficiency, the relationship between entertainment and traveling costs and R&D subsidies became weaker, and R&D subsidies became more positively related to future innovation outputs. The authors also make use of a second natural experiment: the departure of local officials in charge of R&D subsidies after the anti-corruption campaign, which reduced the value of political connections. This event, too, produced effects like those associated with the 2012 anti-corruption campaign. The results imply that China's R&D subsidies were/are driven by both efficiency concerns and corruption, and that the anti-corruption campaign did reduce the negative impact of corruption on R&D allocation efficiency.
http://www.nber.org/papers/w25098

IV Upcoming events and miscellanea

Calls for papers

The eighth edition of the **MoFiR Workshop on Banking** will be held in Chicago on June 10-11, 2019. It is organized by the Money and Finance Research group (MoFiR) together with the Center for Financial Services (DePaul University) and the Department of Finance at the Driehaus College of Business, DePaul University. The keynote speaker will be Luigi Zingales. The deadline for submitting a paper is January 11, 2019. More information is posted here.

The **European Financial Management Association** will hold its 28th Annual Meeting at the University of Azores, Portugal, June 26-29, 2019. Submissions are encouraged in all areas of finance, though the deadline is January 15, 2019. A set of papers presented at the meeting will be invited to be considered for publication in the *European Financial Management* journal. For more information, visit the conference website:
http://www.efmaefm.org/0EFMAMEETINGS/EFMA%20ANNUAL%20MEETINGS/2019-Azores/ecases2019.php

Happy reading!

Your editors Miriam Bruhn (mbruhn@worldbank.org), Bob Cull (rcull@worldbank.org), Colin Xu (lxu1@worldbank.org), and Bilal Zia (bzia@worldbank.org)