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The next issue of Interest Bearing Notes will appear in July 2018 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 July 9th.

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

Banking with agents: Experimental evidence from Senegal
Agents are local retailers that double as lower-cost alternatives to bank branches and enable customers to more conveniently make deposits, withdrawals, money transfers, and payments of loans. In a recent impact evaluation note, our own **Xavier Gine** and **Bob Cull**, together with **Sinja Buri**, **Sven Harten**, and **Soren Heitmann** report on a field experiment in Senegal in which subjects who were encouraged to open a no-frills savings account with an agent became significantly more financially active than those who were

encouraged to open the same account at a branch.
http://documents.worldbank.org/curated/en/358311525841762069/The-pros-and-cons-of-agent-banking-evidence-from-Senegal
For more details on the experiment itself and impacts on savings behavior, see the associated working paper.
http://documents.worldbank.org/curated/en/470981524164012687/Banking-with-agents-experimental-evidence-from-Senegal

II World Bank research

The effects of cash transfers on adult labor market outcomes
Our own **David McKenzie**, together with **Sarah Baird** and **Berk Özler** review the existing
evidence on the effects of cash transfers on adult labor market outcomes, covering a wide range of programs: government transfers, charitable giving and humanitarian transfers, remittances, cash assistance for job search, cash transfers for business start-up, and bundled interventions. The authors argue that the standard economic model of labor supply that predicts that individuals should work less and earn less if they receive an unexpected cash windfall may not apply to cash transfers in low- and middle-income countries, for reasons related to missing markets, price effects from behavioral conditions attached to transfers, and dynamic and general equilibrium effects. This argument is confirmed in the literature. A review of the evidence shows that cash transfers that are made without an explicit employment focus (such as conditional and unconditional cash transfers and remittances) tend to result in little to no change in adult labor. Two exceptions are the elderly who work less when they receive a government pension and Syrian refugees in Lebanon who reduce work when given winter cash assistance. In contrast, transfers made for job search assistance or business start-up tend to increase adult labor supply and earnings, with the likely main channels being the alleviation of liquidity and risk constraints.
http://documents.worldbank.org/curated/en/334251523556191237/The-effects-of-cash-transfers-on-adult-labor-market-outcomes

Unemployment and violent extremism: Evidence from Daesh foreign recruits
Transnational terrorist organizations such as the Islamic State group (also known as ISIS/ISIL or Daesh) have shown an ability to attract radicalized individuals from many countries to join their ranks. **Mohamed Abdel Jelil**, **Kartika Bhatia**, **Anne Brockmeyer**, **Quy-Toan Do**, and **Clément Joubert** study the extent to which this radicalization is driven by lack of economic opportunities. The authors leverage a unique dataset on Daesh’s foreign recruits that is believed to have been leaked by a defector and made available to many institutions including a news organization that shared the data with the authors. The data covers 3,965 foreign recruits who joined the terrorist group in Syria and Iraq in 2013 and 2014 and includes their education and countries of residence. The authors combine this data with information on unemployment rates and wages in the

recruits' countries of residence before they joined the terrorist group, broken down by three levels of education (primary, secondary and tertiary). Regressions at the country-education level that control for country and education fixed effects show that higher unemployment rates are associated with a greater number of Daesh recruits, especially for countries close to Syria. A one percentage point increase in the unemployment rate is associated with 42 additional Daesh recruits. This relationship weakens farther away from Syria and becomes economically and statistically insignificant past 2,500 km. The results are robust to the inclusion of education-specific wage rates.
http://documents.worldbank.org/curated/en/967561522155860057/Unemployment-and-violent-extremism-evidence-from-Daesh-foreign-recruits

The impact of interest rate caps on the financial sector: Evidence from Kenya
IBN co-editor **Bilal Zia** along with **Mehnaz Safavian** carefully document the impact of interest rate caps on commercial bank loans and deposits in Kenya. Using a wide panel dataset on commercial bank balance sheets, the authors find that following the caps, there was a significant shift in lending towards corporate clients at the expense of lending in other sectors such as SMEs, consumer loans, and new borrowers across all types of banks. This is particularly notable since corporate clients already dominated the loan books of the banking sector, and the caps seem to have worsened that imbalance. In the case of SMEs, which make up over 98% of all businesses and provide 30% of all new jobs in the country, the economic effects of a credit crunch are dangerous. Equally troublesome, the proportion of new borrowers receiving credit from banks significantly reduced by over 50% following the caps. These findings are consistent with a September 2017 credit survey conducted by the Central Bank of Kenya, where 54% of respondents confirmed that the interest rate caps had negatively affected lending to SMEs. The authors conclude that while interest rate caps are often introduced to alleviate the repayment burden on borrowers and improve financial access as more individuals and firms would be able to borrow at the lower interest rates, in the case of Kenya the policy has led to reduced access to credit. There are several policy alternatives that can both protect borrowers from excessive interest rates and limit the negative consequences of interest rate caps. These include wider adoption of credit scoring through credit bureaus so banks can differentiate borrowers based on risk; more efficient loan foreclosure procedures and movable collateral registries; and greater emphasis on strengthening consumer protection measures through debt counseling and streamlined redressal mechanisms.
http://documents.worldbank.org/curated/en/681501522684167817/The-impact-of-interest-rate-caps-on-the-financial-sector-evidence-from-commercial-banks-in-Kenya

The importance of business aspirations among small-scale entrepreneurs in Indonesia
In another new working paper, our co-editor **Bilal Zia** and his co-authors **Patricio Dalton** and **Julius Ruschenpohler** explore whether variation in business aspirations across small-scale entrepreneurs can help explain differences in performance outcomes, and differences in the adoption and success rates of business development programs.

Small-scale entrepreneurship is widespread in developing countries, yet very few of these entrepreneurs are successful in growing their businesses beyond initial levels. Many constraints play a role, including financial, technical, and informational barriers, all of which have been identified in the previous literature. Yet, even when these barriers are lifted in experimental studies, we do not see the type of growth one would expect if these constraints were truly binding. In addition, many of the interventions studied, especially those targeting managerial and informational barriers, often suffer from low program take-up. This is a bit of a puzzle. But, what if there are inherent differences in aspirations for business growth, where some entrepreneurs want to grow their businesses while others do not? The fact that much of entrepreneurship in developing countries is involuntary would also square with this type of variation. More importantly, variation in aspirations would help explain why some of the reform ideas tried in the literature have not resulted in substantial business growth and why take-up of business assistance programs tends to be low. In this study, the authors carefully unpack the concept and measurement of business aspirations in a panel field study among urban retail shops in Jakarta, Indonesia. Measuring business aspirations on four distinct dimensions of shop size, number of employees, number of customers, and sales, the authors find large variation in aspirations in the cross-section. Importantly they find that this variation is meaningful and can explain differences in profitability and other performance outcomes. These results hold even after controlling for the usual explanatory suspects, such as entrepreneurs' education levels and business practices, as well as a host of individual and firm level controls. These are quite striking findings and provide new insight into the black box of the determinants of business performance among small-scale entrepreneurs. In terms of policy, the heterogeneity in the findings makes a strong case for better targeting of business aid programs based on aspirations for growth. Given that aspirations are a strong predictor of future behavior, they are likely to complement policies targeting business investment, savings, credit use, and business innovation. Likewise, policymakers can expect these programs to be more effective for entrepreneurs with higher aspirations for growing their businesses.
http://documents.worldbank.org/curated/en/641061523463737564/Determinants-and-dynamics-of-business-aspirations-evidence-from-small-scale-entrepreneurs-in-an-emerging-market

Capital inflows, equity issuance activity, and corporate investment
Charles Calomiris, **Mauricio Larrain**, and **Sergio Schmukler** use data on portfolio equity inflows (defined as the difference between foreign purchases of domestic shares and foreign sales of domestic shares) from 1990 to 2014 to 25 emerging markets to analyze whether firms issue more equity after foreign capital arrives, and how those equity proceeds are used. Using transaction-level information on new issuances of common equity by 17,682 publicly traded firms, they find that foreign equity inflows are strongly correlated with country-level issuance activity. However, firm-level regressions reveal that it is large, liquid, highly valued firms that are much more likely to raise equity when their country receives such capital inflows. These patterns also hold when equity

inflows are instrumented for using country weights from the MSCI Emerging Markets index (both a country's own weight, and those of others) to identify shocks to the supply of foreign equity funding. Their data also indicate that the largest share of the funds raised in their equity offerings is for corporate investment (capital expenditures, acquisitions, and R&D expenditures). The patterns suggest that a select set of large firms are the target of global investors' shares purchases, and that large flows of funds connecting their countries to global capital markets have little effect on the ability of smaller firms to issue equity. Whether this promotes efficiency (by reducing financing constraints for relatively productive firms), or merely increases the market power of a small number of large firms remains an open question for future research.
http://documents.worldbank.org/curated/en/470511523557571868/Capital-inflows-equity-issuance-activity-and-corporate-investment

Spillover effects of the G20 financial reforms
In the wake of the global financial crisis G20 countries undertook an ambitious program of financial regulatory reform aimed at making financial institutions more resilient, dealing with institutions that were too-big-to-fail, addressing risks stemming from shadow banking, and making derivatives markets safer. While no doubt necessary, some cautioned that the program could have unintended spillover effects on emerging markets and developing economies (EMDEs). To assess that conjecture, **Clive Briault**, **Erik Feyen**, **Ines Gonzalez Del Mazo**, **Brian Kwok Chung Yee**, **Jan Rademacher**, and **Ilias Skamnelos** use a detailed qualitative survey of senior officials at regulatory agencies, local banks, and multinational banks in seven countries (Bangladesh, Colombia, Kenya, Morocco, Peru, Romania, and Tanzania). Some of their findings are not surprising – regulators generally expect the reforms to have a positive effect on their banking sectors, especially over the long term, while bankers have concerns that they will negatively impact products, services, and market development. Both bankers and regulators call for greater coordination, though bankers emphasize greater regulatory consistency within and across jurisdictions to create a level competitive playing field, while regulators emphasize the need for greater home-host country coordination to help shoulder heavier supervisory burdens for multinational banks. Though the authors recognize that these qualitative assessments are less rigorous than other forms of analysis, they do provide some important initial impressions of the impact of the reform agenda on EMDEs and point out potentially testable implications of that agenda.
http://documents.worldbank.org/curated/en/146421515705815737/Cross-border-spillover-effects-of-the-g20-financial-regulatory-reforms-results-from-a-pilot-survey

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

The full implications of political connections
Economists have increasingly recognized that firms with and without political connections behave quite differently. **Ufuk Akcigit**, **Salome Baslandze**, and **Francesca Lotti** investigate how firms' political connections in Italy affect innovation and firm

dynamics, and their work represents one of the most ambitious attempts to understand the full implications of political connections on firms. They cover roughly the past two decades, and rely on multiple sources of information such as firm data, the registry of local politicians, elections data, and patent data. Overall, they find evidence that politically-connected firms, which are prevalent among large Italian firms, have higher sales growth and survival rates, but lower productivity growth and are less innovative. To deal with the potential endogeneity of political connections, they rely on a regression discontinuity design defined using narrow electoral margins (i.e., regions where the affiliated politician barely won or lost). Thus, their findings indicate that political connections may reduce static market frictions, but they come at a dynamic cost of distorting competition and retarding innovation.
https://static1.squarespace.com/static/57fa873e8419c230ca01eb5f/t/5a01c1d29140b76733a3c40a/1510064599483/ABL_upload.pdf

Distrust, economic downturns, and political turnover
Using new panel data over six decades, **Nathan Nunn**, **Nancy Qian**, and **Jaya Wen** examine the interplay between a society's culture and its politics. Specifically, they investigate how generalized trust (as reflected in the answer to the question "to what extent can you trust a random person you encounter in your country?") affects political turnover during economic downturns. They find that at low levels of trust, the link between economic downturns and political turnover is stronger. That is, voters are more likely to attribute adverse economic outcomes to their leaders. This is consistent, for example, with recent experience in Europe. In Europe the three least trusting countries are France, Italy, and the United Kingdom; the three most trusting are the Netherlands, Sweden, and Norway. Consistent with their empirical finding, the three least trusting countries have an average political turnover rate that is about 12 percent points higher than the more trusting group. The authors recognize the identification challenge here, and do their best by controlling for country fixed effects, year fixed effects, and other potential confounders such as the characteristics of the leader, the level of democracy, the income level in the country, and the presence of armed conflicts. As a sort of falsification exercise, they also find that this heightened link between economic downturns and political turnover in less trusting societies is not observed in non-democratic countries.
http://www.nber.org/papers/w24187

IV Upcoming events and miscellanea

Call for papers: 9th Univ. Miami Behavioral Finance Conference
The ninth Miami Behavioral Finance Conference will take place December 14-15, 2018 in Coral Gables, Florida. Papers from all areas of behavioral finance and economics will be considered. Researchers from other related disciplines such as experimental finance and neuro-finance are also encouraged to submit papers. The conference is sponsored by the University of Miami Business School and the Review of Financial Studies (RFS) and authors have the option to submit their papers to the conference and the RFS at the same

time. The link for paper submissions will open in June and the deadline for submission is August 1st. Authors of selected papers will be notified by mid-September. Additional information about the conference can be found at https://bus.miami.edu/umbfc.

Call for papers: 7th Conference on Liquidity and Financial Fragility
The seventh annual Conference on Liquidity and Financial Fragility will take place at the Wharton School of the University of Pennsylvania October 12-13, 2018. Empirical and theoretical submissions are invited from various fields of economics and finance that touch upon the broad theme of the conference. Details of last years' program are available at the conference website: http://www.whartonliquidity.org/. Papers can be submitted at: https://whartonfic.wufoo.com/forms/2018-liquidity-financial-fragility-submission/. The submission deadline is July 1, 2018. Authors will be notified by August 15, 2018 about the selection of papers.

Call for papers: 15th Annual Conference on Corporate Finance and Financial Intermediation
Olin Business School at Washington University and its Wells Fargo Advisors Center for Finance and Accounting Research (WFA-CFAR) will be co-hosting the 15th annual Conference on Corporate Finance and Financial Intermediation, November 16-17, 2018 at Washington University in St. Louis. Topics of interest for the conference are broad, including mergers and acquisitions, private equity, corporate control and organization, international issues in corporate finance, capital structure, payout decisions, corporate investment decisions, corporate governance, financial intermediation, and banking. One hitch is that papers need to be submitted almost immediately (by June 1, 2018) via the conference website: https://apps.olin.wustl.edu/conf/cfar/Home/
Those submitting papers will be informed of the organizing committee's decision in August.

Happy reading!

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