Interest Bearing Notes **Vol. 20 No. 4**

July 2017

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The next issue of Interest Bearing Notes will appear in September 2017 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 September 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

Expectations and reality collide in active labor market policies
In a recent policy research talk, our own **David McKenzie** laid out evidence from a slew of studies on the effectiveness of governments' policies to promote jobs. The results are sobering. Most active labor market policies, such as wage subsidies, matching workers to jobs, and vocational training for youth and the unemployed have had little or no effect on job growth. This suggests that it would be good to try less

traditional policies such as efforts to aid firms in navigating labor laws, targeted assistance to help workers transition to growing sectors, and efforts to facilitate workers moving to where the jobs are, all of which have shown some promise. http://www.worldbank.org/en/news/feature/2017/03/16/expectations-and-reality-collide-in-active-labor-market-policies

David has also expanded upon his discussion of the (in)efficacy of active labor market polices in this handy working paper: http://documents.worldbank.org/curated/en/256001490191438119/How-effective-are-active-labor-market-policies-in-developing-countries-a-critical-review-of-recent-evidence

II World Bank research

Financial inclusion and inclusive growth: A review of the evidence
Our own **Asli Demirguc-Kunt**, **Leora Klapper**, and **Dorothe Singer** provide an up-to-date summary of the empirical evidence on the benefits of financial inclusion and how it contributes to inclusive growth and economic development. On the micro-impact of financial inclusion, they discuss four different types of financial services-savings, payments, credit, and insurance. They conclude that the current evidence suggests that inexpensive savings accounts (that serve a specific purpose) and digital payments have shown the most promise in improving the financial lives of the poor. Microcredit has a more checkered track record, and the evidence on insurance is sparse relative to the other types of products, though there is some evidence that insurance enables farmers to grow higher-yielding, but riskier crops. While micro-level evidence from field experiments is growing, the authors caution that research on the impact of financial inclusion on broader economic development is still in its inception, in large part due to data constraints that are gradually being relaxed. Finally, Asli et al. emphasize that realizing the full benefits of financial inclusion will require an effective enabling environment in terms of regulation and financial infrastructure, including national ID systems and reliable ICT connectivity for all.
http://documents.worldbank.org/curated/en/403611493134249446/Financial-inclusion-and-inclusive-growth-a-review-of-recent-empirical-evidence

Status goods: Experimental evidence from platinum credit cards
Our own **Martin Kanz**, together with **Leonardo Bursztyn**, **Bruno Ferman**, **Stefano Fiorin**, and **Gautam Rao** conduct a series of field experiments among credit card holders in Indonesia to causally identify the demand and magnitude of status. In the first experiment, one group of credit card holders are offered a new platinum status credit card while another group is offered a card with the same benefits but without the platinum logo. The research finds significantly higher demand for the new card

among the former group, which highlights the importance of pure status. The authors also study transactional data and find that the platinum card is more likely to be used in social settings where it is observable to others. In a follow-up experiment, the authors show that consumers are more willing to upgrade to a more expensive but functionally identical higher status diamond card when the exclusivity of their platinum status is reduced. Finally, the authors find suggestive evidence that boosting consumer self-esteem by having them participate in a self-affirmation task lowers the demand for status goods, thus indicating that self-image and status are substitutes. http://documents.worldbank.org/curated/en/432691494944222346/Status-goods-experimental-evidence-from-platinum-credit-cards

The heterogeneous effects of the business environment on growth

Firm-level surveys have enabled us to learn much about the effects of the business environment on firm growth. Yet much remains unknown. For example, what are the key elements of the business environment (BE) that affect firm growth in developing countries? How does the agglomeration environment affect firm growth? How do BE effects differ by firm size, age, growth potential, and a country's stage of development? **Jose-Daniel Reyes**, **Mark Roberts**, and our own **Colin Xu** use World Bank Enterprise Survey data covering 709 small cities in 128 countries to answer these questions. They capture the local BE using city-industry averages of firms answers on key indicators, focusing on the association between the BE variables and firms sales growth and labor productivity growth. Their list of BE variables is comprehensive, which they classify into Basic BE (i.e., property rights protection, infrastructure, human capital, and access to finance), Refined BE (i.e., barriers to entry/exit, labor regulations, and the tax environment), and the Agglomeration Environment (i.e., capacity agglomeration, defined to be congregation of high-capacity firms in a city). By focusing on city-industry-level variation in the BE variables, they are able to control for country- and industry-level fixed effects. They find Basic BE, especially property rights protection and access to finance, and the Agglomeration Environment to be more important predictors of sales and productivity growth than Refined BE. Among slower growing firms, sales and productivity growth are tightly associated with property rights protection and capacity agglomeration, whereas for high-growth firms, modern infrastructure, access to finance, low tax burdens and better access to land are the key drivers.
https://openknowledge.worldbank.org/handle/10986/27612

Do individual investors ignore transaction costs?

Using a unique dataset of securities transactions by 66,000 U.S. households, our own **Deniz Anginer**, together with **Snow Xue Han**, and **Celim Yildizhan** investigate whether investors fully understand and incorporate less salient transaction costs such as bid-ask spreads and the price impact of their trades in their trading strategies.

Theoretically, investors should hold illiquid securities longer in their portfolios if they are taking account of these costs (Amihud and Mendelson, 1986), but recent findings from the behavioral finance literature suggest that individual investors have bounded rationality and may ignore these costs when making investment decisions. Consistent with theoretical conjectures, the authors find that a stock with higher transaction costs tends to be traded less frequently than a more liquid stock with otherwise similar characteristics. Moreover, they find that more sophisticated investors (based on education, income and wealth, and experience trading more complex instruments such as options) account for these costs more fully than others in their holding strategies. And it makes a big difference investors whose holding periods are positively correlated with transaction costs have significantly higher gross returns on their portfolios than those that do not. And gross returns do not account for transaction costs, so the disparity in net returns (which do account for such costs) is even greater. Lest readers think this is a U.S. phenomenon, the authors go on to show very similar patterns in an even larger dataset of the securities transactions of Finnish households.
http://documents.worldbank.org/curated/en/406321497012325678/Do-individual-investors-ignore-transaction-costs

Relief from usury? The impact of microcredit in rural India
As noted above in the paper by Asli et al., and in previous IBN issues, the impact of microcredit on household outcomes has generally been modest. But one overlooked aspect of microcredit is the competition it can provide when the poor rely heavily on informal financial services. In a recent paper, **Vivian Hoffman**, **Vijayendra Rao**, **Vaishnavi Surendra**, and **Upamanyu Datta** look at the impact of the randomized roll-out of the Bihar Rural Livelihoods Project (also known as Jeevika, which is the Hindi word for livelihood) a government-led self-help group (SHG) program in the state of Bihar, India, which offered loans to SHG members. At the time of the intervention, 32 million people in Bihar were living below the poverty line, two-thirds of the rural population was landless, and the average annual informal lending rate was nearly 70 percent. Few randomized evaluations of microcredit programs have reported impacts on market interest rates, presumably due to a lack of statistical power on this outcome. But because Jeevika was rolled out across hundreds of geographic areas called panchayats, this is less a concern. In panchayats randomly assigned to early roll-out, households were 51 percentage points more likely to include an SHG member and new borrowing from informal lenders was 18 percent lower than in the control areas. Many in rural Bihar were highly indebted at the time that Jeevika came on the scene, and thus the primary impact of the program was to shift a portion of households debt burden from high-cost informal loans on which monthly interest rates were over 5 percent to much lower-cost SHG loans (2 percent per month), and thus to substantially reduce borrowing costs. But the program also put

competitive pressure on informal lenders as shown by the 3.8 percentage point decline in the informal borrowing rate in early-rollout areas, a decline driven by the reduction in the rates faced by landless households. While Bihar may be unique because of the high levels of indebtedness among the rural poor, and a nearly complete reliance on informal lending sources prior to Jeevika, the episode suggests that microcredit can have important competitive impacts on the overall credit market.
http://documents.worldbank.org/curated/en/619581491240135589/Relief-from-usury-impact-of-a-community-based-microcredit-program-in-rural-India

Taxing the good? Distortions, misallocation, and productivity in Sub-Saharan Africa

In a new working paper **Xavier Cirera**, **Roberto Fattal Jaef**, and **Hibret Maemir** use census data for manufacturing firms in four Sub-Saharan African countries Cote d'Ivoire, Ethiopia, Ghana, and Kenya to identify and measure resource misallocation within industries and across heterogeneous firms. The authors find significant misallocation away from high productivity firms towards low productivity firms in all four countries, and show that these distortions are correlated with indicators for access to finance, corruption, and regulations. Further, the authors estimate the size of these misallocations and hypothesize that manufacturing productivity could be increased by 31.4 percent in Cote d'Ivoire and as much as 162.7 percent in Kenya with a resource reallocation based on equalizing marginal returns across firms. Finally, the authors compare their census data analysis with survey data collected in the World Bank Enterprise Surveys and show that such surveys underestimate the magnitude of misallocations. Overall, the findings of the study highlight that while productivity growth in manufacturing is an important policy objective in emerging markets, the misallocation induced by poor business environments can stymie the growth of the manufacturing sector. Hence, from a policy perspective improving the business environment and removing manufacturing sector frictions should be a priority.
http://documents.worldbank.org/curated/en/492891485178180375/Taxing-the-good-distortions-misallocation-and-productivity-in-Sub-Saharan-Africa

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

Internal capital markets in times of crisis

Raffaele Santioni, **Fabio Schiantarelli**, and **Philip E. Strahan** team up to address whether and how internal capital markets work, especially in times of crises. They examine these issues in the context of group companies in Italy, which account for one-third of total employment and 55% of total value added for all industrial and service sectors in that country. Since the need for external finance is particularly strong during times of financial crises, they rely on Italian corporate data from 2004 to 2014, covering both the pre-crisis period (2004-2008), and the post-crisis period

(2009-2014, including also the more recent Euro crisis). They find that group-affiliated companies were more likely to survive the crises, especially those affiliated with relatively larger groups, even after controlling for company fundamentals. Moreover, after the onset of the crises, intra-group transfers (i.e, net loans within the groups) increased substantially as the banking system became stressed. Interestingly, the intra-group loans tended to flow from firms with high cash flow to those with low cash flow, and toward those firms with better investment opportunities (as proxied by sales growth). Using firm-specific banking information, the authors are also able to show greater reliance on internal capital flows among firms with more distressed banks. They thus build a thorough case for functioning internal capital markets in Italy during the recent crises by exploiting the before-after changes around the crises, linking firm data with data on their banking relationships and bank distress, and using a long and large panel of firms, thus controlling for various granular fixed effects. www.nber.org/papers/w23541.pdf

Hot weather, finance, and mortality in India

Climate change has large potential consequences, especially for the poor and the vulnerable. This is amply demonstrated in a recent paper by **Robin Burgess**, **Olivier Esdchenes**, **Dave Donaldson**, and **Michael Greenstone** who use district-year level panel data from 1957 to 2000 in India to examine the impact of hot weather on rural and urban mortality. They note that some of the key benefits of urbanization are to delink productivity from weather and to reduce volatility in income, and then carefully document several key findings. First, a one-standard-deviation increase in the number of high-temperature days (i.e., 90+ Fahrenheit degrees) in a year reduces agricultural yields and real wages by 13 and 10 percent, respectively, and raises annual mortality among rural populations by 7 percent, effects that are especially pronounced in the growing seasons. In contrast, in urban areas the number of high-temperature days has no effect on productivity and wages, though mortality rates increase by about 3 percent (for a one-standard-deviation increase in high temperature days). Second, using changes in the presence of bank branches induced by government policies as an instrument, they find that the availability of financial services does significantly reduce the mortality effects of the number of hot days in rural areas. Increasing the number of branches per capita from the 25th to the 75th percentile of the sample would wipe out the effects of hot weather on rural mortality. Third, using long-term weather forecasts, the authors estimate that the negative effects of hot weather on lifespans could be almost three years for rural Indian residents that will be born between 2045 and 2059. The policy message is that hot weather remains an important threat to the lives of the rural poor, a threat that might be mitigated by policies that facilitate better access to financial services. http://econ.lse.ac.uk/staff/rburgess/wp/WD_master_140516_v3.pdf

IV Upcoming events and miscellanea

3rd annual conference on banking development, stability, and sustainability, Santiago, Chile

The Superintendency of Banks and Financial Institutions, Chile (SBIF), the Association of Supervisors of Banks of the Americas (ASBA) and the Facultad de Ciencias Econ micas y Administrativas de la Pontificia Universidad Cat lica de Chile invite submissions to the third edition of their Banking Development, Stability, and Sustainability Conference. The organizers seek papers covering a range of topics in the area of banking stability and sustainability, including: the impact of the implementation of the new Basel capital and liquidity frameworks, new banking resolution mechanisms, the use of stress testing in managing risks, the challenges of new technological development, cyber-security, banking supervision, financial inclusion, and environmentally-conscious banking. The conference takes place November 3rd, 2017, but the deadline to submit a paper is soon (August 3rd). http://conference.sbif.cl/

FMA 22nd European Conference

The Financial Management Association (FMA) is devoting a special track to Microfinance at the FMA 22nd European Conference, June 13-15, 2018 in Kristiansand, Norway. This is the first time FMA has done this, and represents a unique opportunity to disseminate research on microfinance among top finance scholars. The organizers of the special track are seeking papers on issues related to the Banking and Finance of Microfinance broadly defined. The deadline for submissions is December 1st, 2017.
http://www.fma.org/assets/docs/norway/norway_callforpapers.pdf

Happy reading!

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