



Contents

Highlights.....	1
Abstracts of the latest working papers	2
Abstracts of the latest occasional papers	5
Forthcoming working papers	5
Recently published working papers	6
Recently published occasional papers	6
Selected journal articles and books	6
Useful links	8

Highlights

On 29-31 March the Bank of Italy's facilities in Perugia hosted the Ninth Annual Workshop on Public Finance, entitled "Fiscal Policy: Current Issues and Challenges," organized by the Economic Research Department, with participants from central banks, finance ministries, international institutions and academia. This year's edition addressed a wide range of themes that feature prominently in the current fiscal policy debate. Specifically, the first session addressed the effectiveness of fiscal policy in stabilising the economy and examined the issue of pro-cyclical public policies. The second session appraised the impact of fiscal consolidation on economic activity and the factors underlying its success or failure. The third session focused on the role of budgetary institutions and procedures. The last session examined the issue of public expenditure control, including the role of expenditure-related fiscal rules.

On 2-3 April, the Conference "Is happiness measurable, and what do those measures mean for policy?"—co-organised by the Bank of Italy, the OECD, the Joint Research Centre of the European Commission, and the University of Tor Vergata— was held in Rome.

Measures of subjective well-being, normally collected by asking a representative sample of individuals questions such as "On a scale from zero to ten, how happy would you say you are?", are receiving increasing attention on the part of both the mainstream media and academic journals.

Economists, psychologist and statisticians from a wide range of institutions gathered at the conference in order to understand how reliable those measures are, how they relate with economic phenomena, and whether they can be used to support collective decisions.

A wide consensus emerged about the fact that indicators of national happiness should be used with caution. Cross-country comparisons are particularly thorny, due to the likely effects of cultural differences in shaping national data.

However, micro-level analyses based on subjective assessment of well-being can be valuable in a number of ways. For instance, they can be used to compute trade-off weights for cost-benefit analysis, in addition to, or instead of, troublesome indicators such as self-reported willingness to pay; or they may help explaining why different communities choose different policies in relation to unemployment or inequality.

The issue of how current measures may be further refined will likely take centre stage in the OECD World Forum to be held in Istanbul next summer.

From 5 to 7 July 2007, the Bank of Italy will host in its headquarters in Rome the conference "The Luxembourg Wealth Study: Enhancing Comparative Research on Household Finance."

Abstracts of the latest working papers

No. 620: Intertemporal consumption choices, transaction costs and limited participation in financial markets: Reconciling data and theory

Orazio P. Attanasio and Monica Paiella

The paper develops a unifying framework bringing together the explanation of the poor empirical performance of the C-CAPM based on limited participation and the explanation of incomplete portfolios based on transaction costs. Using the implications of the consumption model and observed household consumption and portfolio choices, we identify the preference parameters of interest and a lower bound for the costs justifying non-participation in financial markets. Assuming isoelastic preferences, we estimate the coefficient of relative risk aversion to be 1.7 and the cost bound to be 0.4 percent of non-durable consumption. Our estimate of the preference parameter is theoretically plausible and the bound sufficiently small to be likely to be exceeded by the actual total (observable and unobservable) costs of participating in financial markets.

[\(full pdf text\)](#)

No. 621: Why demand uncertainty curbs investment: Evidence from a panel of Italian manufacturing firms

Elena Bontempi, Roberto Golinelli and Giuseppe Parigi

Demand uncertainty does not have a theoretically clear-cut effect on investment,

as the sign of that relationship depends on a number of factors, such as production technology and the degree of competition in the product market. The paper argues that standard cross-section analyses deliver biased estimates of the relationship between investment and uncertainty, and uses a panel of Italian firms for the period 1996-2004—hence a complete business cycle—to obtain a more reliable appraisal of that relationship. Data are available for individual firms' investment plans, expected future sales and demand uncertainty. We may thus take into account both individual firms' characteristics and aggregate macroeconomic shocks; also, our data allow us to examine the evolution of the investment-uncertainty relationship over time. A key finding of our paper is that the gradual loss of market power experienced by Italian manufacturing firms, along with the higher flexibility of labour inputs, may have weakened the negative effect of uncertainty on investment decisions. We then compute repeated cross-section estimates, and show that the omission of that dynamic interplay would have led to misleading conclusions about the relevance of demand uncertainty in explaining investment decisions.

[\(full pdf text\)](#)

No. 622: Employment, innovation, and productivity: Evidence from Italian microdata

Bronwyn H. Hall, Francesca Lotti and Jacques Mairesse

Italian manufacturing firms have been losing ground with respect to many of their European competitors. This paper presents some empirical evidence on the effects of innovation on employment and productivity, with the aim of investigating one of the possible causes of that poor performance. We use firm level data from

the last three surveys on Italian manufacturing firms conducted by Mediocredito-Capitalia, covering the period 1995-2003. Using a modified version of the model proposed by Harrison, Jaumandreu, Mairesse and Peters (2005) — which disaggregates employment growth rates associated with old and new products — we provide robust evidence that there is no employment displacement effect stemming from process innovation. The sources of employment growth during the period are equally split between the net contribution of product innovation and the net contribution from sales growth of old products. However, the contribution of product innovation is somewhat lower than in the four European countries considered by Harrison *et al.*
([full pdf text](#))

3

No. 623: Measurement of income distribution in supranational entities: The case of the European Union

Andrea Brandolini

Greater social cohesion is an explicit goal of the European Union. Progress is monitored considering the performance in each member country on the basis of national indicators. EU-wide estimates of inequality and poverty play no role. Yet this is a basic information to evaluate the progress of the Union toward greater social cohesion. This paper examines the methodological requirements of this evaluative exercise, and provides the first estimates of inequality and poverty in the enlarged European Union as if it was a single country.
([full pdf text](#))

No. 624: A new measure of local endowments of transport infrastructures

Giovanna Messina

The aim of this paper is to develop a method to measure local endowments of transport infrastructures. Starting from the analytical approach of the “new economic geography” — which emphasizes the role of spatial location in determining the growth performance of an economy — new indicators of local transport endowments are built which take into account not only the physical stock of transport infrastructures but also their speed, quality and effectiveness. The approach is applied to Italian provinces in order to appraise the quality of road and rail transport infrastructures in the different areas of the country.
([full pdf text](#); available only in Italian)

No. 625: The forgone gains of incomplete portfolios

Monica Paiella

The paper proposes a test for the cost-based explanation of non-participation in financial markets, by estimating a lower bound for the forgone gains of incomplete portfolios. The latter are, in turn, a lower bound to the costs that could justify non-participation in financial markets: high bounds would imply implausibly high costs. Assuming isoelastic utility and a relative risk aversion of 3 or less, for the stock market an average lower bound of between 0.7 and 3.3 percent of consumption is found. Since total annual (observable plus unobservable) participation costs are likely to exceed these bounds, the cost-based explanation is not rejected by this test.
([full pdf text](#))

No. 626: University drop-out: The case of Italy

Federico Cingano and Piero Cipollone

We combine individual and aggregate-level data on educational attainment to study the determinants of university drop-out in Italy, one of the worst performers among developed countries. Based on detailed information on a representative sample of secondary school graduates and on local university supply, we first show that family and educational background are relevant determinants of continuation probability. In particular, our results show that accounting for enrollment-induced sample selection significantly enhances the estimated coefficients with respect to standard probit analysis. We then combine our estimates with data on family and educational backgrounds of secondary school graduates in comparable European countries and find that differences in endowments only explain a minor fraction of the observed cross-country gap in students' attainments. [\(full pdf text\)](#)

No. 627: The sectoral distribution of money supply in the euro area

Giuseppe Ferrero, Andrea Nobili and Patrizia Passiglia

The strong and prolonged deviation of money growth from its reference value since 2001 has caused concern among policymakers about the upside risks to price stability stemming from monetary developments. In this paper we provide evidence that those risks might be smaller than previously assumed. We provide a sectoral breakdown of money holdings and show that current excess liquidity conditions are related, to a considerable extent, to the acceleration of non-bank financial intermediaries' money demand, as

well as to the accumulation of marketable instruments. Such increases are likely to be related more to portfolio choices than to transaction motives. We also find evidence from balance sheet data on investment funds that points to a general increase of this sector in the economy, rather than to a higher degree of liquidity of their asset positions. This is likely to imply that the recent dynamics reflect, to a large extent, a permanent change in the financial structure of the economy. Finally, our sectoral analysis suggests that no threats to price were there until the end of 2005—which coincides with the start of the ongoing tightening cycle of euro-area monetary policy.

[\(full pdf text\)](#)

No. 628: Changes in transport and non-transport costs: Local vs global impacts in a spatial network

Kristian Behrens, Andrea R. Lamorgese, Gianmarco I.P. Ottaviano and Takatoshi Tabuchi

We develop a multi-country Dixit-Stiglitz trade model and analyze how industry location and welfare respond to changes in: (i) transport frictions (e.g., infrastructure, transportation technology); and (ii) non-transport frictions (e.g., tariffs, standards and regulations). We show that changes in non-transport frictions, which are usually origin-destination specific, do not have clear-cut implications regarding industry location and welfare, while this is not the case for changes in transport frictions, which are usually not origin-destination specific. In particular, we show that reductions in transport frictions occurring at links around which the spatial network is locally a tree are Pareto-welfare improving. [\(full pdf text\)](#)

Abstracts of the latest Occasional Papers

No. 6: **The bank-firm relationship after Basel 2: A survey of Italian firms**

*Chiara Bentivogli, Emidio Coccozza,
Antonella Foglia and Simonetta Iannotti*

The paper presents the results of a survey of firms regarding changes in their relationship with banks after Basel 2. A national survey was conducted alongside a local one directed at small firms located in the regions of Emilia-Romagna, Puglia and Basilicata. A fairly large percentage of firms seem to have understood the likely effects of the new regulation and some think that appropriate organizational changes are necessary. In general, firms do not perceive any major change in banks' behaviour, although there is some dispersion in the answers regarding changes in credit availability and conditions. There is a tendency to reduce multiple bank relationships, especially among firms participating in the national survey. The local survey also attempted to evaluate the impact of Basel 2 on the growth prospects of Italian SMEs. The propensity to grow is greater among firms located in Emilia-Romagna, which receive more financing from the banking system. There is a lack of support for firms' growth from the banking system, notably in terms of assistance and consulting. Other main obstacles to the growth of firms are difficulties with finding suitable managers and with the governance of the firm in general.

(full pdf text; available only in Italian)

No. 7: **House price developments and fundamentals in the United States**

Andrea Finicelli

This paper discusses the limitations of the price-income ratio, the price-rent ratio, and of affordability measures as indicators of housing market conditions. For the purpose of assessing whether house prices are misaligned, the most sensible approach consists of computing the user cost of ownership and the implied theoretical ratio of house prices to rents and comparing the latter with the observed ratio. On the basis of this approach, US house prices appear to have departed from fundamentals since 2004, cumulating an overvaluation of between 25 and 30 per cent by the third quarter of 2006.

(full pdf text)

Forthcoming working papers

João Sousa and Andrea Zaghini, *Monetary policy shocks in the euro area and global liquidity spillovers*

Daniela Marconi, *Endogenous growth and trade liberalization between asymmetric countries*

Fabrizio Balassone, Daniele Franco and Stefania Zotteri, *The reliability of EMU fiscal indicators: Risks and safeguards*

Massimo Del Gatto, Gianmarco I. P. Ottaviano and Marcello Pagnini, *Openness to trade and industry cost dispersion: Evidence from a panel of Italian firms*

Ivan Faiella and Romina Gambacorta, *The weighting process in the SHIW*

Silvia Magri, *The financing of small innovative firms: The Italian case*

Gianluca Moretti, *Detecting long memory co-movements in macroeconomic time series*

Fabio Maccheroni, Massimo Marinacci, Aldo Rustichini and Marco Taboga, *Portfolio selection with monotone mean-variance preferences*

Matteo Bugamelli, *Export prices, product quality and firms' characteristics: An analysis on a sample of Italian firms (in Italian)*

Paolo Mistrulli, *Assessing financial contagion in the interbank market: Maximum entropy vs. observed interbank lending patterns*

Valter Di Giacinto and Giacinto Micucci, *The producer services industry in Italy: Long term growth and its local determinants*

Filippo Altissimo, Riccardo Cristadoro Mario Forni, Marco Lippi and Giovanni Veronese, *New Eurocoin: Tracking economic growth in real time*

Recently published working papers

No. 619 Vincenzo Cestari, Paolo Del Giovane and Clelia Rossi-Arnaud, *Memory for prices and the euro cash changeover: An analysis for cinema prices in Italy* (February 2007)

No. 618 Luigi Cannari and Giovanni D'Alessio, *The opinion of Italians on tax evasion* (February 2007)

No. 617 Stefano Siviero and Giovanni Veronese, *A policy-sensible core-inflation measure for the euro area* (February 2007)

No. 616 Fabiano Schivardi and Eliana Viviano, *Entry barriers in Italian retail trade* (February 2007)

No. 615 Mario Quagliariello, *Macroeconomic uncertainty and banks' lending decisions: The case of Italy* (February 2007)

No. 614 Fabio Busetti and Andrew Harvey, *Testing for trend* (February 2007)

No. 613 Stefano Federico and Gaetano Alfredo Minerva, *Outward FDI and local employment growth in Italy* (February 2007)

No. 612 Claudia Biancotti, Leandro D'Aurizio and Raffaele Tartaglia-Polcini, *A neural network architecture for data editing in the Bank of Italy's business surveys* (February 2007)

Recently published occasional papers

No. 5: Chiara Bentivogli and Manuela Calderini, *Reforming taxi services in Italy: Why and how* (February 2007) (available only in Italian)

Selection of forthcoming or recent articles by Bank of Italy's staff

(full list since 1990)

Angelini P., A. Generale, *Firm size distribution: do financial constraints explain it all? Evidence from survey data*, Forthcoming, American Economic Review (WP No. 549)

Ascari G. and **T. Ropele**, *Optimal monetary policy under low trend inflation*, Forthcoming, Journal of Monetary Economics

Busetti F., L. Forni, A. Harvey and **F. Venditti**, *Inflation convergence and divergence within the European monetary union*, Forthcoming, International Journal of Central Banking

Bonaccorsi di Patti E. and G. Gobbi, *Winners or losers? The effects of banking consolidation on corporate borrowers*, Forthcoming, Journal of Finance (WP No. 479)

Cipollone P. and A. Rosolia, *Social interactions in high school: Lessons from an earthquake*, Forthcoming, American Economic Review (WP No. 596)

Marchetti D. J. and F. Nucci, *Pricing behavior and the response of hours to productivity shocks*, Forthcoming, Journal of Money, Credit and Banking (WP No. 524)

Paiella, M., *The forgone gains of incomplete portfolios*, Forthcoming, Review of Financial Studies (WP No. 625)

Álvarez, L. J., E. Dhyne, M. Hoeberichts, C. Kwapil, H. Le Bihan, P. Lünemann, F. Martins, **R. Sabbatini**, H. Stahl, P. Vermeulen, J. Vilmunen (2006), *Sticky prices in the euro area: A summary of new micro evidence*, Journal of the European Economic Association, 4, 575-584

Bianco M. and G. Nicodano (2006), *Pyramidal groups and debt*, European Economic Review, 50, 937-961

Busetti, F. (2006), *Tests of seasonal integration and cointegration in multivariate unobserved component*

models, Journal of Applied Econometrics, 21, 419-438

Dhyne, E., E. Vilmunen, L.J. Álvarez, H. Le Bihan, **G. Veronese**, D. Dias, J. Hoffmann, N. Jonker, P. Lannemann, F. Rumler (2006), *Price changes in the euro area and the United States: Some facts from individual consumer price data*, Journal of Economic Perspectives, 20, 171-192

Dedola L. and S. Neri, *What does a technology shock do? A VAR analysis with model-based sign restrictions*. Forthcoming, Journal of Monetary Economics, 54, 512-549 (WP No. 607)

Fabiani, S., Druant, M., I. Hernando, C. Kwapil, B. Landau, C. Loupias, F. Martins, T. Mathä, **R. Sabbatini**, H. Stahl, A. Stokman (2006), *What firms' surveys tell us about price-setting behaviour in the euro area*, International Journal of Central Banking, 2, 3-47

Gaiotti E. and A. Secchi (2006), *Is there a cost channel of monetary transmission? An investigation into the pricing behaviour of 2000 firms*, Journal of Money, Credit, and Banking, 2006, 38, 8, 2013-2038 (WP No. 525)

Lippi F. and S. Neri (2006), *Information variables for monetary policy in a small structural model of the euro area*, Forthcoming, Journal of Monetary Economics (WP No. 511)

Brandolini A., P. Cipollone and E. Viviano (2006), *"Does the ILO definition capture all unemployment?"*, Journal of the European Economic Association, 4, 153-179 (WP No. 529)

Fuchs W. and **F. Lippi** (2006), *Monetary union with voluntary participation*, Review of Economic Studies, 73, 437-457 (WP No. 512)

- Busetti F.** and R. Taylor (2005), *Stationarity tests for irregularly spaced observations and the effects of sampling frequency on power*, *Econometric Theory*, 21, 757-794
- Cristadoro R.**, M. Forni, L. Reichlin and **G. Veronese** (2005), *A core inflation indicator for the euro area*, *Journal of Money, Credit, and Banking*, 37, 539-560 (WP No. 435)
- Dedola L.** and **F. Lippi** (2005), *The monetary transmission mechanism: Evidence from the industries of five OECD countries*, *European Economic Review*, 49, 1543-69 (WP No. 389)
- Guiso L., L. Pistaferri and **F. Schivardi** (2005), *Insurance within the firm*, *Journal of Political Economy*, 113, 1054-1087 (WP No. 414)
- Adalid R., G. Coenen, P. McAdam and **S. Siviero** (2005), *The performance and robustness of interest-rate rules in models of the euro area*, *International Journal of Central Banking*, 1, 95-132
- Gambacorta L.** (2005), *Inside the bank lending channel*, *European Economic Review*, 49, 1737-1759
- Marchetti D.J.** and Nucci F. (2005), *Price stickiness and the contractionary effects of technology shocks*, *European Economic Review*, 49, 1137-1164 (WP No. 392)

Useful links

Working papers of the other euro-area central banks:

Banque Nationale de Belgique
Deutsche Bundesbank
Bank of Greece
Banco de España
Banque de France
Central Bank of Ireland
Banque Centrale du Luxembourg
De Nederlandsche Bank
Oesterreichische Nationalbank
Banco de Portugal
Bank of Slovenia
Bank of Finland
European Central Bank

Other

BIS Central Bank Research Hub
International Journal of Central Banking