

# TSE

Mag #7 { Autumn 2014 }

EEA-ESEM 2014

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1961 - 2014



## Tribute to our colleague

Jean-Philippe Lesne, Dean of the TSE-UT1 Capitole School, passed away on 19 September after a courageous battle against illness.

Jean-Philippe had enthusiastically agreed to take command of the TSE School in 2012, after a distinguished career first as a researcher at ENSAE then as expert at INSEE, professor at the University Cergy-Pontoise and ESSEC, and finally as vice president of the polling institute BVA. Jean-Philippe was a graduate of Ecole Polytechnique and obtained his PhD in Economics at our University.

From the moment he was appointed as head of the school through to the end of 2013, Jean-Philippe determinedly rallied the teaching and administrative teams around the ambitious project, launched in 2011, of developing "Grande École excellence within the University". Rapidly successful in his new role, he became a popular figure recognised for his human values, his infectious energy and his ability to "carry" this grand challenge. With the support of the University of Toulouse 1 Capitole and the Toulouse School of Economics Foundation, he consolidated the school's development. But in recent months, severe illness consumed him, finally winning over his fighting spirit and eternal optimism. He continued, nevertheless, to follow the life of the school, insisting on attending the new term welcome gathering of "his" students, just a few days ago.

Under his leadership, the school has established itself in the field as an ambitious collective project, dedicated to delivering the best possible education for the new generations of economists. Jean-Philippe was particularly involved in developing and strengthening the School's international openness, its professional qualifications, its partnerships with businesses, and its tailored services to students.

His colleagues and friends will hold dearly onto the image of an "honest man"; a demanding but compassionate director who helped his teams excel and inspired his students. Right through to the end, he followed the School's challenges and developments. He was proud, and rightly so, of the progress made.

May we now honour his memory by continuing to strengthen the TSE School.

May we now be inspired by his optimism and fighting spirit to carry on his hard work supporting our students.

- *Christian Gollier, TSE Director*
- *David Alary, Acting TSE School Dean*
- *Joel Echevarria, TSE COO*

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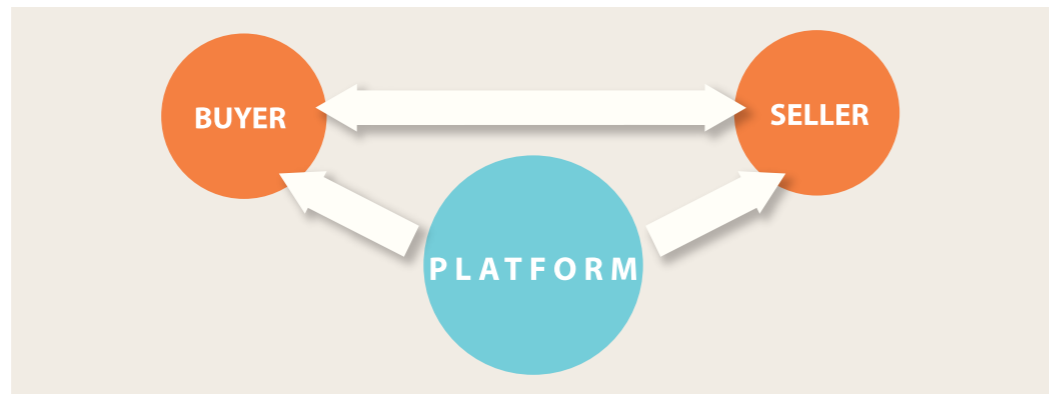


Takuro Yamashita

Takuro Yamashita

## Double auction vision

At the recent EEA-ESEM conference, Takuro Yamashita presented a new paper co-authored with Fuhito Kojima of Stanford University. The paper proposes a new approach to organising double auctions, the competitive buying and selling system behind many of today's economic transactions.



### PROFILE

> Takuro Yamashita is an assistant professor of economics at TSE. He began his higher education at Hitotsubashi University in Tokyo, Japan, before undertaking a PhD in economics at Stanford University, which he obtained in 2011 before directly taking up his TSE position.

Full CV >>



### LEARN MORE...

Double auction with interdependent values: incentives and efficiency

With Fuhito Kojima, working paper



### Firstly, what is a double auction?

**Takuro Yamashita.** Double auctions are one of the most prevalent trading systems in today's markets, used for example by major stock exchanges such as NYSE and AMEX. In double auctions, buyers and sellers submit their bids and asking prices simultaneously to trade shares with one another. The volume of transactions per year generated via double auctions is much larger than the world GDP. Double auctions are also important in standard economic theory, as the micro-foundations of markets.

### What are the challenges of a double auction market?

**TY.** Despite their importance, double auction markets are not easy to organise or analyse. Most common mechanisms quote a price that equates supply and demand and let the objects change hands at that price, but such mechanisms are not always incentive-compatible. That is, sometimes participants have incentives to misreport their preferences. The resulting misreporting can lead to inefficiency of equilibrium outcomes. The problem becomes even more difficult once we allow for traders with interdependent values or multiunit demand or supply, which are both important features of double auctions in practice. In stock exchange, for instance, traders naturally trade multiple shares.

### How does your paper address these problems?

**TY.** By proposing a new system for organising double auctions, the groupwise-price mechanism, which aims to strike the right balance between incentives and efficiency. Our mechanism divides the entire market into a number of submarkets, each composed of a subset of buyers and sellers, with all trades taking place between buyers and sellers in the same submarket. For each submarket, we set a reference price which is independent of the reports of the agents in that submarket. Agents in the submarket then trade on the basis of that reference price, although not necessarily at it.

By dividing the market into smaller submarkets and defining an independent reference price within each market, one may prevent some obvious price-manipulation incentives and hence encourage truth-telling and voluntary participation. At the same time, this means that the price is computed without all the information in the economy, which may result in allocative inefficiency in our mechanism. Nevertheless, with many buyers and sellers in the economy, we show that such inefficiency is negligibly small, and hence obtain "approximate" efficiency.

While our results are primarily of theoretical interest, we believe that they introduce a potentially optimal double auction design that could be applied to a real market.

Franck Portier

## No news, good news?

Franck Portier takes us on a whistlestop tour of the potential impact of news on business cycles. Macro-style.

**Market economies go through business cycles; recurring boom periods with higher than average growth in investment, consumption and employment, followed by recessions characterised by declines in these same macroeconomic aggregates. Traditional analysis tends to put these fluctuations down to economic shocks such as changes in oil prices, taxes or technology. But another approach, the one I investigate in my paper, is to suggest that the cycles are due to a more subtle, expectational cause: the interpretation of news by economic actors who in consequence speculate on the economy's future demands.**

This "news-driven" explanation for business cycles is rather simple: an economic decision-maker anticipates a future need and tries to pre-empt the market, investing early in order to make goods or services readily available when the predicted needs eventually appear. If many investors receive related news about future developments and adopt similar behaviour, this will lead to a boom period. However, the very fact that such behaviour involves speculation leaves scope for error. In this case, the economy will have over-invested, as the anticipated demand will not materialise. This will end in tears: recession and liquidation. Hence, according to the "news view" of the business cycle, both booms and busts are direct consequences of people's incentive to speculate on information related to future economic developments.

The satellite industry provides interesting anecdotal evidence for the unpredictable nature of such speculative cycles. In the early 1980s, in anticipation of long-distance telephone services, video teleconferencing and other forms of sophisticated electronic communications, the launching of telecommunication satellites exploded. A few years later, the market realised that the

increase in demand had failed to materialise, causing significant capacity underutilisation. On a weekday afternoon in December 1983, the Federal Communications Commission observed that only 54% of capacity on communications satellites was in use. Of the 14 satellites studied, 143 of 312 transponders were idle. This "transponder glut", as the industry calls it, was repeated in the early 2000s after the "dot com" boom of the 1990s. Again, satellites outpaced customers, leaving a bonanza of telecoms satellites in want of customers, spiralling towards a bust.

The "news view" of business cycles raises many questions which have yet to be fully explored: the impact of an international as opposed to a closed economy setting, the role of financial markets in propagating and amplifying the effects of news, extensions to housing price dynamics, etc. At this point in time it is hence still difficult to evaluate the credibility and relevance of the "news view". An interesting research path to be explored in order to provide a clearer picture would be the interactions between news and social learning, to give new insights about how dispersed information regarding the future evolution of the economy may affect expectations and thereby cause macro-economic fluctuations.



Franck Portier

### PROFILE

> Franck Portier is a senior TSE researcher and professor at the University Toulouse 1 Capitole. Franck holds a senior chair at the Institut Universitaire de France, and was recently appointed by French Minister of Research & Higher Education to the National Economics Expert Panel.



Full CV >>



### LEARN MORE...

News Driven Business Cycles: Insights and Challenges

With Paul Beaudry, Vancouver School of Economics





Fanny Camara

Fanny Camara & Nicolas Dupuis

## Rotten tomatoes

TSE PhD students Fanny Camara and Nicolas Dupuis have just won the Econometric Society prize for the best paper in applied economics by young researchers. Their paper looks at how movie reviewers may not always report their true opinion of a new film, essentially to protect their reputation and further their career. Fanny and Nicolas get to the bottom of these strategic biases, analysing their impact on the film industry as a whole.

Experts who have advanced knowledge about an issue and care about their reputation may want to distort their private assessment when revealing it to the public. For instance, let's say a rookie movie critic watches a preview of a blockbuster film that the public is eagerly awaiting and expects to be amazing. The critic in reality finds the film poor, but decides to falsify her review, thinking it is more likely that she is mistaken and will pass for a poor predictor

of the movie's quality. Likewise, a very influential reviewer might be able to convince her audience not to see a certain movie, hence preventing them from discovering it's true quality, and preserving her own reputation. These different incentives create strategic biases which result in the loss of valuable information. In our paper, we develop a methodology which allows us to estimate both the ability and accuracy of the movie

expectations  
movie critics  
false reviews  
strategic  
influences biais  
barriers to entry  
perceptions - audience



Nicolas Dupuis

“ Plato, Phaedrus, 260a

On that point, Socrates, I have heard that one who is to be an orator does not need to know what is really just, but what would seem just to the multitude who are to pass judgment, and not what is really good or noble, but what will seem to be so; for they say that persuasion comes from what seems to be true, not from the truth.



critics and the extent of their strategic biases. This methodology will ultimately allow us to assess welfare losses due to these strategic biases. For example, to what extent is a young director with no experience likely to receive harsher reviews than her older colleagues, leading to barriers to entry for that young director?

As private assessments by movie critics on the quality of movies are unobservable, we have to estimate their biases via a strategic information transmission game. In this game, we are able to classify movies according to the probability that they will be perceived as good prior to their general release. The idea is that a movie for which expectations are higher will on average

receive more emphatic reviews. Estimating the extent of strategic biases is then direct as we can simulate the distribution of private assessments, comparing estimated abilities and expected film qualities to the actual distribution of reviews.

We use reviews published by professional movie critics on the "Rotten Tomatoes" website for all movies released in the US between 2004 and 2013. We find that movie reviewers' abilities range from 62% to 90%, meaning that the worst movie reviewer fails to recognize the true quality of a movie 4 times out of 10 against 1 out of 10 for the best one. We also find that the most biased reviewers misreport their assessment to conform to the public expectations 4 times

out of 10. Quite surprisingly, we also find that a large amount of reviewers are either positively or negatively biased but not both at the same time.

+

**LEARN MORE...**

**Structural Estimation of Expert Strategic Bias: the Case of Movie Reviewers**  
Fanny Camara and Nicolas Dupuis



Fanny Camara, TSE PhD student  
Co-winner of Econometric Society annual prize for best young researcher paper in applied economics joint with Nicolas Dupuis, TSE PhD student  
Econometric Society Annual Prize



Watch a Video interview with Fanny Camara on receiving the Econometric Society prize



# Catching up with high-frequency trading

In the “olden days”, the trading of financial instruments required face-to-face interactions in physical locations. But in today’s technological world, floor and phone trading have been almost exclusively replaced by electronic trading platforms, and 70% of the world’s equity trading currently happens at “high-frequency”.

*As high-speed electronic trading began to take off in the late 2000s, the TSE researchers specialised in the microstructure of financial markets realised it was a crucial issue to study, and the team, notably Bruno Biais, Fany Declerck and Sophie Moinas, has since developed internationally-recognised expertise on the issue. Sophie gives us an insight here into the latest challenges and developments in the field.*

## Could you quickly trace back the history of electronic trading?

**Sophie Moinas.** Electronic trading first began to appear in the 1980s, when technology innovations introduced the first tools to help human traders process the great volumes of information needed to assess the fundamental value of assets and make the right trading decisions. The stock exchanges themselves then turned to electronic platforms to meet the demand from the industry to be able to implement these trades.

For a long period of time, everyone slowly moved to electronic trading and nothing much changed. But then in the year 2000, after the internet bubble crashed, brokers who were pressured

by reduced margins started to complain to the regulators about the monopoly of the exchanges and the high access fees they were charging. This pressure led to competition being introduced in the industry, via the 2007 regulations RegNMS<sup>1</sup> in the US and MiFID<sup>2</sup> in the EU, allowing stocks to be traded at 300 different venues rather than at the handful of traditional stock exchanges. This led to a sharp increase in the volume of information to be processed – prices now needing to be checked in multiple locations. In response to this need to quickly process high volumes of market information across fragmented markets, high-speed algorithmic trading quickly spread across all markets, pulling the industry into a new, fully automated phase.

## What exactly is high-frequency trading, or HFT?

**SM.** In short, high-frequency traders employ powerful, sophisticated computer programmes to execute extremely fast trading strategies. The computers scan the markets, processing and analysing data in a split second, hence allowing them to make decisions and place orders much more quickly and accurately than a “slow” human trader, based on algorithms that are “fed” with more relevant information.

While algorithmic trading was spreading across the equity markets, little was known about its potential societal benefits and risks. My colleagues and I have hence tried over the past few years to analyse the impact of algorithmic HFT on financial markets. Does it improve market quality? Should it be regulated? If so, what would

## INTERVIEW WITH SOPHIE MOINAS



One of the main challenges researchers face today is the difficulty of access to HFT data. Given the speed and volume of transactions, we are talking very big data!

be the policies to implement? The answers to these questions have significant policy implications for the regulators.

## What are the risks of HFT?

**SM.** In the current situation, one can qualify HFT as a privilege of the elite: those who have the resources to invest in costly computer technology can hence turn this to their advantage, gleaming profits effortlessly from the “normal” purchasing and selling activities of other “slow” traders. It is inevitable that the remaining slow traders follow the movement, in an attempt to save their own investments and increase profits. This can be considered as financial warfare - an arms race with doubtful social usefulness and economic efficiency. The trades gained through improved technological efficiency are countered by the trades lost through adverse selection problems. If regulators and policy makers do not intervene to curb HFT, various situations may arise. If no major systemic crisis is triggered, HFT will most likely continue to thrive and the arms race will increase in intensity. Whilst this may seemingly lead to improved price discovery and increased liquidity, there is a significant risk that this could be detrimental to slow traders due to adverse selection. These slow traders may slowly retreat from markets, migrating to dark pools and over-the-counter trading, where their orders can be hidden from HF traders. In the long run, this could hinder price discovery and create internalisation, raising agency issues. If the proliferation of HFT should provoke a severe crash, investors may panic and exit the markets, hence sparking a downward price spiral. Similarly, if HF traders were to lose millions of dollars due to a technological problem, this could lead to bankruptcy for lightly capitalised firms, and general counterparty problems.

## What are regulators doing?

**SM.** In the first years following the introduction of HFT, the market regulators held mitigated positions; certain advocated quite severe regulation, while others preferred a laissez-faire approach.

The European Commission reacted quickly, introducing a “series of safeguards” against HFT in its 2014 MiFID II review, subjecting HFT firms to regulatory oversight and capital requirements, which could help prevent systemic risk creation by HFT firms. Initially a little more reluctant to act, the U.S. Securities and Exchange Commission (SEC) has now also raised concerns about the impact of HFT, and is investigating the issue.

## What should regulators be doing?

**SM.** Completely banning fast trading would not be optimal: in a fragmented world, HF traders enable investors to execute their desired trades more easily. However, the potential consequences are serious and one can hence argue that there is a need for a certain level of regulatory monitoring and intervention. In order to reduce the impact of adverse selection, one appropriate policy response could be to tax HFT, for example by taxing collection. Akin to Pigovian taxes, this would oblige HF traders to internalise the adverse selection costs they impose on slow traders. The tax proceeds could be used to fund market surveillance, or to create a stability fund in case a crash should arise.

## What role do researchers play?

**SM.** One of the main challenges researchers face today is the difficulty of access to HFT data. My colleagues and I are lucky enough to have been granted access to market data by the AMF, the French market regulator. This kind of access is very rare. However, given the speed and volume of transactions, we are talking very big data! It is hence a colossal task to collect, filter and analyse the information which will help us to decipher the practise of HFT and make recommendations for managing it. Nonetheless, as the practice of HFT continues to grow, so does the research into its nature and consequences. Hopefully, this will in turn feed into future policy on this very topical issue!

1 - Regulation National Market System  
2 - Markets in Financial Instruments Directive

## Conference: trading in electronic markets

Sophie and her colleague Bruno Biais recently organised a 2-day conference at TSE on the latest research & policy issues in electronic trading.

Find out more



## PROFILE



> PhD from HEC in 2005, Sophie Moinas is Professor of Finance at IAE Toulouse (University



of Toulouse), researcher at the CRM and member of Toulouse School of Economics and IDEI. For her research, Sophie Moinas received the PhD Thesis Award from the French Finance Association and Euronext in 2006, a research grant from the French National Research Agency in 2009 for her project on “Algorithmic Trading”, the Joseph de la Vega prize in 2013 for her work on liquidity supply across multiple trading venues, and the best paper award in Finance 2014 by the Institut Europlace Finance for her article on the bubble game (with S. Pouget).

## FURTHER READING

**Equilibrium Fast Trading**  
TSE Working Paper forthcoming in Journal of Financial Economics, n. 13-387, March 2013, revised September 2014 (with Bruno Biais and Thierry Foucault)

**Prop trading and fast trading**  
mimeo, July 2013 (with Bruno Biais and Fany Declerck)

# What do Roquefort and Champagne have in common?



Zohra Bouamra-Mechemache and Angelo Zago

**TSE & INRA researcher Zohra Bouamra-Mechemache and visiting researcher Angelo Zago recently organised a workshop on “Producer organisations (POs) in agricultural markets”. A timely opportunity to take stock of recent efforts to investigate the issues related to collective endeavours in agriculture. And to talk a little about good food and wine...**

Food markets worldwide are in constant evolution, even more so in recent years as environmental, technical and socio-political factors have forced the industry to reinvent itself in order to deal with supply and price crises and keep up with global demand. Large multinational groups have gained in power, and the production, processing and retailing steps of the food chain are increasingly consolidated and controlled by such large groups.

The surge of these oligopolies has renewed interest in collective action in agriculture, both at the policy and research level. Clusters of agricultural producers, small and large, have joined forces to stand up to the powerful consortiums by making joint investments in processing and marketing facilities, sharing extension costs, bargaining with supplying, processing, and retailing firms, targeting distant

and/or foreign markets, creating shared brand images, and so on. These groups are common in many countries and can take different forms: agricultural cooperatives, producer organisations (POs), producer-owned enterprises, member-owned firms, etc.

In the EU, agricultural cooperatives are very common but other forms are gaining importance. POs, for instance, have been recognised and empowered in the fruit and vegetables (F&V) sector since the 1970s. Compared to cooperatives, by design in their bylaws POs are more flexible organisations, with the major requirement being that they both serve and be controlled by their members. POs have been used by the EU as a vehicle to “strengthen the position of producers in the face of a greater concentration of demand and to integrate environmental concerns in the production and marketing of F&V.” (EU regulation, 2014).

The much-debated Common Agricultural Policy (CAP) was reformed in 2013, extending the use of POs as a transversal policy tool for market organisation in all agricultural sectors.



Università degli Studi di Verona



## The policy low-down

The POs workshop was enriched by a roundtable with industry and policy-makers focusing on the challenges and perspectives for POs in the EU.

**Prodromos Kalaitzis**, Senior Policy Advisor at Copa-Cogeca, the European association of national farmers and POs unions, illustrated that producer groups process and trade about half of the total agricultural output in the EU. The cooperative models vary across the EU: in the Nordic countries, there are a small number of large, highly integrated, specialised cooperatives, while in the South there is a high degree of “atomisation”, with many COOPs of limited size. The main shared objective of these organisations is to increase competitiveness of the sector and their members, to ensure an adequate and secure food supply with a better functioning of the food supply chain, and to preserve the environment and the countryside.

**Bruno Buffaria**, representing DG Agriculture, illustrated that POs have long been recognised in EU agricultural policy, with the basic objectives of concentrating the agricultural supply and strengthening the (otherwise weak) bargaining position of farmers in food supply chains. Since the 1960s the economic environment has changed a lot, with new challenges to be addressed such as market volatility, terms of trade, climate change, new demands for organic produce,

etc. According to Mr. Buffaria, POs play an important role in the (policy) answer to these challenges. Concerning any possible tensions between CAP provisions for POs and competition rules, Mr. Buffaria made it clear that precedence should be given to the CAP objectives, in order to support PO development and increase the economic efficiency of the food chain.

**Philippe Chauve** of DG Competition detailed the special EU competition policy exemptions granted to POs in order to support the CAP objectives. A recent report commissioned by DG Competition shows that POs may indeed have beneficial effects for members and total welfare, increasing economic efficiency of the agricultural sectors. Farmers indeed face commercialisation and competitiveness challenges, and POs can be useful for both. However, since producers in POs are independent undertakings, their coordination practices can potentially limit competition and as such are subject to standard competition rules. So, in essence, POs are welcome as their joint activities increase farmers’ economies of scale, reduce their overall production costs and improve their bargaining power. However, they need to avoid excessive market power and abuse.

Group action in European agriculture, however, has also been encouraged in other ways, for example through the strengthening of collective geographical labels associated with high-quality agricultural products coming from specific regions, such as Roquefort and Champagne. These brands are managed by group of firms that decide collectively on the production and marketing rules for their group of products.

The role and diffusion of group action goes beyond the EU. In Africa, for instance, it is recognised as a useful means to lift smallholders out of poverty. The World Bank has highlighted the critical role of agriculture

for development and poverty reduction. Indeed, since three quarters of the poor in developing countries live in rural areas, the vast majority depend on agriculture for their living. Overall, growth in agriculture has proved to be at least twice as effective in reducing poverty as growth in other areas of the economy. Moreover, poor smallholders need to connect to (trade-induced) economic growth, which is easier with locally-based economic activities. In short, poverty reduction via smallholder participation to

local and international markets can be enhanced by technical assistance and collective action through POs, which help to correct market imperfections due to high transaction costs or missing credit markets, allow to coordinate on shared quality standards, to pool labour and financial resources in order to access new (domestic or international) markets, and overall to increase bargaining power and help democracy by the exercise of voice in policy making at the local level.

## Thanks to... Marie Curie



The POs conference was made possible by the Marie Curie Intra-European Fellowship granted to Angelo Zago, Professor of Economics at Verona University. Thanks to the IEF grant, Angelo was able to spend a year as Visiting Professor within the TSE’s Food, Firms and Farms research group.

As well as the conference, several papers and future collaborations were born from this one-year exchange. In particular, a project with Zohra on the incentives and difficulties in forming POs; a project with Philippe Bontems on the quality choices in cooperatives compared to private firms; a project on cooperatives and exclusive dealings with Zohra, Patrick Rey and Zhijun Chen, and an individual project on collective reputation.

FIND OUT MORE...

[Via the conference website](#)



# EEA-ESEM Congress



Every summer, the European Economic Association (EEA) and the Econometric Society (ES) hold the largest European event in economics: the EEA-ESEM congress. The event brings together over 1500 of Europe's leading economists for a unique opportunity to meet, present and discuss the latest research advances, take part in policy debates, and share ideas on a wide range of topical issues in economics. TSE was honoured to host the 2014 edition of the congress, which took place at the University Toulouse 1 Capitole on 25-29 August.



Full highlights



# WinE: supporting junior female economists

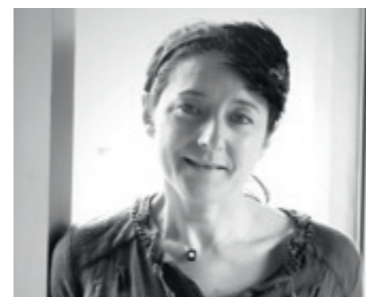
No, it's not about the alcoholic beverage that France is so famous for...

Pronounced "winnie", WinE stands for "Women in Economics", a European Economic Association initiative aiming to provide mentoring support for female economists in the early stages of their career. WinE takes the form of an annual mentoring retreat, organised by the EEA's Women in Economics Committee. WinE aims to support women in the economics profession by facilitating the formation of networks, by circulating information on, or relevant to, female economists, and by providing a forum to discuss issues relevant to women in academics.

The WinE Retreat, launched at EEA-ESEM 2013 in Gothenburg, is becoming an important

annual event on the economics agenda. This year's retreat was held on 24-25 August, prior to the opening of EEA-ESEM Toulouse. The mentees took part in a series of innovative panel discussions covering topics such as how to get known by the profession, how to get published and funded, how to strike the right work / life balance, and whether being a woman really matters in a research environment. All part of the unique challenges that women may face at different stages of their careers.

Among this year's senior mentors at the retreat were Emmanuelle Auriol and Ingela Alger, both TSE researchers. Emmanuelle and Ingela share a few words on this year's event:



**Emmanuelle Auriol**

"Mentoring for junior female economists has been run by the American Economic Association for quite a while. Assessment of this specific training program has shown that it makes a difference for the career of the young women who benefited from it.

The gender balance is not right in our profession, especially at the senior level. The WinE initiative aims to help women to succeed as economists in academia. I am happy to be part of it."



**Ingela Alger**

"In a profession where most seniors are male, it may be more difficult for young women than for young men to find mentors among their colleagues. The WinE mentoring initiative mitigates this difficulty by giving young female economists

an opportunity to meet each other as well as senior female economists from other institutions. I was happy to share some of my impressions with them."

## UPCOMING EVENTS

Special "Jean-Jacques Laffont Anniversary" seminar series, including 8 talks over the coming academic year:

Theme	Speaker	Date
Economic theory	Jean Tirole	Monday 6 October
Development Economics	Antonio Estache	Thursday 6 November
Decision mathematics	Ivar Ekeland	Friday 14 November
Environment	Marcel Boyer	Monday 17 November
I.O.	Quang Vuong	Monday 24 November
Finance	Richard Kihlstrom	Wednesday 10 December
Economic Theory	Jerry Green	Tuesday 17 March
Econometrics & Empirical Economics	Matt Shum	Tuesday 31 March

**15-16 December 2014**

Recent advances and challenges in benefit-cost analysis  
Organised by Christoph Rheinberger and Nicolas Treich

**8-9 January 2015**

Eighth bi-annual conference on The Economics of Intellectual Property, Software and the Internet  
Organised by Jacques Crémer and Paul Seabright



# Jean-Jacques Laffont

1947 - 2004

BY JACQUES CRÉMER

*2014 marks ten years since the passing of Jean-Jacques Laffont, TSE's founding father and a perpetual inspiration to our research teams today. TSE professor Jacques Crémer, a long-time colleague and close friend of Jean-Jacques, pays tribute to his life, works and legacy.*

On the tenth anniversary of Jean-Jacques Laffont's death, the economists working in Toulouse wanted to welcome our friends from Europe and all over the world. It is especially fitting to remember Jean-Jacques in the context of the EEA-ESEM congress, as he was an active member and a past president of both the associations that organise the event.

It is always good to remember great men and great women and there is a bittersweet pleasure in speaking about past times. But there is more to this. Jean-Jacques still has lots to teach us, and more than memories, it is these lessons which we should discuss and take to heart. There are lessons for all economists and special lessons for those of us doing economics in Europe. Jean-Jacques was born in Toulouse in 1947. After carrying out studies in Toulouse and Paris, he found his way to Harvard where he obtained his PhD in 1975 under the supervision of no less than Ken Arrow. By 1978, he was back in Toulouse, where he was a University professor until his death in 2004. Jean-Jacques used to say, sorry, this does not translate: "Toulouse, c'est mon Amérique à moi."

Jean-Jacques' legacy is above all a fantastic set of contributions to economics. 15 books and over 200 papers! It is impossible to do justice to his whole works in such a short space, so here I am

ignoring his work on the theory and econometrics of disequilibrium, on public economics, on entrepreneurship, and so on, and so on.

Jean-Jacques was part of the group who revolutionised economics in the early 1970s by developing the theory of incentives under asymmetric information. This began with his well-known work with Jerry Green on Groves mechanisms, and continued with his work with his close friend Eric Maskin. But very quickly he realised that this approach had important implications for both policy discussions and empirical work. The economic policy implications for regulation were largely pursued with Jean Tirole, culminating in their 1993 MIT Press book "A theory of incentives in procurement and regulation". But also, in more applied work on, among others, the regulation of telecoms.

As Jakub Kastl discussed during the special EEA-ESEM session in honour of Jean-Jacques, he was also a pioneer in the econometrics of auctions - one of the first who understood that you could bring the theory of incentives to the data. I always found it quite amusing that he worked with Quang Vuong and Hervé Ossard on eggplant auctions in Marmande, less than two hours away from Toulouse on the road towards Bordeaux.

In the mid-90s, Jean-Jacques decided that he wanted to use his expertise to help people who

really needed help. During the last ten years of this life, he devoted a considerable chunk of his time to development economics, with a strong focus on the political economy of development, adapting the tools of incentive theory to do so. But Jean-Jacques was not only a great scholar; he was also a great human being and a great leader. Let me repeat a story which Antonio Estache told me. As Jean-Jacques was beginning to work on development economics, Antonio, who was then working for the World Bank, spoke to him about the need for courses on regulation in Africa. In Senegal or the Ivory Coast, if my memory serves me right. Jean-Jacques's immediate reaction was "Get me a ticket and I will go and do it". Without a single thought about fees or other income.

This is because Jean-Jacques wanted to change the world. And he did.

Jean-Jacques could have taught anywhere he wanted. He could have lived in Toulouse, done his teaching there and travelled the world for intellectual stimulation and extra income. Instead, he chose to invest his energy in building what has now become Toulouse School of Economics. In the 1980s, he created a first research group in Toulouse, the GREMAQ. He inspired the young faculty already there and convinced some of the best economists then working in France to come to Toulouse.



## Special EEA-ESEM Congress session in honour of Jean-Jacques Laffont, 27 August 2014

To honour Jean-Jacques' scientific legacy, TSE organised a special panel session at the EEA-ESEM congress gathering three economists of different generations representing different facets of the way in which Jean-Jacques liked to do economics, in particular the insistence on theoretical rigour and, at the same time, empirical and policy relevance.

Memories were shared and papers were presented by:

- Jakub KASTL, Stanford University
- Nicholas STERN, London School of Economics
- Alessandro PAVAN, Northwestern University

At that time there were very few links between industry and French universities. But, in 1990, Jean-Jacques created the IDEI, the Institut d'Economie Industrielle, a non-profit organisation which engages in partnership-based research with public and private organisations. Under his leadership, the IDEI, which is still going strong today<sup>1</sup> with dozens of industrial partners, has been a major source of funding and inspiration for the economists in Toulouse and a great tool for recruitment.

To be clear: TSE would not exist today without Jean-Jacques' leadership and his ability to attract other people to work on making his dreams come true. He was always very active in the management of the University of Toulouse and in the profession. He travelled the world over, visiting and giving seminars, sometimes meeting with top policy makers, but always paying special attention to young researchers and to graduate students. There are an extraordinary number of people, of many nationalities, who have told one or the other of us: "I once heard Jean-Jacques in a seminar", or "I had a short conversation with him" and then ... "it changed my life".

And for those of you who are now thinking "he must have been a very sad and boring man totally focused on his work" - you are wrong.

Jean-Jacques enjoyed good company, good food and good wine. The old-timers in Toulouse remember the many wine tastings and foie gras cooking sessions at his house. And he raised four children with his wife Colette, whom he had met as an undergraduate in Toulouse.

Now, none of us has the range of abilities that Jean-Jacques had. "Do what he did" will not do as advice. But we can still heed his message on several aspects. Firstly, all aspects of economics are important. We cannot have good economics without good theory and good empirical work. Secondly, good economics should help us to both understand the world and to change it - policy work is a noble part of our science and should inform our scholarly pursuits. Thirdly, even when institutional frameworks are broken, even badly broken, things can be done, ways can be found, to build stronger teaching and research institutions. Finally, academic life attracts people interested in teaching and carrying out research. But it also provides many opportunities for those who want to change the world, both within academia itself and outside its walls.



Jacques Crémer

<sup>1</sup>Editors' note: see pages 14-17



# IDEI celebrates its 25th anniversary



Ever since 1990, TSE researchers have been working hand in hand with public and private economic leaders to answer major economic issues in various domains such as energy, the internet, insurance, transportation, financial markets, postal services and several others.

Here's a quick look back at 25 years of fruitful research partnerships.

Created by Jean-Jacques Laffont with the aim of forging an international partnership-based research hub in Toulouse, the IDEI works alongside more than forty partners on a wide range of innovative research themes. For the IDEI researchers, all members of TSE, the brief is two-fold: to be relevant to the economic strategy of firms and the public market regulation policies, whilst also having their work endorsed by the international scientific community through the publication of articles in highly qualitative peer-reviewed journals. Researchers see in these partnerships two main interests: applying their academic work to real-world issues, and

contributing to the decision-making of economic leaders. As for the partnership companies, there are many benefits from getting involved in the IDEI: first of all, they take advantage of a better understanding of the economic science, which, over the past 30 years, has developed into a major decision-making tool, both for top executives and managers. They also enjoy privileged access to the highly skilled pool of TSE researchers and can request policy notes on specific areas of interest. Additionally, they can turn to the IDEI to keep their management up-to-date with market changes, trends and relevant research in economics.

**A word from**  
Jean Tirole,  
IDEI Scientific Director



“ Economics is a positive discipline as it aims to document and analyse individual and collective behaviours. It is also, and more importantly, a normative discipline as its main goal is to better the world through economic policies and recommendations.

## IDEI, IN PRACTICE

A taster of the IDEI's many conceptual innovations over the years:

### 🏭 Competition policy in industrial economy

The opening up to competition in historically regulated markets such as telecoms, electricity, railroad networks, gas and postal services is a major research theme for the IDEI researchers. Their work focuses on the organization of these industries, the design of the rules and the development of strategies both for existing actors and for potential newcomers.

### 💻 Software & IT

For a world leader in IT software, the IDEI has worked on the economics of free and patented software, the understanding of the concept of authority, search engines, the "scarce attention" economy etc. More particularly, the IDEI researchers have analyzed the motivations of contributors and the challenges faced by open source software, as well as the impact of different license types or the task allocation between open-source and patented software. Every other year the IDEI hosts the main European conference on software economics, of which the 8th edition will be held in January 2015.

### 🌐 International payment systems

The IDEI researchers were the first to study how payment system platforms attract both businesses and consumers and to analyze the social impact of their actions. The recommendations made by the IDEI researchers have defined the European Commission policy in this domain.

### @ Two-sided markets

Google, eBay, American Express, Skype, Meetic, Facebook... all examples of platforms hosting two-sided markets. IDEI researchers are at the forefront of research into this concept and have published numerous articles and books that are regularly cited in competition law and business models, especially in the new technologies sector.



**A word from**  
Jacques Crémer,  
IDEI Director, 2002 - 2007

“ I was lucky enough to succeed Jean-Jacques Laffont as IDEI Director, and I was struck by the quality of the relationships between IDEI researchers and partner companies, a quality that is affirmed by the loyalty of those partners - often over decades.

# IDEI celebrates its 25th anniversary



**A word from**  
Patrick Rey,  
IDEI Director, 2007 - 2011

“ IDEI partnerships have allowed us to identify interesting research subjects and to therefore be at the forefront of research in several domains, and to provide our partners with conceptual frameworks adapted to their sectors' challenges and with pertinent empirical perspectives.

## IDEI, IN PRACTICE

### Innovation and intellectual property

The amassing of patents is an important issue which most of today's innovation-based economy is faced with. The IDEI researchers have studied patent pools from a theoretical perspective and identified a simple process to help antitrust commissions to discern the good patent pools from the dangerous ones. This process has been greatly taken into account in the European Commission's directives in 2004 and 2014.

### Energy

Since 1991, the IDEI research teams have been guiding the managers of the world's largest electricity company through the numerous transformations of its business model, organizational structure and processes.

### Banking

The IDEI researchers work closely with banks and French national regulators on the main issues of financial markets - a sector in constant evolution. They propose a more efficient organization of these markets and make recommendations for efficient portfolio and asset management.

### Public economics, health, work and education

Improved collective well-being is directly linked to the implementation of efficient educational policies, good management of public health insurance and retirement schemes, and an effective diffusion of pharmaceutical innovations. The IDEI researchers have proposed new ways to measure the well-being of households, and are working on improved certification norms for medicines.

## IDEI, OUR PARTNERS



And many more...

Full list >>  
[www.idei.fr](http://www.idei.fr)



## Latest TNIT meeting 3 October, Boston

The Toulouse Network for Information Technology (TNIT), funded by Microsoft and managed by the IDEI, aims to stimulate high-quality economic research on the software industry, the role and impact of the internet, and intellectual property.

The network brings together world-class researchers from around the globe. A recent IMF study recognized three of its members among the world's "25 Brightest Young Economists".

TNIT organizes regular meetings for its members to present their work and exchange on the latest developments. This year they met at the Microsoft Research centre in in Boston on 3 October.



TNIT  
web page



TNIT  
2014 meeting



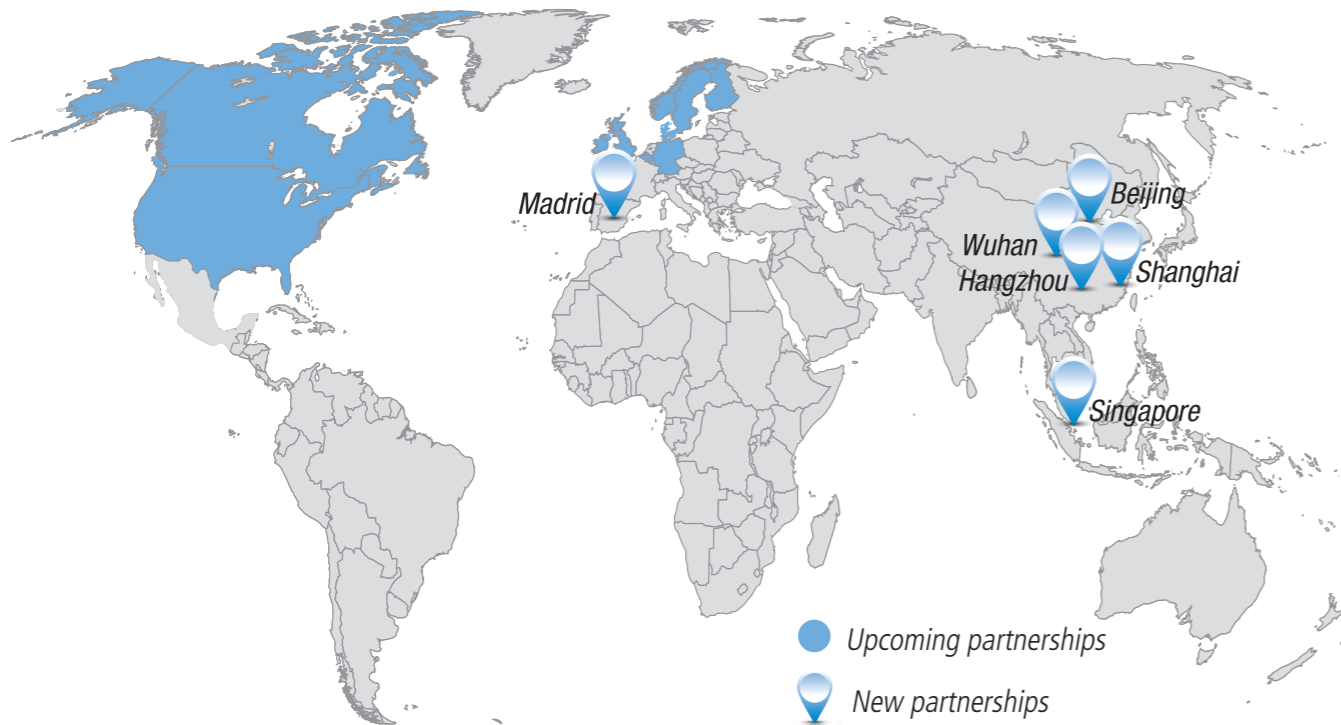
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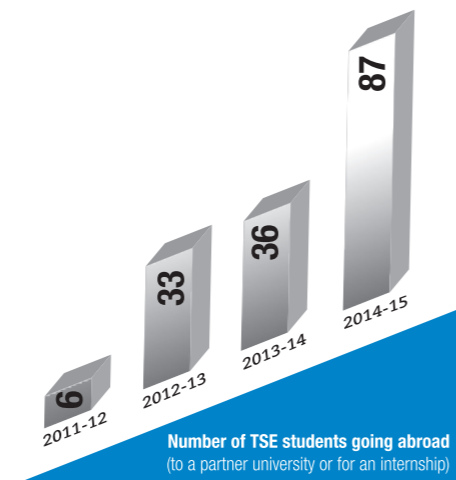
# TSE international partnerships

For TSE, the development of sustainable international partnerships with leading universities worldwide is of the utmost importance, both in terms of research and education. International exchange programmes are key for encouraging students to either study or carry out an internship abroad during their years at TSE.

In this regard, TSE is delighted to have recently forged new exchange programmes in China (Renmin University of China, Shanghai University of Statistics, Tsinghua University, Wuhan University, Zhejiang University), Singapore (Singapore Management University) and Spain (University Carlos III in Madrid). Several other partnerships are planned in Northern Europe and Northern America.



TSE's ongoing investment over recent years in developing partnerships with key universities and providing incentives for students to make the most of the exchange programmes to take a year abroad has paid off.



# The Chinese example



Known for its dynamic society and rising academic excellence, China has a true cultural appeal to our students. Today, more and more TSE students are looking for an exchange in China. Since 2012, we have been developing contacts with leading Chinese universities in economics, and in June this year our teams joined forces with the Toulouse Federal University (COMUE) to send a delegation to finalise five exchange partnerships face-to-face. The trip also allowed us to strengthen our links with Beijing University in view of another potential future partnership.

The first TSE students to benefit from these new programmes are already in the starting blocks: two Law & Economics undergraduates will study this semester at Tsinghua University. The first of a long list of students ready to take up this opportunity to experience first-hand living, studying and working in the world's second-largest economy. The COMUE has also set a Shanghai office whose main mission is to represent the higher education institutes of Toulouse in China and to recruit the students who will come and spend a year at TSE.



# TSE launches its annual graduation ceremony



The very first official TSE graduation ceremony will take place on Saturday 29 November at the Toulouse 1 Capitoles University. The ceremony, chaired by the University President Bruno Sire, TSE's President Jean Tirole, and TSE's executive directors, will also be attended by economic decision-makers including Anne-Juliette Hermant, Global Head of Learning and Development at AXA Group and "godmother" of this year's graduates.

The ceremony offers a unique occasion for TSE to honour its graduates who can be proud to have excelled in TSE's demanding academic environment. Friends and family are invited to the event, which will be followed by a cocktail to celebrate the occasion in style. Get ready to throw your caps into the air!

## SAVE THE DATE



28 November 2014

The third edition of TSE's annual forum allowing students to rub shoulders with business leaders, policy-makers and alumni

Highlights of the 2013 edition >>



# Welcome to our new colleagues

TSE is delighted to welcome its new members at the start of the 2014-15 academic year:

## Professors



**Eric Gautier**  
> ENSAE, Econometrics



**Sebastien Gadat**  
> IMT, Mathematics

## Assistant professor



**Jihyun Kim**  
> Indiana University, Econometrics



> **Curious to find out more?**  
Scan the QR code to watch a 1-minute video profile of each newcomer

## Visiting Professors



**Ryan Chahrouh**  
> Boston College, Macroeconomics



**Zhijun Chen**  
> University of Auckland, Industrial Organisation



**Erzo Luttmer**  
> University of Minnesota, Economic Theory



**Markus Herrman**  
> University of Laval, Environmental economics

## Tribute

### China: conference in honour of Jean-Jacques Laffont



Xinzhu Zhang, former PhD student of the late Jean-Jacques Laffont and currently Deputy Director of the "Institute of Quantitative & Technical Economics" in China, organised a conference in Nanchang in June 2014 in honour of his PhD supervisor and mentor. The conference on "Mechanism Design and Industrial Organization" brought together many high-profile researchers having worked with or been inspired by the works of Jean-Jacques. TSE's President Jean Tirole presented a public lecture on "Have Regulatory Reforms Made Banks Safer?"

## Appointment



### Paul Seabright called to National Innovation Policy Commission

TSE researcher and IAST Director Paul Seabright was recently appointed to the new French National Commission for the evaluation of innovation policies in the research sector. The commission aims to assess the economic impact of such policies and make recommendations for improvement. It also aims to promote examples of good practice in innovation policy, through a national and international review.

## Awards

### Jean Tirole one of the world's "most influential minds"



A Thomson Reuters international study identifies TSE President Jean Tirole as one of the world's most influential scientific minds of 2014. The study uses citation statistics to establish a list of those researchers "performing and publishing work that their peers recognize as vital to the advancement of their scientific field."

### Milo Bianchi Edmond Malinvaud Prize



TSE researcher Milo Bianchi has been awarded the 2014 "Edmond Malinvaud Prize" for his article co-authored with Matteo Bobba on "Liquidity, Risk, and Occupational Choices" published in the Review of Economic Studies. This prize rewards the best scientific article authored by young economists.

## EVENT

### 30 September Environment policy event with French minister & Chinese ambassador



TSE and the Toulouse Capitole University co-hosted a high-level research and policy event on environmental & climate change issues.

Among the special panel members at the roundtable were:

- French Foreign Affairs Minister **Laurent Fabius**
- Chinese Ambassador in France, **Zhai Jun**
- TSE's President **Jean Tirole** and Director **Christian Gollier**
- Professor **Gao Shi-ji**, General Director of the Institute for Resource and Environmental Policies of China
- Professor **Xu He** of Nankai University
- EDF Production and Engineering Executive Director **Hervé Machenaud**
- **Bruno Sire**, UT1 President

EDF Chairman Henri Proglio also joined the participants in the evening of the event.

The prestigious event discussed "The environmental and climatic challenges of growth" thus laying the scientific groundwork for the 21st Conference of the Climate (COP 21) which will take place in Paris.



## IAST NEW RECRUITS

TSE's associated research centre for interdisciplinary advanced studies in the social sciences, the IAST, has also recruited an impressive panel of 11 new research fellows this semester.





# Undergraduate education in economics: what should we teach?



The European Economics Association organised a special panel discussion during the recent congress on the changing face of teaching undergraduate economics in today's ultra technological world. Here is a quick flavour of the discussions:

## Teaching introduction to economics as if the last thirty years had happened

**Wendy Carlin (UCL)** opened the session by suggesting that today's courses in economics are three decades out of date; increasingly remote from what economists now know, and more distant still from the pressing problems of today's society that drew students to economics in the first place. In response to widespread discontent among students, employers, and university teachers, Wendy and a team of international academics have created "CORE": Curriculum Open-access Resources in Economics. The project provides a new approach to the design, content and way of teaching the core economics curriculum for undergraduates, producing open access on-line resources, including e-book course material for students with interactive content including diagrams, data and videos. A step towards "bringing economics alive for students", Wendy hopes.

**Website**  
<http://core-econ.org>



## Teaching what matters where it really matters: developing economics teaching for developing economies

Based on his own experiences in Russia and neighbouring countries, **Sergei Guriev (Sciences Po)** discussed the challenges of teaching economics in emerging markets. According to Sergei, the main difference from the Western world is that in developing countries the public have little idea how markets actually work, leading to varying beliefs on what economics is. This lack of common ground makes having a shared, common curriculum in economics all the more necessary. In emerging zones, economics teachers need to explain why governments and markets fail in those countries, with simple, accessible ways of teaching models and how to use them, so that the students feel they can use these models to understand what's happening around them and engage with policymakers. Faced with teacher shortages, emerging countries need to make good use of web 2.0 tools with wiki principles to accommodate local examples, contexts and data into their courses. According to Sergei, "the main challenge is to create a mechanism, not just a textbook".



## From guru to coach: how technology is transforming the content of what we teach as well as the way we teach it



**Paul Seabright, TSE** researcher and Director of the Institute for Advanced Study in Toulouse (IAST), suggested in his talk that teachers in economics today are no longer the "great wise masters" of long-gone days. The cost of educating teachers has increased five-fold over the past thirty years, while the cost of disseminating content has dropped to virtually zero. One might expect this cost shock to have led to a substitution of the cheap input for the more expensive one.

But information and teaching time are not so much substitutes as complements in the teaching process: students need teachers to help them process and understand the vast amounts of information at their disposal. However, with the phenomenal development of the internet



and related technologies, information has become so plentiful that teachers cannot realistically pre-process it all themselves, and they have hence been knocked off their "guru" pedestal. So, in today's information overload world, teachers in economics have shifted from being information sources to information screeners and analysts, a sort of "gatekeeper" to help students concentrate their scarce attention and navigate safely across the great "big data" seas we are all faced with. Less glamorous surely than being a guru, but more in tune with today's world. It remains to be seen how teachers will adapt to and accept this role.



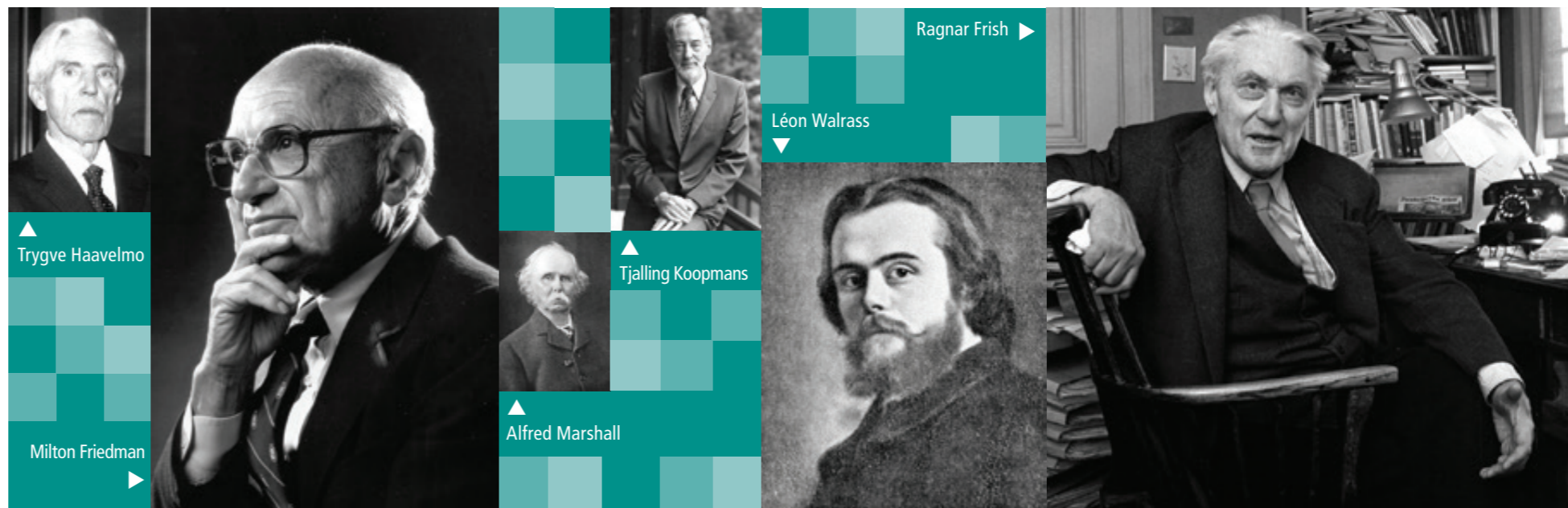
Watch the video of the session



## Sylvain Chabé-Ferret

# A very brief history in econometrics

*One of my secret manias (and one that I am less ashamed to admit) is an interest in the history of econometrics. With such an inclination, the two successive sessions of the EEA-ESEM meeting on the history of econometric thought were obviously an absolute delight to me. Here, I am going to try to convey some of the excitement that I got out of these sessions via a quick summary of the papers presented:*



In the first talk of the first session, John Aldrich detailed how the father of modern econometrics, Trygve Haavelmo, contributed to the understanding and formalization of the concept of causality. John especially emphasized the modernity of Haavelmo's views on this topic and how they have resurfaced in more recent literature. Marcel Bouman then described the interaction between Milton Friedman and the members of the Cowles Commission, the founders of modern econometrics. Both interacted in the late forties in Chicago. Marcel gave a fascinating account of how involved Friedman was in methodological debates of the time, eventually yielding his well-known essays in positive economics. Friedman was at the time extremely critical of the strong theorisation of econometrics promoted by the then Cowles Commission president Tjalling Koopmans (Marcel quoted from an unpublished assessment by Friedman of the works of the Cowles commission). At some point, Friedman defied Koopmans and one of his boys, Lawrence Klein, to check whether the complex macro simultaneous equations model estimated on pre-war data could predict macro conditions in 1948. This was a dismal failure and yielded Klein to reassess his model. Marcel put this debate

in perspective by recalling how it echoed the views of early economists Alfred Marshall on one side and Léon Walras on the other. Till Doppe then presented a thorough account of a trip taken by Tjalling Koopmans to the Soviet Union in 1976. Koopmans was very keen to discover if the linear programming methods developed by Leonid Kantorovich were applied in practice by the planning bureau of the Soviet Union. What he found was a very dispirited Kantorovitch, saying that they might have read about it, at least it was somewhere in published form. Koopmans was also somewhat disappointed by the quality

of economics research that he found there. He was however extremely impressed to meet with some of the most outstanding mathematicians of the world.

The next session started with a minutely accurate description by Olav Bjerkholt of the first meeting of the econometrics society in 1931 in Lausanne. What struck me most was the impressive imprint that Ragnar Frish left on this meeting and on the early years of the econometric society. While Paul Divisia, the Vice President officially in charge of organizing the meeting was preoccupied by such urgent matters as choosing the suitable French translation of "econometrician," Frish used his spare time while recovering from a skiing accident to write a sketch of a programme and one of the three papers he presented at the conference. Frish also insisted that the conference be opened with a presentation of some of the works of six of the founding fathers of economics (Marshall was not one of them). This echoes evidence given by Marcel Bouman that early Econometrica issues published handwritten notes by Walras, along with his correspondence with other economists. Duo Qin then advocated the return of the use of the terms autonomy and confluence in modern econometrics textbooks. These

terms were coined by Frish to separate what we now call structural and reduced form relationships. These late notions were in fact derived from the earlier notions by Tjalling Koopmans. The great advantage of the term "autonomy" is that it puts emphasis on the fact that we are looking for invariant relationships that remain true when the other relations in the economy change. The renowned Lucas critique is in a sense a mere application of the notion of autonomy, which Lucas acknowledged explicitly in his paper. Next, Cléo Chassonery-Zaïgouche presented the evolution of the empirical analysis of discrimination. She notably showed that the traditional econometric techniques developed in the 70s in the Cowles tradition have been progressively replaced by experiments. Although this trend is not apparent in the number of papers published in top journals, it is clear in the influence of the published papers: experiments gain much more citations. Finally, Jan Höffler presented an exciting collaborative wiki project on replication in economics. With his colleagues, he has set up a list of the published papers in top journals with a link to the data sets and code. They are now trying to replicate the authors' findings. Being a collaborative project, anyone can report the results of

his own replication exercise on the web page. An exciting exercise for students in econometrics.

Sylvain Chabé-Ferret - TSE researcher



### PROFILE

> Sylvain Chabé-Ferret is assistant professor at TSE & INRA researcher. He first studied at AgroParisTech. He holds a PhD in economics from the University of Auvergne. He spent a post-doctoral year visiting Cowles Foundation and the Department of Economics at Yale University and worked at IRSTEA, a government-run research centre focused on environmental policies, before joining TSE. Sylvain specialises in the econometrics of causal inference with applications to environmental and labour economics.

### FIND OUT MORE...

[An Economist's Journey: new blog](#)

Enjoyed reading this article? Delve deeper into Sylvain's "scientific kitchen" via his new blog, where he hopes to "take prospective readers throughout the journey of a young academic economist trying to advance economic science along with his own career..."



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