

Report on Master Thesis

Institute of Economic Studies, Faculty of Social Sciences, Charles University in Prague

Student:	Jitka Šenkýřová
Advisor:	Jaromír Baxa, Ph.D.
Title of the thesis:	Influence of Culture on Macroeconomic Stability

The thesis runs a skilled yet conventional panel data estimation to answer an unconventional country-level research question, namely how cultural indicators affect macroeconomic instability. This is a very challenging question, given (i) a rather broad definition of culture and (ii) the vast range of potential channels through which culture may affect economy.

My broad opinion is that this particular research task is overambitious for a Master student, the methodology has a great number of shortcomings, and consequently the estimates achieved are hard to use. The main shortcomings of the proposed standard panel approach to tackle this research questions are as follows:

1. Essentially, the research question lacks any attempt for structural estimation. Simply, we do not know which structural processes the model aims to capture. There are potentially very many channels through which culture may influence an economy, and this blind approach is silent on identifying these particular channels. Therefore, the risk of omitted-variable bias is huge in my view.
2. The omission of key details makes it very difficult to assess the value added by this exercise. For instance, the instability index comprises public debt, inflation as well as external balance. But for each component, there is a huge and separate literatures on the institutional determinants. I see it as impossible to construct an index which merges all the literatures on the determinants of public debt, inflation and external balance into one.
3. In my view, the author overestimates variance in the cultural dimension. (On p. 17, "The optimal way ... is to test the complex panel ... In this work such panel data are tested.") The standard research that employs long-time data (e.g. informal institutions, including language and informal rules) typically uses some instruments associated with random events in the past. In this thesis, there is not even an attempt to construct any instrument.
4. Culture is essentially invariant in short time horizons (on p. 16, "individual outcomes are stable"). This is not an advantage but rather a challenge for identification.
5. Culture penetrates all aspects, including policy-making, markets and household behavior. In my view, all control variables are potentially dependent on the culture. For example, Power Distance is likely to be related to Democracy. The links between Trust and Governance are also established. Education will be likely related to Femininity (i.e., „feminine societies will likely grant women access to education), etc..
6. Controls are very ad hoc. For example, Eurozone membership is a very special control. Typical institutional controls such as legal systems origin are not employed (only continental dummies are checked). Also, I would expect that conventional country variables that are obviously related to instability, such as openness or financial markets integration, to be included. I am not surprised that controls give weird results such that democracy or trust generates more macroeconomic instability.
7. Endogeneity is non-trivial if such variables are combined. For instance, the abstract states that fear about uncertainty is a determinant of macroeconomic instability. Common wisdom however supports the link in the opposite direction; namely instability should generate fear about uncertainty (a nice example about long-run effects of macroeconomic stability upon risk-taking is in a famous paper by Ulrike Malmendier & Stefan Nagel, 2011. "Depression Babies: Do Macroeconomic Experiences Affect Risk Taking?," *The Quarterly Journal of Economics*, 126(1), pages 373-416.). In my view, it is extremely difficult to disentangle the two effects. I can imagine models where both of the two variables are determined in the equilibrium, hence both depend on each other. (A closely related example exploiting WVS data and income distribution is Alesina, Alberto, and George-Marios Angeletos. "Fairness and redistribution." *American Economic Review* (2005): 960-980.)
8. It seems that the author does not even recognize the differences between causality and correlation. In Conclusions, for instance, the effect of Hard Work upon instability is explained in the following way: "The explanation might be that mainly in countries where the most of the people do not have satisfactory living conditions the high percentage of

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them chooses ... Hard Work ..." Well, but this argument assumes an endogenous explanatory variable!

9. Endogeneity is side-stepped by arguing that explanatory variables (culture) is stable in time. I do not understand this point and recommend the committee to discuss this point in details.
10. For instability, I would expect rather variation in the growth rates or variation of any standard business cycle indicator. This would easily generate a cross-sectional analysis which seems, given stability of the culture variables, more appropriate.
11. The focus on business cycle indicators may reveal different things. For example, I suppose that culturally mostly individualistic societies are also associated with financing through mostly developed financial markets, which however also means more volatility in asset prices and more pronounced business cycles.
12. One may also discuss whether inflation is truly a measure of instability if even inflation-targeting central banks prefer low but positive inflation. (That is, a downward deviation is also a sign of instability.) Similarly, unemployment, in view, is not very much related to ordinary understanding of instability but reflects long-run inefficiencies.

In spite of my comments, I would like to stress that the thesis is well executed and the author clearly proves her ability to work well with the panel data. Thus, the thesis definitely deserves to be **defended**. Its only shortcoming is that it aims to crack a complex question with inappropriate tools.

SUMMARY OF POINTS AWARDED (for details, see below):

CATEGORY	POINTS
<i>Literature</i> (max. 20 points)	12
<i>Methods</i> (max. 30 points)	20
<i>Contribution</i> (max. 30 points)	10
<i>Manuscript Form</i> (max. 20 points)	20
TOTAL POINTS (max. 100 points)	62
GRADE (1 - 2 - 3 - 4)	2

NAME OF THE REFEREE: *Martin Gregor*

DATE OF EVALUATION: *January 20, 2015*



Referee Signature