

# Q&A...

with Benjamin Lester,  
a senior economic advisor  
and economist here at the  
Philadelphia Fed.



## Benjamin Lester

Benjamin Lester is a senior economic advisor and economist at the Philadelphia Fed. He grew up in suburban Philadelphia and first encountered economics while a student at the Lawrenceville School. He earned his bachelor's in economics from Cornell in 2002 and his doctorate from the University of Pennsylvania in 2007. After teaching at the University of Western Ontario for four years, he joined the Research Department of the Philadelphia Fed, where he specializes in studying how market frictions affect real-life markets.

## What led you to become an economist?

I always loved mathematics. I got to Cornell thinking, "I'm good at math, so I'll major in it." But then I saw people who are really good at math, and I thought, "I'm not going to be a mathematician." That's when I started taking economics classes. As an economist, you're not a pure mathematician, but you use applied quantitative skills to answer interesting questions.

## Tell us about your interest in market frictions.

In the classic model of supply and demand, no one asks, who traded with who? How did they find each other? How did they settle on that price? That's all brushed under the rug. But think about the housing market. You can't go to the housing market and say, houses are selling at this price and I'll take one. You have to see a house, make an offer, maybe your offer is rejected or maybe the seller makes a counteroffer. The terms of trade are determined bilaterally. It's not as if there's a price for a house.

And it's not as if you know everything about the house. Maybe the furnace is on its last legs, or the neighbors are loud. Knowing that the owner knows more than you do, how does this affect your offer?

Some of these frictions are associated with what economists call search frictions, which refers to the idea that it's often hard—or it takes time—for buyers and sellers who are natural trading partners to find each other and negotiate a price. And where there are search frictions, there are often also information frictions, which occur when one side of a transaction knows more than the other.

As I studied these two frictions, I realized that they fit together. Solving a model with search frictions requires characterizing the terms of trade between two people. Meanwhile, much of the literature on information frictions starts with understanding how two people with different information may or may not trade.

**But hasn't the digital revolution done away with many of these frictions? After all, thanks to digital technology we are swamped with information, and finding a counterparty should be much easier.**

Not always. I'll give you an example. Decades ago, stock exchanges turned equities into a fairly frictionless market. If you want to buy stock in IBM, give me three seconds, I'll check my computer, I'll tell you the price, and I'll trade at that price. But the corporate bond market is not like that at all. If you want to buy a corporate bond, you call up a dealer and say, "I'm looking for this particular bond with this maturity." And they might say, "OK, let me see if I can find that bond. I'll get back to you." Maybe you buy at their price, or maybe you call another dealer. That falls into the search model I've been working on, where it takes time to find and negotiate with a counterparty. For some reason, older technologies seem to be valuable to some market participants.

**You conclude your article for *Economic Insights* by writing, "the Fed's March 23 announcement of the SMCCF... calmed investors and reduced withdrawals from funds." That sounds to me like a psychological response. Where does psychology fit into the models of market frictions?**

When I write about calming the market, I'm thinking about agents who are rational and forward-looking. If I'm a perfectly rational, forward-looking agent, I have reason to be concerned at the beginning of a crisis. I'm not sure who's going to buy my asset. Or there's a lot of uncertainty about the quality of this asset. I'm worried that maybe the rest of the market knows something I don't about my asset. That might make me want to sell it right now. If the Fed says, "We're going to buy these assets," it lessens those worries that derive from information frictions. I use terms that have a psychological interpretation, but I use them within a perfectly rational paradigm. In behavioral economics models, people are systematically biased. But I'm thinking about a world where they're not biased, and policies can resolve inefficiencies that come from frictions. [\[1\]](#)

## Notes

**1** The Secondary Market Corporate Credit Facility allows the Fed, for the first time, to directly purchase investment-grade corporate bonds issued by U.S. companies.