Abstracts

Volatility, Labor Market Flexibility, and the Pattern of Comparative Advantage
Alejandro Cuñat, University of Vienna and Marc J. Melitz, Harvard University

This paper studies the link between volatility, labor market flexibility, and international trade. International differences in labor market regulations affect how firms can adjust to idiosyncratic shocks. These institutional differences interact with sector specific differences in volatility (the variance of the firm-specific shocks in a sector) to generate a new source of comparative advantage. Other things equal, countries with more flexible labor markets specialize in sectors with higher volatility. Empirical evidence for a large sample of countries strongly supports this theory: the exports of countries with more flexible labor markets are biased towards high-volatility sectors. We show how differences in labor market institutions can be parsimoniously integrated into the workhorse model of Ricardian comparative advantage of Dornbusch, Fischer, and Samuelson (1977). We also show how our model can be extended to multiple factors of production.

Financial Development and Vertical Integration: Theory and Evidence
Rocco Macchiavello, University of Warwick

Existing evidence is mostly inconclusive on the relevance of financial development as a determinant of vertical integration. This paper presents evidence that, once industry heterogeneity in firm size distribution is taken into account, financial development is an important determinant of cross-country differences in vertical integration. Financial development fosters entry of firms and increases competition in the industry. This reduces vertical integration of larger firms, but also leads smaller, non-integrated, firms to exit the industry. As a result, higher financial development reduces vertical integration in industries where a high share of output is produced by small firms. The positive effect of financial development on entry also reduces vertical integration by fostering the development of input markets.

Job Market Signaling of Relative Position, or Becker Married to Spence
Ed Hopkins, University of Edinburgh

This paper considers a matching model of the labour market where workers, with private information on their quality, signal to firms that also differ in quality. Signals allow assortative matching in which the highest quality workers send the highest signals and are hired by the best firms. Matching is considered both when wages are rigid (non-transferable utility) and when they are fully flexible (utility is transferable). In both cases, equilibrium strategies and payoffs depend on the distributions of types of workers and the distribution of firms. This is in contrast with separating equilibria of the standard model which do not respond to changes in supply or demand. With sticky wages, despite incomplete information, equilibrium investment in education by low ability workers can be inefficiently low and this distortion can become worse in a more competitive environment. In contrast, with flexible wages, greater competition improves efficiency.

Which Sectors Make Poor Countries so Unproductive?
Berthold Herrendorf, Arizona State University and Akos Valentinyi, National Bank of Hungary

Which sectors are mostly responsible for the low total factor productivities (TFP) of developing countries? To answer this question we develop a new framework for sectoral development accounting. Applying this framework to the Penn World Table, we find that in equipment, construction, and food the sectoral TFP differences between developing countries and the United States are much larger than on the aggregate. In contrast, in manufactured consumption the sectoral TFP differences are about equal to the aggregate TFP differences and in services they are much smaller. We show that our level of disaggregation allows us to reconcile the results of existing studies of sectoral productivity
differences, which have focused on non-comparable two-sector decompositions of the aggregate data. We also show that our results help us shed light on various theories of aggregate TFP differences.

**Willpower and the Optimal Control of Visceral Urges**  
Emre Ozdenoren, London Business School, Steve Salant, University of Michigan, and Dan Silverman, University of Michigan

Common intuition and experimental psychology suggest that the ability to self-regulate ("willpower") is a depletable resource. We investigate the behavior of an agent with limited willpower who optimally consumes over time an endowment of a tempting and storable consumption good or "cake." We assume that restraining consumption below the most tempting feasible rate requires willpower. Any willpower not used to regulate consumption may be valuable in controlling other urges. Willpower thus links otherwise unrelated behaviors requiring self-control. An agent with limited willpower will display apparent domain-specific time preference. Such an agent will almost never perfectly smooth his consumption, even when it is feasible to do so. Whether the agent relaxes control of his consumption over time as experimental psychologists predict or tightens it as most behavioral theories predict depends in our model on the net effect of two analytically distinct but opposing forces.

**Does Employment Protection Create Its Own Political Support?**  
Björn Brügemann, Yale University

This paper investigates the ability of employment protection to generate its own political support. A version of the Mortensen–Pissarides model is used for this purpose. If wages are set through Nash bargaining, workers value employment protection because it strengthens their hand in wage negotiations. Workers in high productivity matches benefit most from higher wages as they expect to stay employed for longer. By reducing turnover employment protection shifts the distribution of match-specific productivity toward lower values. Thus stringent protection in the past actually reduces support for employment protection today. Introducing involuntary separations reverses this conclusion. Now workers value employment protection because it delays involuntary dismissals. Workers in low productivity matches gain most since they face the highest risk of dismissal. The downward shift in the productivity distribution is now a shift towards supporters.

**Education and Mobility**  
Stephen Machin, University College London, Panu Pelkonen, University of Sussex, and Kjell G. Salvanes, Norwegian School of Economics

We show that the length of compulsory education has a causal impact on regional labor mobility. We reach this conclusion from an analysis of a quasi-exogenous staged Norwegian school reform, using register data on the whole population. Based on the results, we conclude that part of the US–Europe difference, as well as the European North–South difference in labor mobility, is likely to be due to differences in levels of education in the respective regions.