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Abstracts

JEEA-BBVA Lecture 2012: Use and Abuse of Authority: A Behavioral Foundation of the Employment Relation

Björn Bartling, University of Zurich, Ernst Fehr, University of Zurich and Klaus M. Schmidt, University of Munich

Employment contracts give a principal the authority to decide flexibly which task his agent should execute. However, there is a tradeoff, first pointed out by Simon (1951), between flexibility and employer moral hazard. An employment contract allows the principal to adjust the task quickly to the realization of the state of the world, but he may also abuse this flexibility to exploit the agent. We capture this tradeoff in an experimental design and show that principals exhibit a strong preference for the employment contract. However, selfish principals exploit agents in one-shot interactions, inducing the latter to resist entering into employment contracts. This resistance to employment contracts vanishes if fairness preferences in combination with reputation opportunities keep principals from abusing their power, leading to the widespread, endogenous formation of efficient long-run employment relations. Our results inform the theory of the firm by showing how behavioral forces shape an important transaction cost of integration – the abuse of authority – and by providing an empirical basis for assessing differences between the Marxian and the Coasian view of the firm, as well as Alchian and Demsetz’s (1972) critique of the Coasian approach.

Misbehavior, Education, and Labor Market Outcomes

Carmit Segal, University of Zurich

Using data on young men from the National Education Longitudinal Survey, this paper investigates the relationship between education and labor market outcomes and childhood misbehavior. The main finding is that eighth-grade misbehavior is important for earnings over and above eighth-grade test scores. Moreover, controlling for educational attainment, childhood misbehavior is associated with earnings at all educational levels. By contrast, achievement test scores are only related to earnings for young men with postsecondary degrees. Possible explanations for the association between eighth-grade misbehavior and economic success are explored.

Social Networks in the Boardroom

Francis Kramarz, CRESt (ENSAE) and David Thesmar, HEC School of Management

This paper provides evidence that social networks strongly affect board composition and are detrimental to corporate governance. Our empirical investigation relies on a large data set of executives and outside directors of French public firms. This data source is a matched employer–employee data set that provides detailed information on directors/CEOs as well as information about the firm employing them. We find a strong and robust correlation between the CEO’s network and that of his directors. Networks of former high-ranking civil servants are the most active in shaping board composition. Our identification strategy takes into account not only firm and directors’ fixed effects but also the matching of firms and director in terms of one observable and one unobservable characteristic. Turning to the direct effects of such network activity, we find that firms in which these networks are most active pay their CEOs more, are less likely to replace a CEO who underperforms, and engage in less value-creating acquisitions. These findings suggest that social networks are active in the boardroom and have detrimental effects on firms’ governance.
The Unequal Enforcement of Liberalization: Evidence from Russia’s Reform of Business Regulation

Evgeny Yakovlev, UC Berkeley and Ekaterina Zhuravskaya, Paris School of Economics (EHESS) and the New Economic School

We document the unequal enforcement of liberalization reform of business regulation across Russian regions with different governance institutions, which leads to unequal effects of liberalization. National liberalization laws were enforced more effectively in sub-national regions with more transparent government, a more informed population, a higher concentration of industry, and stronger fiscal autonomy. As a result, liberalization had a substantial positive effect on the performance of small firms and the growth of the official small business sector in regions with stronger governance institutions. In contrast, in regions with weaker governance institutions, we observe no effect of reform and, in some cases, even a negative effect.

Do Lab Experiments Misrepresent Social Preferences? The Case of Self-Selected Student Samples

Armin Falk, University of Bonn, Stephan Meier, Columbia University and Christian Zehnder, University of Lausanne

Social preference research has received considerable attention among economists in recent years. However, the empirical foundation of social preferences is largely based on laboratory experiments with self-selected students as participants. This is potentially problematic as students participating in experiments may behave systematically different than non-participating students or non-students. In this paper we empirically investigate whether laboratory experiments with student samples misrepresent the importance of social preferences. Our first study shows that students who exhibit stronger prosocial inclinations in an unrelated field donation are not more likely to participate in experiments. This suggests that self-selection of more prosocial students into experiments is not a major issue. Our second study compares behavior of students and participants recruited from the general population in a trust experiment. In general, we find very similar behavioral patterns for the two groups, but non-students make significantly more generous repayments suggesting that results from student samples might be seen as a lower bound for the importance of prosocial behavior.

Do Wage Cuts Damage Work Morale? Evidence from a Natural Field Experiment

Sebastian Kube, University of Bonn, Michel André, Maréchal, University of Zurich and Clemens Puppe, University of Karlsruhe

Employment contracts are often incomplete, leaving many responsibilities subject to workers' discretion. High work morale is therefore essential for sustaining voluntary cooperation and high productivity in firms. We conducted a field experiment to test whether workers reciprocate wage cuts and raises with low or high work productivity. Wage cuts had a detrimental and persistent impact on productivity, reducing average output by more than 20%. An equivalent wage increase, however, did not result in any productivity gains. The results from an additional control experiment with high monetary performance incentives demonstrate that workers could still produce substantially more output, leaving enough room for positive reactions. Altogether, these results provide evidence consistent with a model of reciprocity, as opposed to inequality aversion.

Outsourcing when Investments are Specific and Interrelated

Alla Lileeva, York University and Johannes Van Bisebroeck, K.U. Leuven

Using the universe of large Canadian manufacturing firms in 1988 and 1996, we investigate to what extent outsourcing patterns concord with the predictions of a simple property rights model. The unique availability of disaggregate information on outputs as well as inputs permits the construction of a detailed measure of vertical integration. We rely on five measures of technological intensity to proxy for investments that are likely to be specific to a buyer-seller relationship. A theoretical model that allows for varying degrees of investment specificity and interrelatedness---externalities between buyer and supplier investments---guides the analysis. Property rights predictions on the link between
investment intensities and optimal ownership are strongly supported, but only for transactions with low interrelatedness. High specificity and low risk of appropriation strengthen the predictions in the model and in the data.

**Separating Moral Hazard from Adverse Selection and Learning in Automobile Insurance: Longitudinal Evidence from France**  
George Dionne, HEC Montreal, Pierre-Carl Michaud, University du Quebec and Maki Dahchour, Aviva Canada

The identification of information problems in different markets is a challenging issue in the economic literature. In this paper, we study the identification of moral hazard from adverse selection and learning about risk within the context of a multi-period dynamic model. We extend the model of Abbring et al. (2003) to include learning about risk and insurance coverage choice over time. We derive testable empirical implications for panel data. We then perform tests using longitudinal data from France during the period 1995-1997. We find evidence of moral hazard among a sub-group of policyholders with less driving experience (less than 15 years). Policyholders with less than 5 years of experience have a combination of learning about risk and moral hazard, whereas no residual information problem is found for policyholders with more than 15 years of experience.

**Do Public Ownership and Lack of Competition Matter for Wages and Employment?**  
Dora L. Blaise Melly, Brown University and Patrick A. Puhani, Leibniz Universität Hannover and SEW, University of St. Gallen

Do public sector firm ownership and lack of competition matter for wages and employment? To address this question, we consider a large public sector company that is privatized. Using personnel records, we find employment contract liberalization to generate relative wage losses for older, high-tenure, low-skilled, part-time workers, permanent residents, and women. Employment reductions mostly affect the same groups experiencing a wage decline. Overall, wage liberalization leads to an increase in wage inequality of between 6 and 9 percent, which – if applied to the whole public sector – would lead to a 52 to 76 percent closure of the “inequality gap” between the private and public sectors in Europe. Our results suggest that differences between public and private sector wage structures found in descriptive studies are to a large extent causal rather than the result of selection into these sectors and that public sector employment and career path regulations limit a firm’s ability to maintain a competitive workforce.

**Firm Default and Aggregate Fluctuations**  
Tor Jacobson, Sveriges Riksbank, Jesper Lindé, Federal Reserve Board and Kasper Roszbach, Sveriges Riksbank

This paper studies the relationship between macroeconomic fluctuations and corporate defaults while conditioning on industry affiliation and an extensive set of firm-specific factors. By using a panel data set for virtually all incorporated Swedish businesses over 1990-2009, a period which includes a full-scale banking crisis, we find strong evidence for a substantial and stable impact from aggregate fluctuations on business defaults. A standard logit model with financial ratios augmented with macroeconomic factors can account surprisingly well for the outburst in business defaults during the banking crisis, as well as the subsequent fluctuations in default frequencies. Moreover, the effects of macroeconomic variables differ across industries in an economically intuitive way. Out-of-sample evaluations show that our approach is superior to models that exclude macro information and standard well-fitting time-series models. Our analysis shows that firm-specific factors are useful in ranking firms' relative riskiness, but that macroeconomic factors are necessary to understand fluctuations in the absolute risk level.