Civil Society and the State: The Interplay between Cooperation and Minimum Wage Regulation
Philippe Aghion, Harvard University, Yann Algan, Science Po, and Pierre Cahuc, Ecole Polytechnique

In a cross-section of countries, state regulation of labor markets is negatively correlated with the quality of labor relations. In this paper, we argue that these facts reflect different ways of regulating labor markets, either through the state or through the civil society, depending on the degree of cooperation in the economy. We rationalize these facts with a model of learning of the quality of labor relations. Distrustful labor relations lead to low unionization and high demand for direct state regulation of wages. In turn, state regulation crowds out the possibility for workers to experiment negotiation and learn about the potential cooperative nature of labor relations. This crowding out effect can give rise to multiple equilibria: a “good” equilibrium characterized by cooperative labor relations and high union density, leading to low state regulation; and a “bad” equilibrium, characterized by distrustful labor relations, low union density and strong state regulation of the minimum wage. (JEL: J30, J50, K00)

Forgetting We Forget: Overconfidence and Memory
Keith M. Marzilli Ericson, Harvard University

Do individuals have unbiased beliefs, or are they over- or underconfident? Overconfident individuals may fail to prepare optimally for the future, and economists who infer preferences from behavior under the assumption of unbiased beliefs will make mistaken inferences. This paper documents overconfidence in a new domain, prospective memory, using an experimental design that is more robust to potential confounds than previous research. Subjects chose between smaller automatic payments and larger payments they had to remember to claim at a six-month delay. In a large sample of college and MBA students at two different universities, subjects make choices that imply a forecast of a 76% claim rate, but only 53% of subjects actually claimed the payment. (JEL: C91, D81, D83, D84)

What Determines Entrepreneurial Clusters?
Luigi Guiso, European University Institute and Einaudi Institute for Economic and Finance, and Fabiano Schivardi, University of Cagliari and Einaudi Institute for Economic and Finance

We contrast two potential explanations of the substantial differences in entrepreneurial activity observed across geographical areas: entry costs and external effects. We extend the Lucas model of entrepreneurship to allow for heterogeneous entry costs and for externalities that shift the distribution of entrepreneurial talents. We show that these assumptions have opposite predictions on the relation between entrepreneurial activity and firm level TFP: with different entry costs, in areas with more entrepreneurs firms’ average productivity should be lower; with heterogeneous external effects it should be higher. We test these implications on a sample of Italian firms and unambiguously reject the entry costs explanation in favor of the externalities explanation. We also investigate the sources of external effects, finding robust evidence that learning externalities are an important determinant of cross-sectional differences in entrepreneurial activity. (JEL: D24, D62, J23)
Is the Elasticity of Intertemporal Substitution Constant?
Thomas F. Crossley, University of Cambridge and Institute for Fiscal Studies and Hamish W. Low, University of Cambridge and Institute for Fiscal Studies

In all common models of inter-temporal allocation, the assumption of a constant elasticity of intertemporal substitution (EIS) imposes surprising limitations on within period budget allocations. Consequently, the constant EIS assumption can be tested with demand data. In fact, the EIS is pinned down completely by the shape of Engel curves: if the EIS is constant then the EIS can be estimated without variation in the interest rate. That a price elasticity can be estimated without variation in the relevant price illustrates just how strong the constant EIS assumption is. The constant EIS assumption is rejected by demand data. (JEL: D91, E21, D12)

Screening Disability Insurance Applications
Philip de Jong, University of Amsterdam and Aarts, De Jong, Wilms & Goudriaan Public Economics B.V., Maarten Lindeboom, VU University Amsterdam and Tinbergen Institute, HEB & Netspar, and Bas van der Klaauw, VU University Amsterdam and Tinbergen Institute and CEPR

This paper investigates the effects of stricter screening of disability insurance applications. A large-scale experiment was setup where in two of the 26 Dutch regions caseworkers of the disability insurance administration were instructed to screen applications more stringently. The empirical results show that stricter screening reduces long-term sickness absenteeism and disability insurance applications. We find evidence for direct effects of stricter screening on work resumption during the period of sickness absence and for self-screening by potential disability insurance applicants. Furthermore, stricter screening improves targeting efficiency without inducing negative spillover effects on the inflow into unemployment insurance. (JEL: C93, H53, I18)

Financial Globalization and the Governance of Domestic Financial Intermediaries
Thierry Tressel, International Monetary Fund and Thierry Verdier, Paris-Jourdan Sciences Economiques (PSE) and University of Southampton

We model a small open economy in which both domestic financial intermediaries and entrepreneurs face incentive constraints, as in Holmstrom and Tirole (1997), to study the general equilibrium impact of various types of capital inflows on the efficiency and governance of domestic banks. Banks have an advantage in monitoring firms, but the latter can collude with banks and offer side-payments to reduce the intensity of monitoring. Opening up to international capital flows makes domestic banks' capital scarcer relative to uninformed capital, thus increasing the relative cost of monitoring. We show that capital account liberalization has ambiguous effects on the governance of the domestic financial system by sometimes increasing firms' incentives to collude with banks. We characterize the conditions under which governance is more likely to deteriorate after opening up the capital account, and discuss the effects on investment, productivity and output. We also analyze the effects of foreign direct investment in the corporate and banking sectors. Stylized facts are consistent with the predictions of the model. (JEL: G21, F34, O16)