Economic Development and the Organization of Production

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Abstract

How important is managerial talent in accounting for cross country income differences? We address this question using a model that distinguishes between workers human capital and managers human capital. In our model, the ablest people leverage their talent and this has important consequences for a country's standard of livings. A key object for the existing literature argument is the returns to schooling. Once we distinguish between workers and managers: returns to schooling appear as profits rather than wages. We consider an overlapping generations economy where each individual chooses to be a manager or a worker depending on its human capital (as in Lucas, 1978), individual accumulate human capital both in school and on the job (as in Ben-Porath, 1967), and production occurs in teams where there is sorting between workers and managers (as in Garicano and Rossi-Hansberg, 2006). By nesting a model of managerial occupational choice and endogenous skill accumulation in a framework in which the span of control is endogenous, we develop a rich framework that yields a number of empirical implications. We find that (1) aggregate output is more sensitive to managerial talent than worker talent, (2) the span of control of managers is constrained by workers human capital, and (3) small variations in human capital can have large effects on wages and profits so that incentives to accumulate human capital at the top of the distribution are large. We calibrate the model to the US economy and show that it can rationalize simultaneously the life-cycle of wages of managers and workers as well as the life-cycle of firms. We then ask how much variations do we need to account for output per capita differences? Preliminary results show that modest distortions can lead to large income differences.

Keywords: human capital, sorting, occupational choice, managers