Reading List for Second Half of the Course (Davis)

Books
The four books listed here treat topics that are closely related to the course. I will place these books on reserve in Regenstein with 4-hour privileges.

Course Outline and Annotated Reading List
All readings can be found online. Unless otherwise noted, you should read the published version.
** = Papers considered in lectures; required reading for the course.
* = Papers treated briefly in lectures, or which are useful complements to papers covered in lectures; highly recommended readings.
No ** or * = other suggested readings if you want to explore a particular topic

I. Using Large-Scale Longitudinal Business Databases: Selected Studies
Papers in this section use large-scale longitudinal business databases to study business dynamics, labor market flows and productivity growth. Papers 1-5, 7 and 8 introduce you to several major U.S. longitudinal firm-level and establishment-level databases and a variety of research strategies to exploit these data. Section II below introduces other important longitudinal establishment-level U.S. databases. Similar datasets are increasingly available for other countries, as illustrated by Hsieh and Klenow (2009).

This section develops empirical foundations for the flow approach to labor market dynamics and theories of frictional unemployment. Some studies in this section – e.g., Job Creation and Destruction and related work reviewed in “Gross Job Flows” – mainly exploit longitudinal business databases. Other studies – e.g., Blanchard and Diamond (1989) and Elsby et al. (2009) – mainly exploit household surveys. You should first read Davis, Faberman and Haltiwanger (2006) for a gentle introduction to the literature. Then read my short piece for the NBER reporter, which ties together several papers in Sections I and II. From there, you can profitably read any of the studies listed in this section.


Selected Micro-Oriented Analyses of Labor Market Flows


III. Introduction to Search and Matching Models of Frictional Unemployment

This section introduces the “textbook” equilibrium search and matching model of frictional unemployment. Be sure to carefully read and absorb Chapters 1 and 2 in Pissarides (2000). These chapters provide the minimal background in equilibrium search theory required for the rest of the course. We will mainly consider search and matching theories in the tradition of Mortensen and Pissarides (1994) and Pissarides (2000). For a broader perspective on the development of search theory and the use of search-theoretic models to address macroeconomic issues, see the 2010 scientific background paper prepared by the Royal Swedish Academy of Sciences and the survey paper by Rogerson and Shimer (2010).

IV. The Unemployment Volatility Puzzle in Equilibrium Search Models

When calibrated in a standard manner, the textbook equilibrium search model requires implausibly large shocks to generate unemployment fluctuations comparable in volatility to what we see in the data. This quantitative theoretical result is called the unemployment volatility puzzle. Shimer (2005) first drew attention to the puzzle. Hagedorn and Manovskii (2008) propose an alternative calibration to resolve the unemployment volatility puzzle. Resolutions that rest on wage rigidities are the focus of Section V below. Mortensen and Nagypal (2007), Pissarides (2009), Ramey (2008), Eyigungor (2010) and Petrosky-Nadeau and Wasmer (2010) and Kilponen and Vanhala (2011) discuss other resolutions.


V. Wage Rigidities as a Solution to the Unemployment Volatility Puzzle

An important outgrowth of work on the unemployment volatility puzzle is a resurgence of interest in wage stickiness as an amplification mechanism – that is, a mechanism that magnifies the effects of exogenous driving forces (e.g., productivity shocks or government spending impulses) on aggregate employment, unemployment, output, etc. As stressed by Hall (2005), Hall and Milgrom (2008) and Shimer (2010), among others, frictions in the matching process create room for (limited) wage stickiness while adhering to the principle that matched worker-employer pairs exploit all private gains to trade. Wage stickiness, however, leads to greater sensitivity of vacancy creation by firms (and hence, of job-finding rates by unemployed workers) to aggregate shocks. Equilibrium search theories with wage stickiness provide one possible response to a well-known critique of wage (and price) stickiness by Barro (1979).

VI. Empirical Studies of Wage Behavior on the New Hires Margin and the Persistent Wage Effects of Past Labor Market Conditions

Part A treats wage behavior on the new hires margin – the older papers are part of a broader literature on real wage cyclicality, and the newer ones are motivated by recent theories that stress the potential for wage rigidities to amplify unemployment responses to aggregate shocks. Part B investigates whether labor market conditions at the time of hiring or labor market entry have persistent effects on earnings and, if so, whether such persistence can be explained in models with spot-market models of wage-setting behavior.

A. Wage Behavior on the New Hires Margin

1. Abraham, Katharine G. and John C. Haltiwanger, 1995. “Real Wages and the Business Cycle,” Journal of Economic Literature. This paper surveys the older literature on wage cyclicality, which goes back many decades.


B. Persistent Wage Effects of Market Conditions at Hiring and Labor Market Entry


VII. Other Empirical Studies of Wage Rigidities

The papers in Parts A and B develop evidence on the prevalence and nature of nominal and real wage rigidities. Those in Part C develop evidence about the source and nature of wage rigidities using field interviews and direct survey evidence. Part D lists a few studies that seek to test various theories of wage rigidities and their consequences.

**A. Statistical Evidence on the Timing and Frequency of Nominal Wage Changes**


**B. The Distribution of Wage Changes and Its Relationship to Inflation**


C. Field Interviews and Survey Evidence on Wage Rigidities and Its Sources

D. Evaluating and Testing Other Theories of Wage Rigidities
VIII. Displaced Workers: Earnings Losses and other Effects of Job Loss

Equilibrium search theory and competitive equilibrium theory do not offer ready explanations for the magnitude of the earnings losses and other costs that many workers experience in the wake of job loss. Empirical research on this topic goes back a long way, but the extent and quality of this work has improved greatly in recent years, largely due to the advent of large-scale longitudinal worker-employer datasets. Jacobson, Lalonde and Sullivan (1993) provide an early and influential study that exploited the power of such datasets and applied empirical techniques previously developed in the literature on program evaluation. More recent studies in the same mold include Couch and Placzek (2010), Von Wachter, Song and Manchester (2009) and several other studies listed below.


Theoretical and empirical studies of specific human capital are highly relevant to the literature on the earnings losses associated with job loss. See the studies listed above under Selected Micro-Oriented Analyses of Labor Market Flows and the following studies:

**Selected Studies of Specific Human Capital**


**IX. Other Aspects of Employer Behavior on the Hiring Margin**

A vast empirical literature explores the characteristics, behavior and outcomes of the unemployed. Theories of individual and aggregate unemployment behavior are also well developed. Explaining cyclical fluctuations in the unemployment rate, for example, is one of the principal goals of the equilibrium search models treated in Sections IV and V above. In contrast, the study of employer behavior in the process of forming new employment relationships is relatively underdeveloped. The papers in Section VI, Part A are part of an effort to understand
wage behavior on the new hires margin. The papers listed here consider other aspects of employer behavior on the new hires margin.

A. Job Vacancies in the Hiring Process

B. Evidence on Hiring Costs

C. Selected Recent Theoretical Models of the Hiring Process

D. Hiring as an Investment Decision

X. Psychological Effects of Job Loss and Unemployment
If time permits, I will spend part of one class scratching the surface of research into the psychological effects of job loss and effects on search intensity by unemployed workers.

**Other Readings and Literature Notes**

The topics and readings listed below will not be covered in the course, but I will mention some of them in passing. They are related to topics that we will treat in the course. So I include a list of readings here, along with some remarks, in case you want to pursue one of these topics on your own.

**XI. Employer Behavior on the Separation Margin**

The extent to which worker separations from employers are privately inefficient is an important, unresolved question in macroeconomics and labor economies. A related issue is whether the quit-layoff distinction has economic content. These topics have not received much attention from macroeconomists in recent years, despite their importance, at least in part because the bilateral matching perspective that dominates macro-oriented research on labor market flows and unemployment seems to leave little scope for privately inefficient separations. Nevertheless, I think the area is ripe for important theoretical work and theoretically grounded empirical research. If you are interested in the topic, you might start by reading Hall and Lazear (1994).

McLaughlin develops the view that quits and layoffs are merely labels that indicate which party to the employment relationship was hit by a shock to the continuation value of the match. Brugemann (2008) is an interesting, but unfinished, effort to construct a more robust diagnostic test of departures from privately efficient separation behavior. MacLeod (2010) offers an interesting and eclectic perspective on many aspects of the employment relationship, including the efficiency of separations.

XII. New Keynesian Models with Wage Rigidities

New Keynesian models provide another major impetus to research on wage rigidities and their aggregate consequences. These models are highly influential in the analysis of monetary policy and, increasingly, in the analysis of fiscal stabilization policy. Work that develops, estimates and applies New Keynesian models is a very active of research.


XIII. New Keynesian Models with Wage Rigidities and Frictional Unemployment

A recent wave of theoretical models and quantitative theoretical analyses incorporate search and matching frictions into New Keynesian models with wage rigidities. See the papers listed below, most of which are very recent.


XIV. Theoretical Explanations for Wage Rigidities

The papers in this section develop theoretical explanations for wage rigidities and, in many cases, explore their implications. Bewley (1999) discusses several prominent theories of wage rigidities.


