

The Returns to Hierarchy

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Abstract:

Hierarchies allow individuals to leverage their knowledge through others' time. This mechanism increases productivity and amplifies the impact of skill heterogeneity on earnings inequality. To quantify this effect, we analyze the earnings and organization of U.S. lawyers and use the equilibrium model of knowledge hierarchies in Garicano and Rossi-Hansberg (2006) to assess how much lawyers' productivity and the distribution of earnings across lawyers reflects lawyers' ability to organize problem-solving hierarchically. We analyze earnings, organizational, and assignment patterns and show that they are generally consistent with the main predictions of the model. We then use these data to estimate the model. Our estimates let us infer how much production would be lost and how much the earnings distribution would change if lawyers were not able to "vertically specialize." We find that the impact of hierarchy on productivity and earnings distributions is substantial but not dramatic, reflecting the fact that the problems lawyers face are diverse and that the solutions tend to be customized.