

Job Search with Formal and Informal Sectors

December 1, 2020

1 Reservation Wage

Using the value from being employed in a job j , $\rho E_j(w_j) = w_j + \eta_j[U - E_j(w_j)]$, we find

$$E_j(w_j) = \frac{w_j + \eta_j U}{\rho + \eta_j}$$

which we can substitute into the value function for being unemployed:

$$\rho U = b + \lambda_f \int_{\rho U} \frac{w_f - \rho U}{\rho + \eta_f} dG_f(w_f) + \lambda_i \int_{\rho U} \frac{w_i - \rho U}{\rho + \eta_i} dG_i(w_i)$$

in this expression, we took the reservation wage to be

$$w_j^* = \rho U$$

which gives us the fixed point equation for reservation wage:

$$w_j^* = b + \lambda_f \int_{w_j^*} \frac{w_f - w_j^*}{\rho + \eta_f} dG_f(w_f) + \lambda_i \int_{w_j^*} \frac{w_i - w_j^*}{\rho + \eta_i} dG_i(w_i).$$

The reservation wage is common between jobs since conditional on being offered some wage in a sector, the worker chooses only between that job or unemployment. This means that there is a parallel between the two sector case incentives and the single sector case incentives that drives reservation wage to be the same across sectors.

2 Steady-State Proportion of Employment

As in the lectures, the probability that a randomly-sampled individual is unemployed is

$$\begin{aligned} p(u) &= \frac{Et_u}{Et_u + Et_i + Et_f} \\ &= \frac{(\lambda_i \tilde{G}_f(w^*) + \lambda_f \tilde{G}_i(w^*))^{-1}}{(\lambda_i \tilde{G}_f(w^*) + \lambda_f \tilde{G}_i(w^*))^{-1} + \eta_i^{-1} + \eta_f^{-1}} \end{aligned}$$

in addition,

$$\begin{aligned} p(i) &= \frac{\eta_i^{-1}}{(\lambda_i \tilde{G}_f(w^*) + \lambda_f \tilde{G}_i(w^*))^{-1} + \eta_i^{-1} + \eta_f^{-1}} \\ p(f) &= \frac{\eta_f^{-1}}{(\lambda_i \tilde{G}_f(w^*) + \lambda_f \tilde{G}_i(w^*))^{-1} + \eta_i^{-1} + \eta_f^{-1}} \end{aligned}$$

where $\tilde{G}_j(w^*) = Pr_j(w > w^*)$.

3 Log-likelihood Function

For an individual that is unemployed, the likelihood is

$$L(t_u, u) = \mathbf{G}(w^*) \exp[-\mathbf{G}(w^*)t_u] \times p(u)$$

where $\mathbf{G}(w^*) = \lambda_i \tilde{G}_f(w^*) + \lambda_f \tilde{G}_i(w^*)$, the likelihood of finding an employed individual in sector j is

$$L(w_j, j) = \frac{g_j(w_j)}{\tilde{G}_j(w^*)} \times p(j).$$

these give the empirical likelihood function for each k individual of a population size N :

$$L(\mathbf{w}, \mathbf{j}, \mathbf{t}_u) = \prod_{k \in j} \left[\frac{g_j(w_j) \mathbf{G}(w^*) \eta_j}{\tilde{G}_j(w^*) (\eta_i \eta_f + \mathbf{G}(w^*) \eta_i + \mathbf{G}(w^*) \eta_f)} \right] \times \prod_{k \in u} \left[\frac{\mathbf{G}(w^*) \exp(-\mathbf{G}(w^*) t_u) \eta_i \eta_f}{\eta_i \eta_f + \mathbf{G}(w^*) \eta_i + \mathbf{G}(w^*) \eta_f} \right]$$

giving a log-likelihood:

$$\begin{aligned} \ln L = & \sum_{k \in i} \ln(g_i(w_i)) + \sum_{k \in f} \ln(g_f(w_f)) + N \ln(\mathbf{G}(w^*)) + \sum_{k \in i} \ln(\eta_i) + \sum_{k \in f} \ln(\eta_f) + \sum_{k \in u} \ln(\eta_i \eta_f) \\ & - N \ln(\eta_i \eta_f + \mathbf{G}(w^*) \eta_i + \mathbf{G}(w^*) \eta_f) - \sum_{k \in i} \ln(\tilde{G}_i(w^*)) - \sum_{k \in f} \ln(\tilde{G}_f(w^*)) - \sum_{k \in u} \mathbf{G}(w^*) t_u. \end{aligned}$$

4 Identification

Taking the derivative of the log-likelihood with respect to the job termination rates η_j :

$$\begin{aligned} \frac{N_f}{N} &= \frac{\mathbf{G}(w^*) \eta_f}{\eta_i \eta_f + \mathbf{G}(w^*) \eta_i + \mathbf{G}(w^*) \eta_f} \\ \frac{N_i}{N} &= \frac{\mathbf{G}(w^*) \eta_i}{\eta_i \eta_f + \mathbf{G}(w^*) \eta_i + \mathbf{G}(w^*) \eta_f} \end{aligned}$$

and the first-order condition with respect to the hazard rate out of unemployment $\mathbf{G}(w^*)$:

5 Empirical Estimation and Results