

Employer: Sets no-shirking effort,  $\underline{e}$ , termination probability,  $t$  and wage,  $w$

Capitalist sector worker's choice:

Does not work  $e = 0$       Works  $e = \underline{e}$

Chance:

Worker is terminated  $(t)$       Worker keeps job  $(1 - t)$

Chance:

Moves to informal sector  $(j)$       Gets a new job  $(1 - j)$

$\gamma^l - \underline{u}$        $w - \underline{u}$        $w$        $w - \underline{u}$

