

EQUILIBRIUM WAGE AND DISMISSAL PROCESSES†

Christopher J. Flinn

*Department of Economics
New York University
269 Mercer Street
New York, NY 10003*

Abstract

We develop and estimate an equilibrium model of the labor market in which inefficient employees are systematically eliminated from the sector of the market characterized by asymmetric information and moral hazard. Systematic selection on the distribution of productivity characteristics produces unique wage sequences which are increasing in tenure for employees never previously terminated even in the absence of long-term contracting between employees and individual firms. We provide sufficient conditions for there to exist a unique termination-contract type equilibrium, and we estimate the equilibrium model using micro-level data from the National Longitudinal Survey-Youth Cohort panel.

JEL Classification: J41, J63, C51

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