Asymmetric information, wage dispersion and unemployment fluctuations*

Ng. Ha Dao

UQAM†

March 26, 2009

Abstract

The standard matching model successfully describes how the labor market functions, but it has at least two major problems. First, unemployment and vacancies are as volatile as labor productivity yet the aggregate data illustrates that the number is much higher – by a factor of 10. Second, the wage dispersion magnitudes occurring throughout the micro databases – the ratio between average wage paid and lowest wage paid – is at least 2 times greater than that predicted by the model. This paper proves that within a two-side asymmetric information environment, the take-it-or-leave-it offer mechanism effectively amplifies wage dispersion but it fails to amplify unemployment volatility. Through possessing private information, both firms and workers will make only modest wage offers to avoid separation, a mechanism that increases the mean-to-min ratio. When aggregate productivity increases, low productivity firms make more generous offers than those with high productivity, while high amenity workers require more than the low ones. Consequently, average wage closely follows aggregate productivity, implying little job creation.

JEL codes: D82, J31, J64

*I would like to thank my thesis advisers Alain Delacroix and Etienne Wasmer for their helpful comments and suggestions.

†Department of Economics, Université du Québec à Montréal, P.O Box 8888, Downtown Station, Montreal (QC) H3C 3P8. E-mail: dao.ngoc_ha@courrier.uqam.ca