Bankruptcy, Wage Scheme, and the Structure of Labor Market

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Abstract

This paper explores the implications of possible bankruptcies of firms for their own wage schemes and the structure of labor market, using a two-period general equilibrium model. The bankruptcy risk flattens a wage profile of each firm, weakening its incentive effect, thereby making room for efficiency wage to be used as a supplementary incentive device. The use of the efficiency wage, in turn, stratifies the labor market into the primary one, in which job rationing is observed, and the secondary one, in which job rationing is not observed. As a result, a substantial utility differential emerges between those who have luckily found a job of the primary market and those who have not, although there is no difference in their innate abilities. This differential widens, as bankruptcies become more probable. In addition, the dual structure of the labor market renders the employment size of the primary market too small to attain a social optimum.

Keywords: severance pay, efficiency wages, dual labor markets.
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