

Three Essays in Labor Economics

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Abstract

Labor regulations which are not conducive for business often result in a shift in production from the formal covered sector to the informal uncovered sector. This paper studies how labor legislations affect total output and employment in the formal sector and informal sector. This effect is identified using the variation in the implementation of labor market regulations across Indian states. The theoretical model is an extension of the Mortensen and Pissarides matching model to two sectors. In this two sector economy, unemployed workers and workers in the informal sector search for jobs. The number of vacancies in each sector is governed by a zero profit condition. The total number of matches formed in each sector depends on the number of workers searching for a job and on the number of vacancies. Labor regulations increase the cost of regulations only in the formal sector. This cost of regulations is due to firm's inability to downsize the labor force when profit is low. An increase in the cost of regulations reduces the incentive to create a vacancy in the formal sector and increases the incentive to create a job in the informal sector. The results show that labor regulations, as captured by the cost of regulations, vary significantly across different Indian states. A policy of employment at will doubles the employment in the formal sector and reduces unemployment by 24%, decreases average unemployment spell by 26% and average tenure by 21%, and increases the total output by 26%.

The second chapter studies the efficient risk sharing hypothesis under heterogeneous preference. It is shown that, if households have heterogeneous risk preferences, past tests might reject efficiency even if households do share risk efficiently. If agents have heterogeneous preferences and prices are constant then efficient risk sharing implies that consumption of each agent moves in the same direction as aggregate income. Using this implication, a three test method is proposed to test efficiency when households have different preferences for risk. The first test examines whether households have homogeneous risk preferences. The second and third tests are used to evaluate efficient risk sharing when the hypothesis of homogeneous risk preferences is rejected. We reject efficiency if either of these two tests is rejected. In the second test, the hypothesis of efficient risk sharing is rejected if individual consumption is a decreasing function of aggregate resources. In the third test, the hypothesis of efficient risk sharing is rejected if individual consumption is affected by idiosyncratic shocks to the individual's income, after controlling for aggregate resources. This method is used to test efficient risk sharing in rural India. The first test strongly rejects the hypothesis of identical risk preferences. We then test efficiency with and without the assumption of preference homogeneity. In the first case, efficient risk sharing at the village and caste level is rejected. In the second case, we still reject efficiency at the village level, but we cannot reject efficiency at the caste level.

The third chapter studies effect of working while in college on the drop out rate. The chapter presents a dynamic model in which agents make the decision whether or not to go to college, whether or not to work and whether to continue in college or drop out based on the new information about one's ability obtained while in college. The model is estimated using data on white males extracted from the National Longitudinal Survey of Youth (1979). The results show that working while in college increases probability of dropping out. However, the ability to work while studying increases the enrollment rate. The policy experiments suggests that a policy which provides aid to college students and later taxes the income of college graduates increases the enrollment rate and decreases the drop out rate.