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Network effects across the earnings distribution: Payoffs to visible and invisible job finding assistance

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ABSTRACT

This study makes three critical contributions to the "Do Contacts Matter?" debate. First, the widely reported null relationship between informal job searching and wages is shown to be mostly the artifact of a coding error and sample selection restrictions. Second, previous analyses examined only active informal job searching without fully considering the benefits derived from unsolicited network assistance (the "invisible hand of social capital") – thereby underestimating the network effect. Third, wage returns to networks are examined across the earnings distribution. Longitudinal data from the NLSY reveal significant wage returns for network-based job finding over formal job searching, especially for individuals who were informally recruited into their jobs (non-searchers). Fixed effects quantile regression analyses show that contacts generate wage premiums among middle and high wage jobs, but not low wage jobs. These findings challenge conventional wisdom on contact effects and advance understanding of how social networks affect wage attainment and inequality.

1. Introduction

To date, the economic and sociological research community has reached a tentative consensus on the effectiveness of informal hiring for generating wage benefits. Several prominent studies (e.g., Mouw, 2003; Pellizzari, 2010) have found that searching for jobs with the help of personal contacts results in no wage advantage for job seekers in the United States, relative to workers who found their jobs via formal job search methods – such as answering job advertisements, using employment agencies, and applying directly to employers. This has led to the commonly held conclusion that social capital has little impact on wages (Ioannides and Loury, 2004; Lin, 1999; Marsden and Gorman, 2001). Furthermore, descriptive analyzes have shown that informal job searching is most common among workers in low-wage blue collar occupations (Falcón, 1995; Holzer, 1996; Smith, 2000).

Many researchers have therefore concluded that, to the extent that social capital matters, it is most important at the low end rather than the high end of the jobs hierarchy. For example, citing evidence on the higher frequency of informal job searching among people entering low wage occupations, esteemed economist Harry Holzer has been quoted in the *New York Times* as saying, "For jobs that require higher education and technical skills, network connections don't matter as much" (quoted in Gross, 2004). This conclusion has important implications for the debate over the sources sustaining the high levels inequality in the United States. The extent to which human capital explains wage allocation at the top of the wage distribution, the escalating inequality can be viewed as merit-based. By contrast, the meritocratic view is more problematic if social capital generates wage returns to top jobs (cf., Chua, 2011; Elliott, 2000; Gerber and Mayorova, 2010).

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While many important insights have been gleaned from earlier research on contact effects, there are reasons to suspect that these lines of research have (1) underestimated the overall impact of network connections on job finding and (2) misidentified the places in the employment hierarchy where informal job finding is most effective. First, deficiencies in methodological applications of the contact effects studies (Mouw, 2003; Pellizzari, 2010) – which include an error in the coding of contact users, the suboptimal measurement of the timing of the dependent variable, and the presence of bias due to sample limitations – have led to a highly questionable interpretation of the causal relationship between informal job search and wages.

Second, previous research has focused only on a portion of the job finding benefits that accrue to social capital. Sociologists and economists alike have emphasized the role of the more "visible" aspects of social capital – resources mobilized through active job search and instrumental networking activities – in producing wage advantages. In reality, job finding processes are far more serendipitous than standard theories suggest (Betsworth and Hansen, 1996; Bright et al., 2005; McDonald, 2010). And yet, only recently have researchers begun to examine the role of the "invisible hand of social capital" – that is, the unsolicited benefits of network embeddedness – for improving labor market outcomes (Lin and Ao, 2008; McDonald and Day, 2010). For instance, about one out of every four workers changes jobs without engaging in a job search (Campbell and Rosenfeld, 1985; Granovetter, [1974]1995; McDonald and Elder, 2006). This "non-search" process is indicative of the invisible hand of social capital, as it is fundamentally social and most often occurs in situations where the job changes are facilitated by the receipt of unsolicited information about job opportunities from personal intermediaries (Granovetter, [1974]1995; McDonald, 2010). People who are informally recruited through the non-search process tend to receive significant wage benefits over people who find jobs through a formal job search (McDonald and Elder, 2006). However, research on non-searching has yet to fully account for the endogeneity associated with those wage benefits (Mouw, 2006), as non-searchers are likely to self-select into informal recruitment on the basis of higher skills and productivity (Lazear, 1986). Therefore, a definitive test of social network benefits is needed to fully understand the dual impacts of both visible and invisible hands of social capital on wages.

Third, researchers have yet to directly examine how the effectiveness of personal connections in generating wage returns may vary depending on a person's structural positioning within the jobs hierarchy. Standard approaches to modeling average contact effects assume homogeneity in those effects across the wage distribution. Studies of contact use among people in different occupations have identified where informal job finding is most *common*, but they reveal little about where informal job finding is most *effective* for generating higher wage returns. The use of connections may be more common at the low end of the income distribution, but there are many reasons to believe that low wage workers may in fact benefit the least from relying on their social capital to find employment. High wage workers may have greater leverage to use their connections to extract rents from employers and employers may also be more willing to pay wage premiums for hiring well-connected workers to fill their most risky labor investments. Therefore, an investigation is needed to assess precisely where in the income distribution social networks can be used to leverage wage gains in order to clarify where in the labor market sponsorship mobility is most effective.

The analyses conducted here make significant contributions to these debates about whether and where contacts matter. First, I correct the methodological problems associated with previous investigations of the relationship between contact use and wages. Second, I elaborate on the theory of the invisible hand of social capital and isolate the causal effects of informal recruitment on wages. Third, I employ an innovative statistical technique – fixed effects quantile regression (Koenker, 2005) – in order to assess variation in contact effects across the wage distribution.

2. Background

2.1. Do contacts matter?

The debate over whether or not contacts matter began with Mark Granovetter's ([1974]1995) pioneering study of getting a job. He found that people who got their jobs through contacts have higher salaries on average than people who found their jobs through other means. Subsequent scholarship has asserted that personal connections enhance employment opportunities by providing individuals with social capital: the set of resources (e.g., information, influence, and status) embedded within a person's social networks which can be accessed and mobilized in order to improve their lot in life (Lin, 2001). Maintaining a broad set of social connections therefore enriches the pool of potential job offers and raises the overall quality of the opportunities available (Montgomery, 1992). Moreover, the use of personal contacts in job finding can be viewed as a means of rent extraction,[1] in that contacts can provide exclusive access to job information and reduce competition for job openings, generating wage premiums over what can be obtained through the use of formal job finding strategies (DiTomaso, 2013).

Despite the early evidence of wage premiums associated with informal hiring, subsequent research has produced mixed results. Case-based studies of job finding generally support the notion that social connections can improve career opportunities and that the lack of such connections can hinder careers (for example, Collins, 1989; Jackall, 1988; Kanter, 1977;

[1] Rent seeking refers to the maximization of the difference between the price of assets and their rental price (Sorensen, 2000). Employment rents are a special type of rent paid in the form of salary/wages and may be generated by closing off access to occupational positions, which raises wage rates by limiting labor supply.