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Gergely Horvath, Rui Zhang

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Social Network Formation and Labor Market Inequality*

Gergely Horvath ^{†1} and Rui Zhang ^{‡ 2}

²International School of Economics and Management, Capital University of
Economics and Business

¹International Business School Suzhou, Xi'an Jiaotong Liverpool University

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Abstract

We study how differences in interpersonal skills lead to inequality among workers when social connections are endogenously formed and workers find jobs through their contacts. We show that the equilibrium network structure is very unequal in terms of links and access to jobs. The equilibrium network is not socially optimal because workers impose negative externality on each other by forming more links. The degree of inequality is larger in the equilibrium than what would be socially optimal. In the equilibrium, high-skilled individuals overinvest in networking while low-skilled individuals underinvest, which enlarges the impact of differences in interpersonal skills. The degree of inequality is largest when job availability is moderate.

Keywords: Social networks, labor markets, inequality, interpersonal skills

JEL codes: J30, J01, D85, J64

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[†]E-mail address: horvathgergely@gmail.com. Address: International Business School Suzhou, Xian Jiaotong Liverpool University, 111 Renai Rd., Suzhou Industrial Park 215123 Suzhou, China. Tel: +86 512 8188 3270

[‡]Corresponding author. E-mail address: ruizhangecon@163.com. Address: International School of Economics and Management, Capital University of Economics and Business 121 Zhangjialukou, Huaxiang Fengtai District 100070 Beijing, China. Tel: +86 15210923160

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