

Job Market Signaling Via Social Ties

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Abstract

When there is asymmetric information about abilities of applicants, employees can “signal”—recommendation letter or put in a good word—some of this information to firms by recommending applicants they personally know. I consider how employees strategically transmit information to firms when there are both gratitude benefits for recommendations and reputation costs for providing inaccurate information. Unlike the classic setting of job market signaling by applicants, senders (employees) can now have imperfect information about abilities and my analysis builds upon this feature. I then develop two applications of this model which consider the strategic “selections” of ties and hiring channels by applicants. This allows me to help explain mixed evidences about the returns to using different types of ties (weak vs strong) and hiring channels (formal market vs referral), as well as the relatively higher use of referrals by low skill/ability applicants. My analysis shows that public policies aimed at more social/racial integration can help firm’s ability to screen applicants using referrals, and therefore improve efficiency of referrals as a screening mechanism.

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