

Abstract

This paper extends the standard Pissarides model of equilibrium unemployment in three ways. First, we assume that workers are heterogeneous in terms of human capital. Second, we assume that productivity is match specific and that the distribution of match-specific productivity is more favorable the higher is a worker's human capital. Third, we allow for both private- and public-sector employment. We lay out the model, prove the existence of equilibrium and we numerically analyze the effects of public-sector employment policy on the distributions of wages, productivities and human capital levels in the two sectors and on overall employment and welfare.