DISCUSSION PAPER NO. 452-R

AN EMPIRICAL INVESTIGATION

OF THE RETURNS TO JOB SEARCH

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October 1981

Forthcoming in The American Economic Review

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I wish to acknowledge the extensive comments and assistance offered by Stephen R. Coatslett, Walter D. Fisher, Daniel S. Hamermesh, Stephen R. King, Shelly J. Lundberg, Wesley Mellow, Dale T. Mortensen, Edward C. Prescott, George W. Wilson, two anonymous referees, and participants in the Macro/Labor Workshop at Northwestern University. All errors and omissions remain the sole responsibility of the author.
AN EMPIRICAL INVESTIGATION OF THE RETURNS TO JOB SEARCH

The assumption of diminishing returns to job search plays a crucial role in the results derived from a search model presented recently in this Review by John Seater (1979). This assumption is justified by noting that "spatial aspects of the search process cause diminishing returns" since the travel time required to search firms in a circular area increases faster than the area to be searched.

Besides being an important property of a class of theoretical models, returns to search may serve to explain partly the paradox of an approximately 40 hour workweek contrasted with a seven hour "search-week" (Barron and Mellow (1979), p. 396). The interaction of diminishing returns to and positive costs of search may result in an optimal allocation of search time of only a few hours per week.

In this paper, we examine whether the assumption of diminishing returns to job search can be supported by the data. Following Seater, the returns to search are measured by the number of firms contacted, and we focus on the ability of unemployed individuals to translate search time into employee contacts. Returns to search are evaluated by noting whether the "production process" exhibits diminishing returns with respect to the input variable.

I. ECONOMETRIC MODEL

Estimating the contacts-search time "technology" by Ordinary Least Squares (OLS) is inappropriate since employee contacts, the dependent variable is integer-valued and non-negative. The possibility that the
variables in the regression may be zero for some individuals precludes
a logarithmic transformation of the model as a solution to the non-
negativity problem.

These problems can be treated adequately in the following two-step
econometric procedure. First, the number of firms contacted in a fixed
period of time is assumed to "arrive" at a rate described by a Poisson
distribution,

\[
\text{PROB}(N_i = k | \lambda_i) = e^{-\lambda_i} \frac{\lambda_i^k}{k!}
\]

(1)

\(N_i\) = The number of firms contacted in a given period by \(i\)
\(K\) = 0,1,2,....
\(\lambda_i\) = Expected number of firms that will be contacted by \(i\)
(i.e., \(\lambda_i = E(N_i)\), \(E(\cdot)\) is the expected value operator)
\(i = 1,1\) (individuals).

In turn, the Poisson parameter for individual \(i\), \(\lambda_i\), is related generally
to search time, and a set of demographic and labor market variables en-
tered both separately and interactively with search time. In order to
allow for the possibility of non-constant returns to search, a term
squared in search time is included as an explanatory variable:

\[
\lambda_i = E(N_i | \lambda_i) = \beta_0 + \beta_1 \cdot ST_i + \beta_2 \cdot ST_i^2
\]

(2)

\(\beta_0, \beta_1, \beta_2\) = Parameters to be estimated.

\(ST_i\) = The total hours spent looking for work in a given
period by \(i\)
\(Z_{i,j}\) = The \(j\)th demographic or labor market variable

Equation (2) generalizes Seater's equation (18), which describes a
representative individual searching in a geographical plane, by re-
ognizing that individual characteristics may affect the intercept or
The econometric model, (1) and (2), can be estimated by the method of maximum likelihood. Gordon (1979) has demonstrated that the maximum likelihood estimator for a Poisson process is equivalent to an iterated Weighted Least Squares estimator (IWLS), which can be calculated easily with conventional software packages.

\[ \hat{\Theta} = \left( X'W^{-1}X \right)^{-1} X'W^{-1}N \]  
\[ V(\hat{\Theta}) = \left( X'W^{-1}X \right)^{-1} \]  
\[ \hat{\Theta} = (\hat{b}_0, \hat{b}_1, \ldots, \hat{b}_k) \] - Kx1 vector of parameters  
\[ X = 1 \times K \] matrix of explanatory variables  
\[ N = 1 \times 1 \] vector of dependent variables  
\[ W = I \times I \] diagonal weighting matrix whose non-zero elements are given by \[ N \times X \]  
\[ V(\hat{\Theta}) = K \times K \] asymptotic covariance matrix.

The estimator (3) is computed iteratively. First, \( \Theta \) is set equal to the identity matrix and a standard OLS regression is performed. These initial estimates of \( \Theta \) are inserted into \( W \) and (3) is reestimated. The process of recomputation of \( W \) and reestimating \( \hat{\Theta} \) continues until the changes in elements of \( \hat{\Theta} \) are less than a predetermined convergence criteria.24

The returns to search hypothesis is stated in terms of the coefficient on \( ST_1^2 \):

\[ H_0: \quad b_2 = 0.0 \]  
\[ H_1: \quad b_2 < 0.0 \]  

Given \( \hat{\Theta} \), \( V(\hat{\Theta}) \), and a large sample, (5) can be evaluated using a normal distribution to determine if the null hypothesis can be rejected in favor of the alternative.
II. EMPIRICAL RESULTS

The model is estimated using two samples drawn from a special survey of unemployed individuals in the Current Population Survey (CPS), May 1976. The respondents were asked, among other questions, the number of hours spent looking for work, the method used most frequently, and the number of firms contacted during the previous four weeks. Those who classified themselves as being on layoff and not looking for another job, or unemployed and not spending any time searching have been excluded. Since participants in the special survey were also included in the CPS, we are able to assess the influence on the contacts-search time technology of a broad range of demographic and labor market characteristics.

A. Direct Search - Sample A

This sample is restricted to those respondents whose most frequent method of search was to "apply directly to employers without suggestions or referrals by anyone," and it is this type of activity that closely approximates Seater's notion of spatial search. The regression is specified with the number of firms contacted by an individual dependent on search time \( ST_1 \), the square of search time, a constant, a dummy variable, \( CITY_1 \) (1 if living in a SMSA), and interactive terms, defined as search time multiplied separately by a series of variables: \( AGE_1 \) (chronological age), \( RACE_1 \) (dummy variable, 1 if nonwhite), \( SEX_1 \) (dummy variable, 1 if female), \( UC_1 \) (dummy variable, 1 if receiving unemployment insurance benefits), and \( TL_1 \) (dummy variable, 1 if on temporary layoff and searching). This equation was estimated with the 1WLS technique described in Section I, and the results for the first and fifth (final) iterations are presented in the first two
columns of Table 1.

The estimated coefficients on ST\textsubscript{1}, the constant term, and CITY, are positive and significant, the latter coefficient being consistent with Seater's theoretical model in which an increased density of potential employers has a favorable effect on contacting firms. Among the interactive terms, only (UC\textsubscript{1} \* ST\textsubscript{1}) proves significant, reflecting that, with the receipt of unemployment insurance benefits, an individual also receives assistance from the state agency concerning available jobs. Alternatively, UC\textsubscript{1} may segment the sample between those with and without a recent attachment to the labor market, the former presumably having a better knowledge of existing opportunities. In order to determine the marginal returns to search, we examine the estimated coefficient on ST\textsuperscript{2}\textsubscript{1}, which is negative and significantly different from zero. Thus, based on a dataset that reflects direct search activity, we are able to reject the null hypothesis (5) at the 1% level of significance in favor of diminishing returns to search.\textsuperscript{11}

B. Direct + Indirect Search - Sample B

This dataset includes Sample A plus those respondents who contacted firms most frequently using indirect methods. These methods are divided between a self-directed search strategy, where contacts are made as a result of friends or advertisements, and an intermediary strategy, where contacts are made through state or private employment agencies.\textsuperscript{5} In so far as direct and indirect methods may have differing impacts on the relationship between employee contacts and search time, the regression model has been augmented with dummy variables for respondents who most frequently used self-directed (SDS\textsubscript{1}) and intermediary (IS\textsubscript{1}) search strategies.
The estimates for Sample B, displayed in columns 3 and 4 of Table 1, are broadly similar to those obtained previously, as all of the coefficients significant in the former sample remain significant. In Sample B, the interactive term \( RACE_1 \times ST_1 \) emerges with a negative and significant coefficient, possibly reflecting the adverse effects of discrimination at employment agencies, or the lack of an effective "network" of friends and relatives for nonwhites.

In either sample, the coefficients on \( SEX_1 \) and \( TL_1 \) (expected to be negative due to sexual discrimination and lowered search intensity, respectively), and \( AGE_4 \) (capturing a positive experience effect) do not prove statistically significant. The negative and significant coefficients on \( SDS_1 \) and \( IS_1 \) indicate that indirect methods lead to fewer employee contacts per hour of search time than direct methods. The estimated coefficient on \( ST_1^2 \) is smaller in absolute value than before, reflecting that diminishing returns "set-in" slower when using indirect methods, and the null hypothesis is again rejected at the 1% level.

Thus, the empirical evidence presented in this note suggests that the hypothesis of diminishing returns to job search, which underlies a class of theoretical search models and may explain partly the low levels of search by the unemployed, can be supported by the data.
In this appendix, the sufficient conditions for which the likelihood function will have a unique maximum are derived. Given the GLS interpretation of the maximum likelihood estimator, critical values for the likelihood function are found by minimizing the following expression:

$$\min \begin{pmatrix} N - c_i \end{pmatrix}' W^{-1} \begin{pmatrix} N - c_i \end{pmatrix}$$

where

$$\begin{pmatrix} N_i \end{pmatrix} - \sum_{k=1}^{K} c_k x_{i,k}$$

is more convenient to write \((1a)\) in scalar notation.

$$\min \sum_{k=1}^{K} \left( x_{i,k} - N_i + \sum_{k=1}^{K} c_k x_{i,k} \right)^2$$

$$k=1, K$$

where \(c_k\), \(x_{i,k}\), and \(N_i\) are elements of \(C\), \(X\), and \(N\), respectively.

A unique maximum to the likelihood function is assured if \((2a)\) is a convex function, which is equivalent to the Hessian of \((2a)\) being positive definite. Differentiating \((2a)\),

$$\frac{\delta^2}{\delta c_k^2} x_{i,k} (1 - \frac{1}{K} \sum_{k=1}^{K} c_k x_{i,k}) = \frac{1}{K} \sum_{k=1}^{K} c_k x_{i,k} x_{i,k}$$

$$k=1, K$$

Differentiating \((3a)\),

$$\frac{\delta^2}{\delta c_k \delta c_j} x_{i,k} x_{i,j} = \frac{1}{K} \sum_{k=1}^{K} c_k x_{i,k} x_{i,j}$$

$$k=1, K$$

(4a)

Letting

$$\gamma_{i,j} = 2 x_{i,j}^2$$

$$i=1, I$$

(5a)

(4a) can be written

$$\frac{\delta^2}{\delta c_k \delta c_j} x_{i,j} = \sum_{i=1}^{I} \gamma_{i,k} x_{i,k} x_{i,j}$$

$$k=1, K$$

$$j=1, K$$

(6a)

* The paper to be published in The American Economic Review will not contain this Appendix.
which are the elements of the Hessians

\[ H = \begin{bmatrix}
1 & \sum_{i=1}^{I} \sum_{k=1}^{K} \sum_{j=1}^{J} Y_{i,k} X_{i,k,j} \\
Y_{i,k} X_{i,k,j} & \sum_{k=1}^{K} \sum_{j=1}^{J} Y_{i,k} X_{i,k,j}
\end{bmatrix} \quad (7A) \]

Defining

\[ H_i = \begin{bmatrix}
Y_{i,k} X_{i,k,j} \\
Y_{i,k} X_{i,k,j}
\end{bmatrix} = \begin{bmatrix}
X_{i,k} X_{i,k,j} \\
X_{i,k} X_{i,k,j}
\end{bmatrix} \quad i=1, I \quad (8A) \]

\[ H = \sum_{i=1}^{I} H_i \quad (9A) \]

H can be rewritten by summing \( H_i \) across all \( i \)'s.

It is straightforward to show that the summation of positive definite (PD) and positive semi-definite (PSD) matrices is itself PD. In order to establish that \( H \) is PD, it will be sufficient to show that, for an arbitrary \( i \), \( H_i \) is PSD and, for some \( i \), \( H_i \) is PD. (8A) can be written as

\[ H_i = \begin{bmatrix}
Y_{i,k} X_{i,k,j} \\
Y_{i,k} X_{i,k,j}
\end{bmatrix} = \sum_{i=1, I} X_{i,k} X_{i,k,j} \quad (10A) \]

where \( X_{i,k} = [x_{i,1}, x_{i,2}, \ldots, x_{i,k}] \)

(10A) will be PSD if \( Y_{i,k} > 0 \) and \( X_{i,k} X_{i,k} \) is PSD.

From (5A), a sufficient condition for \( Y_{i,k} \) to be positive is

\[ \sum_{k=1}^{K} \sum_{i=1, I} Y_{i,k} X_{i,k} = \begin{bmatrix}
\sum_{k=1}^{K} Y_{i,k} X_{i,k} \end{bmatrix} > 0 \quad i=1, I \quad (11A) \]

\( X_{i,k} X_{i,k} \) will be PSD if

\[ A' X_{i,k} X_{i,k} A \geq 0 \quad \text{for all} \quad (12A) \]

where \( A \) is a \( K \times 1 \) vector, not all of whose elements are zero. By matrix manipulation, (12A) becomes

\[ (X^A)' (X^A) \geq 0 \quad (13A) \]

Since \( X^A \) is a scalar, \( (X^A)' = X^A \), (13A) can be written

\[ (X^A)^2 \geq 0 \quad (14A) \]
Thus, $X^i X^i$ is PSD for an arbitrary $i$.

However, under standard conditions of the GLS model, it cannot be the case that $X^i X^i$ is PSD for all $i$. Suppose $X^i A = 0$ for $i=1, I$.

Then we can write the following expression:

$$a_1 X_1 + a_2 X_2 + \ldots + a_K X_K = 0$$

where $a_j \in A$, $j=1,K$

$X_j$ = $1x1$ vector of explanatory variables, $j=1,K$

$X$ = $Kx1$ vector of zeros.

(15A) implies that $(X_j) \in X$ are linearly dependent and $X$ is of rank less than $K$. $X^i W^{-1} X$ is of rank $K$ by an assumption of the GLS model and the empirical fact that $(X^i W^{-1} X)^{-1}$ can be computed. Furthermore, the rank of $X^i W^{-1} X$ is equal to the rank of $X$. (The lemmas cited in the following demonstration are found in Theil (1971), pp. 11-12.)

Let

$$W = \begin{bmatrix} a_1 & b_1 \\ a_2 & b_2 \\ \vdots & \vdots \\ a_K & b_K \end{bmatrix}$$

(16A)

$$X^i = W^i X$$

(17A)

then, by Lemma 8.4,

$$\text{rank}(X^i W^{-1} X) = \text{rank}(X^i X^i) = \text{rank}(X^i)$$

(18A)

By Lemma C.3, $b_j > 0$, $j=1,I$, implies det($W^i$) $\neq 0$. Thus, $W^i$ is nonsingular and, using Lemma C.6, we can conclude

$$\text{rank}(X^i) = \text{rank}(W^i X) = \text{rank}(X)$$

(19A)

Therefore, $X^i A = 0$, for all $i=1,I$, leads to a contradiction, and we conclude that $b_j$ is PSD for at least one $i$.

Therefore, provided $X^i W^{-1} X$ is of full rank and $b_j > 0$, $j=1,I$, (2A) is strictly convex and we are assured that the likelihood function possesses a unique maximum.
REFERENCES


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**NOTE:**Estimated standard errors in parentheses.

a Multiply by 10<sup>-3</sup>.  

* Significant at the 1% level  

b Significant at the 5% level  

c Significant at the 10% level
FOOTNOTES

1. The likelihood function is constructed under the assumption of independently distributed \( N_1 \)'s. The inclusion of explanatory variables to account for differing abilities in obtaining contacts due to demographic and labor market characteristics will tend to preserve the independence of the \( N_1 \)'s.

2. Sufficient conditions under which the likelihood function will possess a unique maximum, hence a unique \( \theta \), are \((X'N^{-1}X)\) being of full rank and \( N_1 > 0 \) for all \( i \). The derivation of these conditions, which are satisfied by the estimates presented in this note, can be found in Chirinko (1980).

3. For a further discussion of the survey, see Rosenfeld (1977).

4. Econometric problems remain due to the endogeneity of \( ST_1 \) and the composition of the sample. The residuals from a cross section regression will tend to represent individual characteristics influencing the amount of time devoted to search, determined by optimizing behavior with regard to a utility function and binding constraints (cf. Nerlove (1967), p. 107). Thus there may exist a correlation between the error term and \( ST_1 \) resulting in biased coefficients. However, the inclusion in the regression of demographic and labor market variables, which affect the optimal level of search time, will attenuate this problem. Since low efficiency searchers may have a low probability of "escaping" unemployment, the estimates may be tainted by a sample selection bias. Correcting for the non-randomness of the sample may be particularly difficult for computational reasons, owing to the presence of many different categories within the sample (cf. the present situation, where categories are defined by the number of weeks unemployed, to the dichotomous classification of Willis and Rosen (1979)).

5. Differentiating between direct and indirect, and self-directed and intermediary search methods has been suggested by Barron and Gilley (1981).
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ABSTRACT

The assumption of diminishing returns to job search is crucial to the results derived from a number of theoretical search models. This assumption is tested with an econometric model that is general enough to allow for decreasing, constant, or increasing returns to search.

The model is estimated by a recently developed Iterated Weighted Least Squares technique which, under certain conditions, is equivalent to maximum likelihood. Sufficient conditions under which the estimator will be unique are derived. The estimator converges quickly to a unique, maximum likelihood solution, and the results suggest that the hypothesis of diminishing returns to search can be supported by the data.
The assumption of diminishing returns to job search plays a crucial role in the results derived from a search model presented recently by John Seater (1979). This assumption is not uncommon in search models but Seater's paper differs in that he motivates this assumption by noting that "spatial aspects of the search process cause diminishing returns." The key idea behind this result is that the travel time required to search firms in a circular area increases faster than the area to be searched.

In this paper, we examine whether the assumption of diminishing returns to job search can be supported by the data. The point of departure is to measure the returns to search by the number of firms that an individual contacts for a given amount of search time. We do not measure the returns to search by the number of job offers obtained because these offers will be influenced strongly by the existing vacancies, a variable that is not under the control of the searcher and will vary widely over time and space. The emphasis on the number of firms contacted is in keeping with the notions developed in the Seater paper, for his model generates diminishing returns as a result of restrictions in the contact "technology," with vacancies entering as a multiplicative constant. Thus, we focus on the ability of individuals to translate search time into job contacts, and evaluate the returns to search by noting whether this "production process" exhibits diminishing returns with respect to the input variable.
Estimating the relationship between firms contacted and search time by Ordinary Least Squares (OLS) is inappropriate since the former variable is discrete, while the latter is continuous. In order to avoid this problem, a two-step procedure is utilized. First, the number of firms contacted by an individual is modeled as a Poisson process. In turn, the Poisson parameter, $\lambda$, is related to search time and a set of dummy variables that capture demographic and labor market effects. The model is estimated by Iterated Weighted Least Squares (IWLS) which, in the case of a Poisson process, is equivalent to a maximum likelihood estimator. Sufficient conditions for the existence of a unique maximum to the likelihood function are derived. The model is estimated using two different samples, and the evidence rejects strongly the hypothesis of constant in favor of diminishing returns to job search.

I. ECONOMETRIC MODEL

In this section, we develop an econometric model in a two-step procedure that allows for an estimation of the technology that transforms search time into employer contacts. First, in order to account for the continuous/discrete nature of this relationship, the number of firms contacted in a fixed period of time is assumed to "arrive" at a rate described by a Poisson distribution.

$$\text{PROB}(N_i = k | \lambda_i) = e^{-\lambda_i} \frac{\lambda_i^k}{k!}$$

- $N_i$ = The number of firms contacted in a given period by $i$.
- $k$ = $0, 1, 2, ..., n$
- $\lambda_i$ = Expected number of firms that will be contacted by $i$ (i.e., $E(N_i) = \lambda_i$, $E(\cdot)$ is the expected value operator).
- $i$ = 1, 1 (individuals).
In turn, the Poisson parameter for individual \( i \), \( \lambda_i \), is related to search time, and a set of demographic and labor market variables that are multiplied by search time. These interactive terms capture those factors that might influence significantly the frequency with which an individual contacts firms, for a given amount of search time. In order to allow for the possibility of non-constant returns to search, a term squared in search time is included as an explanatory variable.

\[
\lambda_i = E(N_i) = a + b_1 \; ST_i + b_2 \; ST_i^2 + \sum_{j=1}^{J} b_{j+2} \; ST_i^a \; z_{i,j}
\]  

(2)

\( ST_i \) = The total hours spent looking for work in a given period by \( i \).

\( z_{i,j} \) = The \( j \)th demographic or labor market variable.

\( a, b_1, \ldots, b_{j+2} \) = Parameters to be estimated.

The model, equations (1) and (2), can be estimated by the method of maximum likelihood. Assuming that the \( N_i \)'s are independent, the log-likelihood function can be written as

\[
L(N|\lambda) = \sum_{i=1}^{I} (-\lambda_i + N_i \; \ln(\lambda_i) - \ln(N_i!))
\]  

(3)

Note that \( \lambda_i \) is a function of \( ST_i \). Gilbert (1979) has shown that the maximum likelihood estimator for a Poisson process is equivalent to a Generalized Least Squares estimator (GLS) that can be calculated easily with conventional software packages.

The notation for this model can be generalized in the following manner.
\[ \lambda_i = X^i \hat{C} \quad \text{i=1,I} \quad (4) \]

\[ C = (a_1 \ b_1; b_2; \ldots; b_{J+2}) \quad \text{- Kx1 vector of parameters.} \]

\[ X^i = (1; S^i_1; S^i_2; S^i_{1+1}; \ldots; S^i_{J+1}) \quad \text{- 1xK vector of explanatory variables for the i-th unemployed job seeker.} \]

For all individuals, (4) can be written

\[ \lambda = X \hat{C} \quad (5) \]

\[ \lambda = \text{1x1 vector of } \lambda_i \text{'s.} \]

\[ X = \text{1xK matrix of explanatory variables.} \]

With the model written compactly as (3) and (5), Gilbert's GLS estimator for \( \hat{C} \) is

\[ \hat{C} = (X'W^{-1}X)^{-1}X'W^{-1}N \quad (6) \]

\[ N = \text{1x1 vector of dependent variables.} \]

\[ W = \text{1x1 diagonal weighting matrix defined as follows.} \]

\[ W = \begin{bmatrix} X'^{1+C} \\ X'^{2+C} \\ \vdots \\ X'^{C+C} \end{bmatrix} \]

OR

\[ W = \begin{bmatrix} S_1 \\ S_2 \\ \vdots \\ S_N \end{bmatrix} \]

\[ X^i = \text{The i-th row of X.} \quad \text{i=1,I} \]
The estimator given by (6) and (7) is computed iteratively. First, (6) is estimated with \( W \) equal to the identity matrix, thus a standard OLS regression is performed. These first-round estimates of \( \hat{C} \) are inserted into (7) and a GLS estimation of (6) is implemented. The process of recomputing \( W \) and reestimating \( \hat{C} \) continues until the change in particular values of \( \hat{C} \) from iteration to iteration is less than some predetermined amount.

Given \( \hat{C} \), Gilbert has shown that the asymptotic covariance matrix for \( \hat{C} \) is given by

\[
V(\hat{C}) = (X'W^{-1}X)^{-1}
\]  

(8)

Since the model is being estimated by a maximum likelihood technique, we need some conditions to ensure that \( \hat{C} \) is the unique solution to the likelihood function (3). In the appendix, we show that \( X'W^{-1}X \) being of full rank and the estimated number of contacts, \( \hat{N}_1 \), being positive are sufficient conditions for the uniqueness of \( \hat{C} \).

The returns to search hypothesis is stated in terms of the coefficient on \( St^2 \).

\[
H_0 : b_2 = 0.0
\]

\[
H_a : b_2 \neq 0.0
\]

(9)

Given a large sample, \( \hat{C} \), and \( V(\hat{C}) \), (9) can be evaluated, using a normal distribution, to determine if the null hypothesis can be rejected in favor of the alternative.
II. EMPIRICAL RESULTS

The model is estimated using two samples drawn from a special survey of unemployed respondents in the Current Population Survey (CPS), May 1976.\(^3\) For the previous four weeks period the respondents were asked, among other questions, the number of hours spent looking for work, the method used most frequently, and the number of firms contacted. Those respondents who classified themselves as being on layoff and not looking for another job, or unemployed and not spending any time searching are excluded from the samples used in this paper. Since participants in the special survey were also included in the CPS, we are able to assess the influence on the unemployed of a broad range of demographic and labor market characteristics.

Before examining the empirical results, we discuss two biases that may affect the estimated coefficients. First, a frequent problem in estimating conventional, value-added production functions, with output specified as some function of the inputs, is the possibility of a significant correlation between the omitted variables, as represented by the regression residuals, and the choice variables of the decision making unit.\(^4\) In the cross section analysis of this paper, the residuals will tend to represent differences among individuals that will influence the amount of time devoted to search, as they optimize with regard to their utility functions and associated constraints. Thus there may exist a correlation between the error term and explanatory variables in the regression model, and the estimated coefficients may be biased. Using the search model of Seater
as a point of reference, we are unable to determine analytically the direction of the bias on the estimated coefficients since "the response of search \[ \text{to an increase in the returns to search} \] is ambiguous because the income and substitution effects on search oppose each other (Seater (1977), p. 361)." However, the inclusion in the regression equation of variables representing demographic and labor market characteristics which influence the optimal level of search time, will tend to minimize this bias.

Second, the sample may be contaminated by a self-selection bias. Search models imply that individuals will choose all work or all search if they face constant returns to search (Seater (1979), p. 415). If this model is "correct," then since the dataset is comprised entirely of unemployed job searchers, the sample will not be representative of the population, and the estimated coefficient on the square of search time will be biased towards zero. This bias will not affect the overall conclusion of this paper, however, if the null hypothesis is rejected despite the biased coefficient.

A. Direct Search - Sample A

This sample is restricted to those respondents whose most frequent method of search was to "apply directly to employers without suggestions or referrals by anyone," and it is this type of search activity that is closest to Seater's notion of spatial search. The regression equation is specified with the number of firms contacted by an individual dependent on search time \( \text{ST}_i \), the square of search time, a constant, a dummy variable, CITY, which takes a
value of 1 if the respondent lives in a SMSA, and interactive terms, defined as search time multiplied separately by a series of variables: AGE (equal to chronological age), RACE (dummy variable, 1 if nonwhite), SEX (dummy variable, 1 if female), UC (dummy variable, 1 if receiving unemployment insurance benefits), and TL (dummy variable, 1 if on temporary layoff and searching). This equation was estimated with the WLS technique described in Section I, and the results for the first and fifth (final) iterations are presented in the first two columns of Table 1.

The estimated coefficients on ST and the constant term are both positive and significant at the 1% level, the significant constant indicating that some relevant explanatory variables may have been omitted from the regression equation. The coefficient on CITY is also positive, and significant at the 5% level, reflecting that an increased density of potential employers has a favorable effect on contacting firms. Among the interactive terms, only (UC * ST) proves statistically significant. This positive coefficient reflects that, with the receipt of unemployment insurance benefits, an individual also receives information from the state agency concerning available jobs. Furthermore, this variable also serves to segment the sample between those with and without a recent attachment to the labor market, the former presumably having a better knowledge of existing opportunities.

In order to determine the marginal returns to job search, we use the estimated coefficient of ST, which is negative and signifi-
cantly different than zero. Thus, based on a dataset that reflects
direct search activity, we are able to reject the null hypothesis (9)
at the 1% level of significance in favor of the alternative of dimin-
ishing returns to search.6/

B. Direct + Indirect Search - Sample B

In this sample, the dataset is expanded to include Sample A plus
those respondents who contacted firms most frequently using indirect
methods. These methods are divided between a self-directed search
strategy, where contacts are made as a result of friends or advertise-
ments, and an intermediary strategy, where contacts are made through
state or private employment agencies.7/ In so far as direct and in-
direct methods may have differing impacts on the contacts-search time
relationship, the regression model used above has been augmented with
dummy variables for respondents who most frequently used self-directed
(SDS1) or intermediary (IS1) search strategies. The regression re-
results for Sample B are displayed in columns 3 and 4 of Table 1.

The estimates for Sample B are broadly similar to those ob-
tained previously. All of the coefficients that were statistically
significant in the former sample remain significant and at the same
level, with the exception of the coefficient on CITY, which was sig-
ificant at the 5% level and remains significant, but at the 10% level.
Unlike in Sample A, the interactive term (RACE1 * ST1) emerges
as significant at the 10% level with a negative coefficient, possibly
reflecting the effects of discrimination. The estimated coefficient
and standard error on ST12 are both smaller in absolute value than
before, and the null hypothesis is again rejected at the 1% level in favor of the alternative of diminishing returns to search.

The negative coefficients on SDS$_1$ and IS$_1$ indicate, somewhat paradoxically, that despite the assistance offered with these search methods, respondents tend to contact fewer firms per hour of search time than those who use direct methods. However, it must be kept in mind that the dependent variable in the regression is the number of firms contacted, but the desideratum of searchers is employment. The probability of employment can be viewed as the product of the probabilities of contacting a firm and, given a contact, of obtaining an acceptable offer. It would then appear quite reasonable for an individual to choose an indirect strategy which, as indicated by the regression results, leads to a lower probability of employer contacts if there is a correspondingly higher probability of obtaining an acceptable job offer.8/

It should be noted that the model estimated with either sample converged quickly, and the estimated coefficients and standard errors on ST$_1$ and ST$_2$ all changed by less than .35% between the fourth and fifth iterations. Furthermore, for all iterations and both samples, $(X'W^{-1}X)$ was of full rank, and $N_i > 0$, for all $i$. Thus, using the results developed in the Appendix, we are assured of the uniqueness of the estimates used in rejecting the null hypothesis.
SUMMARY

In this paper, the assumption of diminishing returns to job search has been tested with the data by estimating a cross section relationship between the number of firms contacted and the amount of time spent searching by unemployed individuals. In order to account explicitly for the discrete-continuous nature of this relationship, we have employed a two-step procedure that relies on a Poisson process. The equivalence between the maximum likelihood and Iterated Weighted Least Squares techniques facilitated the computations, and the estimator converged quickly to a unique solution. The model has been estimated using two different samples, and the results suggest that the hypothesis of diminishing returns to job search can be supported by the data.
APPENDIX

In this appendix, the sufficient conditions for which the likelihood function will have a unique maximum are derived. Given the GLS interpretation of the maximum likelihood estimator, critical values for the likelihood function are found by minimizing the following expression.

\[
\min_C (N - XC)' \kappa^{-1} (N - XC) \tag{1A}
\]

It is more convenient to write (1A) in scalar notation.

\[
\min_{\{c_k\}} \sum_{i=1}^{K} \sum_{k=1}^{K} \left( N_i - \sum_{k=1}^{K} c_k x_{i,k} \right)^2 \tag{2A}
\]

where \( N_i, c_k, \) and \( x_{i,k} \) are elements of \( N, \kappa, \) and \( X, \) respectively.

A unique maximum to the likelihood function is assured if (2A) is a convex function, which is equivalent to the Hessian of (2A) being positive definite. Differentiating (2A),

\[
\frac{\delta}{\delta c_k} = \sum_{i=1}^{I} x_{i,k} (1 - (N_i / \sum_{k=1}^{K} c_k x_{i,k})^2) \quad \text{for } k = 1, K \tag{3A}
\]

Differentiating (3A),

\[
\frac{\delta^2}{\delta c_k \delta c_j} = \sum_{i=1}^{I} \left( \frac{2}{\sum_{k=1}^{K} c_k x_{i,k}} \right)^2 x_{i,k} x_{i,j} + \sum_{k=1}^{K} \left( \frac{2}{\sum_{k=1}^{K} c_k x_{i,k}} \right)^3 c_k x_{i,j} \quad \text{for } k, j = 1, K \tag{4A}
\]

Letting

\[
\gamma_i = \frac{2}{\sum_{k=1}^{K} c_k x_{i,k}} \quad \text{for } i = 1, I \tag{5A}
\]

(4A) can be written

\[
\frac{\delta^2}{\delta c_k \delta c_j} = \sum_{i=1}^{I} \gamma_i x_{i,k} x_{i,j} \quad \text{for } k, j = 1, K \tag{6A}
\]
which are the elements of the Hessian

\[ H = \begin{bmatrix}
  \Sigma_{i=1}^{\infty} x_{1,k} x_{1,j} \\
  \sum_{k=1,K}^{\infty} x_{1,k} x_{1,j} \\
  \sum_{j=1,K}^{\infty} x_{1,k} x_{1,j}
\end{bmatrix} \quad (7A) \]

Defining
\[ H_i = \begin{bmatrix}
  \gamma_i x_{1,k} x_{1,j} \\
  \sum_{k=1,K}^{\gamma_i} x_{1,k} x_{1,j} \\
  \sum_{j=1,K}^{\gamma_i} x_{1,k} x_{1,j}
\end{bmatrix} = \gamma_i \begin{bmatrix}
  x_{1,k} x_{1,j} \\
  \sum_{k=1,K}^{x_{1,k}} x_{1,j} \\
  \sum_{j=1,K}^{x_{1,k}} x_{1,j}
\end{bmatrix} i=1,I \quad (8A) \]

\( H \) can be rewritten by summing \( H_i \) across all \( I \)'s.

\[ H = \sum_{i=1}^{I} H_i \quad (9A) \]

It is straightforward to show that the summation of positive definite (PD) and positive semi-definite (PSD) matrices is itself PD. In order to establish that \( H \) is PD, it will be sufficient to show that, for an arbitrary \( i \), \( H_i \) is PSD and, for some \( i \), \( H_i \) is PD. (9A) can be written as

\[ H_i = \gamma_i x_{1,i} x_{1,i} \quad i=1,I \quad (10A) \]

where \( x_{1,i} = (x_{1,1}, x_{1,2}, \ldots, x_{1,k}) \)

(10A) will be PSD if \( \gamma_i > 0 \) and \( x_{1,i} x_{1,i} \) is PSD.

From (5A), a sufficient condition for \( \gamma_i \) to be positive is
\[ \Sigma_{k=1}^{x_{1,i}} x_{1,k} = \frac{\Sigma_{k=1}^{x_{1,i}} x_{1,k}}{x_{1,k}} > 0 \quad i=1,I \quad (11A) \]

\( x_{1,i} x_{1,i} \) will be PSD if
\[ A^T x_{1,i} x_{1,i} A \geq 0 \quad (12A) \]

where \( A \) is a \( x \times 1 \) vector, not all of whose elements are zero. By matrix manipulation, (12A) becomes

\[ (X^T A)^T (X^T A) \geq 0 \quad (13A) \]

Since \( X^T A \) is a scalar, \( (X^T A)^T = X^T A \), (13A) can be written

\[ (X^T A)^2 \geq 0 \quad (14A) \]
Thus, $X_i'X_i$ is PSD for an arbitrary $i$.

However, under standard conditions of the GLS model, it can not be the case that $X_i'X_i$ is PSD for all $i$. Suppose $X_i'A = 0$ for $i=1,I$.

Then we can write the following expression.

\[ a_1X_1 + a_2X_2 + \ldots + a_KX_K = 0 \]  \hspace{1cm} (15A)

where

\[ a_j \in A \quad j=1,K \]
\[ X_j = 1 \times 1 \text{ vector of explanatory variables}, \quad j=1,K \]
\[ X_j \in X \quad \theta_j = 1 \times 1 \text{ vector of zeros} \]

(15A) implies that $(X_j) \in X$ are linearly dependent and $X$ is of rank less than $K$. $X' \theta^{-1}X$ is of rank $k$ by an assumption of the GLS model and the empirical fact that $(X' \theta^{-1}X)^{-1}$ can be computed. Furthermore, the rank of $X' \theta^{-1}X$ is equal to the rank of $X$. (The lemmas cited in the following demonstration are found in Theil (1971), pp. 11-12.)

Let

\[ \theta = \begin{bmatrix} \frac{1}{2}v_1 \\ \frac{1}{2}v_2 \\ \vdots \\ \frac{1}{2}v_K \end{bmatrix} \]  \hspace{1cm} (16A)

\[ X = \theta^{-1}X \]  \hspace{1cm} (17A)

then, by Lemma B.4,

\[ \text{rank}(X' \theta^{-1}X) = \text{rank}(X'X) - \text{rank}(X' \theta^{-1}X) \]  \hspace{1cm} (18A)

By Lemma C.3, $N_i > 0$, $i=1,I$, implies $\text{det}(\theta^{-1}) \neq 0$. Thus, $\theta^{-1}$ is nonsingular and, using Lemma C.6, we can conclude

\[ \text{rank}(X') = \text{rank}(\theta X) = \text{rank}(X) \]  \hspace{1cm} (19A)

Therefore, $X' \theta = 0$, for all $i=1,I$, leads to a contradiction, and we conclude that $H_i$ is PD for at least one $i$.

Therefore, provided $X' \theta^{-1}X$ is of full rank and $N_i > 0$, $i=1,I$, (2A) is strictly convex and we are assured that the likelihood function possesses a unique maximum.
REFERENCES


1. This equivalence has been demonstrated by Gilbert (1979), pp. 4-5.

2. The inclusion of variables to account for differing abilities in obtaining contacts due to demographic or labor market characteristics will tend to preserve the independence of the $X_i$'s.

3. For a further discussion of the survey, see Rosenfeld (1977).

4. For a discussion of this problem in regards to conventional, value-added production functions, see Nerlove (1967), especially p. 107.

5. All dummy variables used in this study assume integer values of either 0 or 1.

6. Utilizing a similar dataset and a linear-in-logs specification, Barron and Gilley (1979) also found evidence supporting diminishing returns to search. A linear-in-levels version of the Barron-Gilley model was reestimated using the IWLS technique, and we were able to reject the null hypothesis in favor of the alternative of diminishing returns. However, when compared to the converged IWLS solution, the estimated standard errors on the coefficient relevant to the hypothesis test was higher by 57% in the linear-in-logs (original Barron-Gilley) and by 25% in the linear-in-levels (OLS) version of the model.

7. Differentiating between direct and indirect, and self-directed and intermediary search methods has been suggested by Barron and Gilley (1979).

8. This argument has been put forth by Barro and Gilley (1979), and they discuss empirical evidence supporting this view.
## TABLE 1
Iterated Weighted Least Squares (IWLS) Estimates of the Contacts-Search Time Model

<table>
<thead>
<tr>
<th>Variable</th>
<th>Direct Search</th>
<th></th>
<th></th>
<th>Direct + Indirect Search</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>First Iteration</td>
<td>Fifth Iteration</td>
<td>First Iteration</td>
<td>Fifth Iteration</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Constant</td>
<td>3.256 (0.6769)</td>
<td>3.284 (0.3132)</td>
<td>4.642 (0.5091)</td>
<td>4.581 (0.4229)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>STI</td>
<td>0.2196 (0.0388)</td>
<td>0.2623 (0.0418)</td>
<td>0.1612 (0.0255)</td>
<td>0.1845 (0.0273)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>STI²</td>
<td>-0.9998* (0.2276)*</td>
<td>-1.192* (0.2543)*</td>
<td>-0.6539* (0.1694)*</td>
<td>-0.7714* (0.1668)*</td>
<td></td>
<td></td>
</tr>
<tr>
<td>AGEI * STI</td>
<td>0.196* (0.6707)*</td>
<td>-0.373* (0.8257)*</td>
<td>0.438* (0.4541)*</td>
<td>0.234* (0.5554)*</td>
<td></td>
<td></td>
</tr>
<tr>
<td>RACEI * STI</td>
<td>-0.0197 (0.0189)</td>
<td>-0.0297 (0.0222)</td>
<td>-0.0192 (0.0129)</td>
<td>-0.0282 (0.0167)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>SEXI</td>
<td>0.0109 (0.0184)</td>
<td>0.0078 (0.0221)</td>
<td>-0.0128 (0.0118)</td>
<td>-0.0161 (0.0134)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>UC1 * STI</td>
<td>0.0580 (0.0153)</td>
<td>0.0596 (0.0195)</td>
<td>0.0481 (0.0107)</td>
<td>0.0468 (0.0134)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>TLI * STI</td>
<td>2.285* (25.64)</td>
<td>3.972* (32.31)</td>
<td>0.0192 (0.0184)</td>
<td>0.0178 (0.0235)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>CITYI</td>
<td>2.037 (0.6041)</td>
<td>1.407 (0.5794)</td>
<td>1.358 (0.6782)</td>
<td>0.6976 (0.3972)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>SDSI</td>
<td>---</td>
<td>---</td>
<td>-2.667 (0.4952)</td>
<td>-2.159 (0.4463)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>ISI</td>
<td>---</td>
<td>---</td>
<td>-2.857 (0.6826)</td>
<td>-1.940 (0.5782)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>θ of Cases</td>
<td>835</td>
<td>835</td>
<td>1647</td>
<td>1647</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**NOTE:** Estimated standard errors in parentheses.

* Multiplied by $10^{-3}$. 