Entry Cohort-Effects at the Firm Level:
Testing for Permanent vs. Temporary Effects using Evidence from Job Losers

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Abstract

Persistent wage differences among entry-cohorts within firms pose a puzzle for standard economic models. Why should workers stay at firms at wages below market levels? Similarly, why should firms keep workers from highly-paid entry cohorts? We use 25 years of longitudinal career information on all workers who ever worked in large German manufacturing establishment to analyze the sources of establishment entry-cohort effects in wages. In contrast to the previous literature, the data enables us to follow workers after they exit the firm, allowing us to directly discriminate between alternative theoretical explanations. Models based on job search, insurance, or incentive contracts predict that cohort effects constitute temporary rents, while cyclical training or learning-by-doing models imply that cohort effects reflect permanent improvements in productivity. Preliminary results show that workers seem to keep firm entry-cohort premiums even after leaving the firm. This is independent of whether workers left voluntarily or involuntarily, and of the time since exit or of worker characteristics. However, we also find that wages of high-wage cohorts grow slower within the firm and that exit rates of workers from these cohorts are higher. Thus, it appears the firm adjusts to high initial cohort wages partly by raising workers' productivity through cohort-specific training and partly by compressing wages and firing expensive workers.