

Exploring the causes of frictional wage dispersion

Felix Wellschmied (Bonn Graduate School of Economics)

Abstract

Standard search models are inconsistent with the amount of residual wage dispersion found in U.S. data. This renders them unreliable for structural inferences of underlying wage risk. We resolve this apparent puzzle by modeling skill development (learning by doing on the job, skill loss during unemployment) and duration dependence in unemployment benefits in a random on the job search model featuring two-sided heterogeneity. Our calibrated model replicates empirically observed frictional wage dispersion. Skill development on the job is the most important driver behind this result. Search on the job is also relevant, but a realistic quantitative appraisal of search efficiencies should account for the frequent job to job transitions resulting in wage losses. Controlling for these channels reduces implied firm productivity heterogeneity compared to other recent studies. As a result, the search friction never accounts for more than twenty percent of overall wage inequality within an age cohort.