

Employment Stability, Earnings Dynamics, and Life-Cycle Savings

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Abstract :

Labor markets feature large heterogeneity in employment stability. Some careers provide life-time employment with rare separations, while others involve frequent transitions into and out of employment. Such heterogeneity shapes earnings dynamics and labor market risk but implications for households' financial decisions remain poorly understood. We first document two new empirical facts: careers of more stable employment (i) exhibit steeper life-cycle earnings profiles and (ii) are associated with more wealth accumulation per dollar of income. To interpret these facts, we then develop a life-cycle search-and-saving model that embeds heterogeneous employment risk, job-to-job mobility, endogenous human capital and wealth accumulation. The model matches the earnings and wealth life-cycle differences across heterogeneous careers consistent with the empirical evidence. Differential earnings growth across careers accounts for 60% of the differences in wealth accumulation, with consumption smoothing dynamics accounting for the remainder. We demonstrate the importance of heterogeneity in employment stability for the macroeconomy by studying the consequences for earnings losses and wealth inequality.