Earnings Dynamics and Firm-Level Shocks

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Abstract

In this paper we use matched employer employee data from Sweden to study the role of the firm in affecting the stochastic properties of the wage process. We consider two ways in which the firm may induce variations in pay across workers and over time: match effects (allowed to vary over time), and the transmission of firm-specific productivity shocks. In both cases we separate temporary from more persistent effects. Our statistical model accounts for endogenous participation and mobility decisions and thus deals with the potential truncation in the impact of productivity on wages that is induced by people quitting into unemployment or changing employer. We document a number of key findings. First, firm-specific permanent productivity shocks transmit to individual wages, but the effect is mostly concentrated among the high-skilled workers; the opposite pattern is found for firm-specific temporary shocks. Moreover, we find only modest updates in match effects over the life of a firm-worker relationship. Finally, we estimate a significant role for permanent individual shocks that stick with the worker. However, a substantial part of the growth in earnings variance over the life cycle for high-skilled workers is driven by firms. By age 55, 44% of the cross-sectional variance is attributable to firm-level shocks.

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