

Wage Dispersion and Labor Turnover with Adverse Selection (joint with Leo Kaas, Konstanz)

Abstract:

This paper analyzes the effects of adverse selection on worker turnover, wage dispersion, and resource allocation in labor markets. We consider a model of on-the-job search where firms offer long-term wage contracts to workers of different ability. Firms do not observe worker ability upon hiring but learn it gradually over time. Provided that information frictions are sufficiently strong, low-wage firms offer screening contracts and hire all types of workers in equilibrium, whereas high wage firms specialize in attracting high-ability workers only. This implies that low-ability workers have higher turnover rates, earn lower wages on average and face an earnings distribution with a higher frictional component. Furthermore, positive sorting obtains in equilibrium.