

IMPROVING THE MEASUREMENT OF EARNINGS DYNAMICS

PUBLICATION FACTS

JOURNAL

INTERNATIONAL ECONOMIC
REVIEW

PUBLICATION DATE

2022

VOLUME/ISSUE

63 (1)

PAGES

95-124

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ABSTRACT

Empirically, earnings at the start or end of earnings spells are lower and more volatile than in the interior of earnings histories, reflecting mainly the effects of working less than the full year. Ignoring these properties leads to a mismeasurement of the permanent and transitory shock variances and induces the large and widely documented divergence in the estimates of those variances based on fitting the earnings moments in levels or growth rates. Accounting for these effects enables more accurate analysis using quantitative models with permanent and transitory earnings risk and improves empirical estimates of consumption insurance against permanent earnings shocks.

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Times Cited

5

Journal Citation
Indicator

0.39