

Abstract

We develop a continuous-time model of career concerns that incorporates human capital accumulation throughout the working life. Workers are able to generate an output that follows a diffusion process with a drift that is the sum of effort and ability ("talent"). Talent corresponds to a hidden process that mean-reverts toward a trend that is endogenously changing over time as a consequence of on-the-job skills accumulation.

We find that estimates of talent discount past output observations at excessively high rates, leading to broad inefficiencies in the standard setting of career concerns with exogenous talent specifications. Nevertheless, it is precisely this high-discounting which makes human capital accumulation an additional channel for extracting gains from belief-distortion. This in turn implies that effort levels are typically above the ones predicted by traditional models of career concerns, yet inefficiencies are far from being eliminated.