Abstract

This paper addresses the estimation of individual income dynamics. It introduces a novel methodology that detects the presence of patterns in the life cycle and the economic forces in action. I estimate a Bayesian LSTAR(1) model with a rich level of heterogeneity and that there is a life-cycle pattern in earnings shocks: before age 29, workers experience shocks with higher variance and a positive probability of having a lower persistence than older workers.

A comparison with conventional models shows the importance of modeling correctly the level of heterogeneity in the innovations. The results can be used by macroeconomists to calibrate income processes.