

# Wage Risk and the Skill Premium

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The skill premium has increased significantly in the United States in the last five decades. During the same period, individual wage risk has also increased. This paper proposes a mechanism through which a rise in wage risk increases the skill premium. Intuitively, a rise in uninsured wage risk increases precautionary savings, thereby boosting capital accumulation, which increases the skill premium due to capital-skill complementarity. Using a quantitative macroeconomic model, we find that the rise in wage risk observed between 1967 and 2010 increases the skill premium significantly. This finding is robust across a variety of model specifications.

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