abstract

This paper examines dynamics of wage inequality and education investment in an overlapping generations model where future income is uncertain. An individual education level is heterogeneous in two ways, and uncertainty exists in whether each worker is correctly identified in his skill. This paper assumes that each worker may not be correctly identified in his skill and that this uncertainty is an increasing function of the difference of the education level of each type. There are the following two kinds of education investments.

- the investment which can contribute to labor skill and can also affect the uncertainty.
- the investment which can affect only the uncertainty and does not contribute to labor skill.

These can be interpreted as human capital investment and signal investment, respectively. In the main result, it is shown that the rate of the investment level of human capital to the investment level of signal becomes an U-shaped function of wage differentials. This paper also indicates that there exist three patterns of stable steady states of wage differentials: no wage differential, no wage differential and positive wage differential, and positive wage differential.