Mincer earnings function

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- i indexes people
- s denotes years/grades of completed schooling
- x denotes potential work experience; $x = \text{age} - s - 6$
- β_1 is the return to schooling; $100 \cdot \beta_1 \approx \frac{\% \Delta w}{\Delta s}$

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- ε has at least two problematic components:

1. **Unobservable personal characteristics correlated with s and w** (abilities, comparative advantage, family background, ...)

2. **Downstream choices correlated with s and w** (occupation, industry, location, ...)

Since schooling has an up-front cost and long-term benefit, need a dynamic model

- period 1: decide how much schooling to get
- period 2: choose whether or not to work; if working, receive $\ln w$ by equation (1)
- individuals choose schooling level to maximize lifetime utility