

# UNEQUAL BUSINESS CYCLES

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## Abstract

I document that low-skilled workers exhibit lower consumption cyclicalities than high-skilled workers, despite holding fewer liquid assets and facing more cyclical income. Standard incomplete-markets (SIM) models are inconsistent with this evidence as they predict a more cyclical consumption process for low-skilled workers. This paper extends the SIM model to allow for non-homothetic preferences, estimated using cross-sectional data from CEX on how the consumption share of luxuries and necessities varies with income. The model reproduces the observation that consumption is more cyclical for high-skilled workers because these workers spend a larger share of their income on luxuries, which are easier to substitute over time. The model predicts higher welfare costs of recessions for lower-skilled workers, despite their lower consumption declines.

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