

**Abstract :**

We model a competitive labor market populated by workers who are heterogeneous in wealth and skills, in which education might play a signaling role. We show that whenever an increase in the endowment of accumulable factors of production -- such as physical capital, and/or (skill biased) technology -- results in a wider wage premium for skills, the minimum investment in education needed to sustain a perfectly separating equilibrium (PeSE) in which skilled workers are able to perfectly signal their skills increases. Hence, increases in the wage skill premium induce an education race as skilled individuals invest more to signal themselves. However, if due to imperfect capital markets, borrowing capacity of poor individuals is lower than that of those who are rich, this race will finally lead to a situation in which --for a sufficiently large increase in the endowment of the accumulable factor-- poor and skilled individuals are no longer able to invest enough to signal themselves and end up pooled together with unskilled and rich at a lower level of education. Hence, the supply of skills is sluggish with respect to an increase in the wage-skill differential. Such mechanism supports a supply side explanation for the observed behavior of wage-skill differential as well as for the widening of the wage gap between postgraduates and college graduates.

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We are pleased to invite you to the  
**Lunchtime Seminar in Economics:**

**Skill premium, education race,  
and supply of skills**

**Luca Deidda**  
University of Sassari

**October 5, 2011**  
13:00 – 14:00

Campus Limpertsberg  
Main Building– Room BC208  
162a, avenue de la Faïencerie L-1511 Luxembourg

Lunch is planned for the participants

Registration: by email to [fdef-colloques@uni.lu](mailto:fdef-colloques@uni.lu)

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