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Getting more unequal: Rising labor market inequalities among low-skilled men in West Germany

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ABSTRACT

During recent decades, earnings differentials between educational groups have risen in most advanced economies. While these trends are well-documented, much less is known about inequality trends within educational groups. To address this issue, we study changes in labor market inequalities among low-skilled men in West Germany. Using data from the German Socio-economic Panel, we show that both risks of labor market exclusion and earnings dispersion have grown dramatically since the mid-1980s. We consider possible explanations for these trends, drawing on an analytic distinction between compositional changes with respect to worker/job characteristics and changes in the effects of these characteristics on labor market outcomes. Using a reweighting strategy and regression models, we find that both compositional trends and changes in the effects of important characteristics have contributed to the observed increase in labor market inequalities. We discuss the likely influence of German welfare state programs, labor market regulation, and of recent changes in these domains, and sketch promising avenues for future research.

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1. Introduction

Labor market inequalities have risen substantially over recent decades in most advanced economies (Dolton, Asplund, & Barth 2009; OECD, 2008). A practically universal feature of this trend is that labor market outcomes of low-skilled people have deteriorated compared to those

of high-skilled people (e.g., Blackburn, Bloom, & Freeman 1989; Gesthuizen, Solga, & Künster 2011; Maxwell, 2008). Yet evidence is accumulating that inequalities have also risen *within* relatively homogeneous socio-demographic and educational groups (e.g., Barth & Lucifora, 2006; Devroye & Freeman, 2001). As early as 1993, Juhn, Murphy, and Pierce (1993) highlighted the contribution of rising earnings inequality within educational groups to overall inequality growth in the United States (cf. also Lemieux, 2006; for Western Europe: Barth & Lucifora, 2006; for Germany: Dustmann, Ludsteck, & Schönberg 2009). Few studies, however, have taken an in-depth look at changing within-group inequalities. In this paper, we therefore seek to advance our understanding of inequality trends by

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zooming in on one specific group of workers in one large industrialized country: low-skilled men in West Germany (the former Federal Republic of Germany including West-Berlin).³

Low-skilled men in West Germany are an interesting case. Not only has overall wage inequality in Germany risen substantially during recent decades, previous research also documents exceptionally large increases in inequality among low-skilled men (Dustmann et al., 2009; Erlinghagen, 2006; Giesecke & Heisig, 2010).⁴ These findings are underscored by a comparative study of twelve Western European countries for the period from the 1980s to 2003: Only in the cases of Germany and Finland was wage dispersion within the low-skilled group higher than among middle-educated workers (Barth & Lucifora, 2006: 30).

Our analysis of low-skilled men complements previous studies of within-group inequalities, which have mostly focused on the higher educated. Many researchers predict that educational expansion boosted inequalities among the higher educated, as workers with lower overall “ability” were added to this group (“skills erosion”, cf. Barth & Lucifora, 2006) and/or because the supply of higher-educated workers rose faster than demand (“over-education”, cf. Lindley & McIntosh, 2010). Low-skilled workers, by contrast, are often expected to have become more homogeneous due to the outflow of individuals with higher ability (Barth & Lucifora, 2006; Leuven, Oosterbeek, & Ophem 2004; Solga, 2002).⁵ Some researchers draw the seemingly obvious conclusion that labor market inequalities among the less educated have remained stable or even decreased over time (e.g., Barth & Lucifora, 2006: 6).

It is important to clarify at the outset whom we treat as “low-skilled” in the West German context. We define this group as including all men who hold neither a vocational certificate nor a university degree and who are not currently pursuing either of those degrees. In other words, we treat men as low-skilled if they have dropped out of secondary education or only completed a general secondary (as opposed to vocational secondary, post-secondary, or tertiary) program. According to our definition, men with an *Abitur* – the degree conferred by the highest tier of Germany’s tracked system of secondary education – belong to the low-skilled if they do not hold a vocational or university certificate.⁶ This is appropriate because the German labor market emphasizes occupation-specific skills acquired through vocational training or specialized higher education. Even though men with only an *Abitur* have completed upper secondary education, they will often lack

the occupation-specific skills (and credentials) that are so important for success on the German labor market— and it is in this sense that they can be considered as “low-skilled”.⁷

Using data from the German Socio-Economic Panel we will examine inequality trends with respect to two outcomes: the risk of long-term non-employment and earnings conditional on employment. Fig. 1 gives a first impression of changes in these outcomes between the mid-1980s and mid-2000s. The lower graph displays the percentage of low-skilled men who were “chronically non-employed,” that is, who did not earn any labor income during a given three-year period. The upper graph depicts the distribution of three-year average annual earnings (in 2008 Euros) among those with positive earnings.⁸

Fig. 1 provides clear evidence of growing labor market inequalities. The share of 20–54-year-old low-skilled men who spent a whole three-year period outside of paid employment is subject to cyclical fluctuations, but clearly shows an upward trend. Over the observation period, it rose from less than 6 percent in the mid-1980s to 13 percent in the mid-2000s (lower graph in Fig. 1). Among those with positive earnings, the shape of the earnings distribution also changed quite dramatically (upper graph in Fig. 1). In the first three-year period, 1984–86, the distribution of low-skilled men’s earnings was clearly unimodal and not too far away from a normal distribution, with the majority earning an annual average between €15,000 and €40,000. By 2005, the distribution had become considerably flatter and acquired a heavy lower tail, with many men making only modest annual incomes below €20,000. The middle and upper parts of the distribution likewise became more dispersed from the mid-1980s to the mid-2000s. Detailed inspection of results for the intermittent periods (lighter lines in upper graph) reveals that this trend is secular rather than cyclical.

Our goal is to better understand and shed more light on potential drivers of these striking trends. Following standard approaches in the inequality literature, we distinguish between two general sources of distributional changes among low-skilled men: *compositional changes* with respect to earnings- and employment-related characteristics and *changes in the effects* of these characteristics. We distinguish two broad sets of relevant characteristics: worker characteristics (e.g., health or migration background) and job characteristics (e.g., sector or firm size).

The paper is structured as follows. We first highlight a few essential details of the German institutional context (Section 2). Section 3 discusses potential explanations

³ We exclude East Germany because persistent differences in labor market conditions call for a separate analysis, which is not feasible due to space constraints.

⁴ Wage inequality among low-skilled West German women has also increased, but less strongly than for men (Dustmann et al., 2009). It would be interesting to take a closer look at this development, but we cannot do so here: Space limitations conflict with the need to conduct gender-specific analysis due to persistent differences in labor market behavior.

⁵ But note that Gesthuizen and Solga (2013) find no evidence for a decline in the cognitive skills of less-educated men in the US.

⁶ See Schneider (2008) for further details on the German education system.

⁷ Empirical studies have indeed found that the employment prospects of individuals with an *Abitur* who lack a VET or university certificate are almost as poor as for persons with lower school degrees who also lack a VET diploma (Giesecke, Ebner, & Oberschachtsiek 2010; Solga, 2002). We also reran our analysis with workers with an *Abitur* removed from the sample and results were similar.

⁸ We focus on three-year averages of earnings throughout the paper to ensure that our findings are not driven by increasing short-term variability. We only include low-skilled men aged 20 to 54 (in the first year of a given three-year period) who did not participate in full-time education at any time during a given period. See Section 4 and the Online Supplement for further information.

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