Sources of growing labour market inequalities among low-skilled men in Western Germany

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In recent years, the labour market prospects of unskilled workers have deteriorated in most advanced economies. Germany is no exception. While many studies document increasing income and labour market inequalities between educational groups, inequality trends within educational groups have received far less attention. Recent findings suggest substantial inequality growth among low-skilled Western German men—but so far these changes are neither well documented nor well understood.

We use the German Socio-Economic Panel 1984-2008 to identify the sources of this apparent „polarization“ among unskilled men. We start by confirming that earnings inequality among low-skilled men has grown substantially (measured as earnings over a given three-year period in order to minimize effects of short-term fluctuations). Drawing on economic and sociological theories, we then discuss potential explanations for the rise in inequality within the low-skilled group. We gauge their empirical content by estimating counterfactual wage distributions and regressions of (a) the risk of chronic non-employment and (b) the log hourly wage of individuals who are employed at the time of interview.

Our results can be summarized as follows: Compositional changes with respect to basic socio-demographic characteristics (age, health, migration background) have made a small, but noticeable contribution to inequality growth. Perhaps surprisingly, we find only small effects of changes in economic structure, most importantly declining employment in manufacturing and in large firms. Institutional changes in labour market and social policy play a role, though their total net impact is hard to assess. The clearest result of our analysis is that the “scar effects” of unemployment have grown, both in terms of re-employment chances and in terms of post-unemployment wages. This suggests that differentials between labour market insiders and outsiders are an important force behind rising inequality—an interpretation which is also supported by the finding that wage differentials by employer tenure have increased.

Keywords: Education; Employment Dynamics; Inequality; Labour Markets

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