Higher and Higher? Performance Pay and Wage Inequality in Germany

Katrin Sommerfeld*

– Preliminary! –
This version: June 22, 2012

Abstract: Performance pay is of growing importance as it applies to a rising share of employees. A parallel trend has been that of growing wage dispersion. From this the question evolves of how is the growing use of performance pay schemes related to the increase in wage inequality? German SOEP data for the years 1984 to 2009 confirm the large increase in the application of performance pay schemes. This growing use of variable pay schemes led to an upward shift of the wage structure by about one log point. However, it did not contribute to the growth in wage inequality. Wage inequality grew within the group of employees who receive performance pay, but even more so within the group who do not receive this. The results are in line with a hypothesis according to which skill-biased technological change (SBTC) changes the returns to skills and this translates into higher wage inequality by means of performance pay schemes. The empirical analysis employs sequential decompositions in a quantile regression framework.

Keywords: Performance Pay, Wage Structure, Quantile Regression, Sequential Decomposition
JEL-Classification: J31, J33, C21

* University of Freiburg (Germany). E-mail: katrin.sommerfeld@vwl.uni-freiburg.de

Acknowledgements: For fruitful discussions I would like to thank Juan J. Dolado and seminar participants at the University Carlos III de Madrid and Freiburg University as well as at the XV. Encuentro de Economía Aplicada en A Coruña. This research was started when the author was visiting Universidad Carlos III de Madrid. Financial support from the University of Freiburg and the German Academic Exchange Service (DAAD) is gratefully acknowledged.