2 Basic Trends in Wages and Employment Across Skill Groups

... the earnings distribution has continued to become more compressed in Germany.

OECD (1996, p. 63)

The stylized view of the labor market in West Germany during the 70's and 80's considers West Germany to be a high-wage and high-productivity economy with a fairly compressed wage structure and resulting insufficient employment growth. In particular, wage floors set by the prevailing wage bargaining system result in a lack of jobs for low-skilled workers (refer to the two-sides-of-the-same-coin hypothesis discussed in chapter 1). This view is "confirmed" by descriptive evidence showing that the distribution of wages has been stable or even "continued to become more compressed" in situations of considerable unemployment and imbalances in the distribution of unemployment across different groups of workers (see Abraham and Houseman, 1995, Kraft, 1994, Paqué, 1995, Pischke, 1998, Steiner and Wagner, 1998, OECD, 1993, 1996, or Fitzenberger and Kurz, 1997). This evidence is based either on aggregate data for different groups of workers or on micro datasets such as the German Socioeconomic Panel or the Qualifications and Careers Survey ("Qualifikation und Berufsverlauf", data collected by the Federal Institute for Occupational Training (Bundesinstitut für Berufsbildung, BiBB) and the research institute of the Federal Employment Service (IAB). On the employment side, West Germany exhibited modest employment growth (small compared to the United States) with a continuous trend towards skill upgrading of the labor force (see figure A.1 in the appendix).

The above stylized view did not remain unchallenged. Based on the same dataset (IAB-Beschäftigtenstichprobe, IABS) as used in this study, a series of studies (Möller, 1996, 1997, Möller and Bellmann, 1996, and Beißinger and Möller, 1998) finds an increasing wage dispersion for full-time working males in West Germany during the 80's. The results in the earlier studies by Möller (1996) and Möller and Bellmann (1996) were questioned by Steiner and Wagner (1998) pointing to a structural break in the IABS wage data between 1983 and 1984 (I will come back to this issue later and a correction for this structural break is developed in the appendix). Comparing the marginal
wage distribution in the IAB dataset and the German Socioeconomic Panel, Steiner and Wagner show that this structural break results in a spurious increase in wage inequality between 1983 and 1984 (see also figures A.3 and A.4 in the appendix). However, even after accounting for the structural break, Möller (1997) and Beißinger and Möller (1998) as well as Fitzenberger (1996) and Fitzenberger and Franz (1998) still find that the wage dispersion for full-time working males in West Germany increases during the 80's. Fitzenberger (1996), Fitzenberger and Franz (1998), and, based on an earlier dataset for the time period from 1976 to 1984, Fitzenberger et al. (1995) show that various conflicting trends appear to be operating across the wage structure. Even though wage dispersion for full-time working males was increasing during the 70's and 80's, the wage differences narrowed between workers with and without vocational training degree while the difference between workers with vocational training degree and university degree increased. This U-shaped pattern in average wage trends across skill groups coincided with increasing wage dispersion within the groups with higher skill levels. The latter effect accounts for most of the aggregate increase in wage dispersion measured in the IAB dataset.

Nickell and Bell (1995, 1996) forcefully questioned the employment side of the two-sides-of-the-same-coin hypothesis mentioned above. They argue that in international comparison, West Germany did not experience a disproportionate increase in the relative unemployment rates for low-skilled workers even though the relative wage of low-skilled workers did not deteriorate during the 80's to the extent as it was observed for the United States or the United Kingdom. Nickell and Bell view this as a challenge for the two-sides-of-the-same-coin hypothesis of a simple trade-off between increased wage flexibility or increasing unemployment for low-skilled workers. They consider low-skilled workers in West Germany to be more productive compared to their counterparts in the United States or the United Kingdom. Pischke (1998) and Beißinger and Möller (1998) provide evidence for this view using a similar framework as developed in Card et al. (1996). These two studies for West Germany form age-skill (industry) cells of workers and contrast changes in wages and employment rates over the 80's with the wage level at the end of the 70's. Assuming a skill bias in labor demand trends, they take the wage level at the end of the 70's as a proxy for the skill level and therefore for the relative demand shock experienced by the respective group of workers. If the two-sides-of-the-same-coin hypothesis is correct, one expects for West Germany a positive correlation between the initial wage levels and the change in employment rates and no correlation with the changes in wages. However, the first correlation does not prove significantly positive. And the second is significantly positive in the study by Beißinger and Möller (1998) and negative in the study by Pischke (1998). This difference mainly appears to reflect the use of different datasets as pointed out above. Overall, in my opinion, it remains questionable whether changes in employment rates