Pay Inequalities and Economic Performance:
Research Projects to be Pursued by the German Team

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Introduction

Given the large sample sizes, we are able to test a number of hypotheses that have not yet been subject to convincing econometric analyses. We distinguish between three different projects, of which the latter two are closely related as will (hopefully) become clear by the end of our proposal.

1. Collective Bargaining, Union Coverage, Workplace Representation and Wage Dispersion

According to Blau and Kahn (1996, 1999) institutions for wage formation also play an important role for wage dispersion: In the US wages are almost completely determined at the firm level, in the Scandinavian countries wage formation is said to be more or less centralized at the national level, while some other countries (most notably Belgium, Germany and the Netherlands) are characterized by an intermediate system, often referred to as “corporatism”. Their main finding is that centralized collective bargaining, minimum wages and antidiscrimination policies raise the relative wages of the low paid, i.e. reduce wage inequality. In order to be able to test the influence of wage setting institutions on wage inequality for different groups of workers (which has – due to data limitations – not been done yet), we will pursue the following strategy:

- We will first calculate various measures of wage dispersion for all workers within a given industry as well as for different subgroups (men and women, low- and high-skill workers, young and old workers) in each of the countries for which the data is available.
- We will then regress various measures of wage setting institutions (such as bargaining coverage, union density and workplace representation) on wage inequality.

Our expectation is that not only the impact of different institutions differs among the countries we are able to include in our study, but that these institutions also exert a different influence on different groups of workers.

Literature

2. Firm Size and Wages: An International Comparison

It is one of the few stylized facts in labor economics that wages increase with firm size. Although this has been shown in a number of studies using data from different countries, employing different research strategies and different pay variables (gross vs. net pay; hourly vs. weekly or monthly pay; pay including or excluding fringe benefits, etc.) the reasons have not yet been identified. The most prominent candidates are:

- Working conditions (hours, physical environment, etc.) are worse in larger firms – a hypothesis that is rejected by all available studies). On the contrary: Some of the more important indicators (such as job security) show that working conditions are better in large firms, i.e. there is simply no need to pay a compensating differential to workers in large firms.
- Workers are more of higher quality in larger firms, one reason being the higher capital intensity and capital-skill complementarity of large plants. The higher levels of both human and physical capital per worker in large firms are seen to be due to scale economies and/or better access to credit in imperfect capital markets. Thus, large firms either select higher quality workers or these workers self-select themselves into larger firms. If this were the case we should observe that across Europe, large employers should pay higher returns to human capital
- Wages are higher in large firms to induce workers to put forth effort (by raising the opportunity costs of being fired). If this were the case, we should observe significantly different wage-size relationships in countries with and without a pronounced dismissal protection legislation.
- Finally, it has been argued that large firms are more likely to operate in imperfect competitive markets with the resulting product market power leading to monopoly rents, which the employer may be willing to share with his employees. If this were true, we should observe that in countries with weak union representation the firm size-wage differentials are less pronounced than in countries with strong unions, because they can expropriate larger shares of the excess profits generated by the firm.

Literature

A second stylized fact in labor economics is the finding that wages tend to rise with job seniority. Theory offers three different explanations for this phenomenon:

- Human capital theory suggests that the accumulation of skills and knowledge leads to an increase in productivity which, in turn, leads to an increase in wages over the lifetime of a worker.

- Matching theory suggests that due to information asymmetries recently hired workers earn less than observationally similar workers whose productivity is known to the employer. As the employer learns a worker’s productivity, he either lays him off or he pays him a wage that reflects his productivity. As the percentage of workers whose productivity is unknown to the employer decreases over time, wages increase with tenure.

- Finally, the theory of seniority wages suggests that deferred compensation is used as a worker discipline device: Workers who are caught hirking can be immediately dismissed.

Since there are obviously no decreasing returns to higher levels of (formal) schooling, human capital theory predicts that we should observe similar age-earnings profiles across countries when using individual data from similar industries. Since, on the other hand, monitoring costs differ significantly between industry and services we should observe relatively flat age-earnings-profiles in industry and much steeper ones in the service sector (where individual productivity is much more difficult to measure). Moreover, the differences between these two sectors as well as within more detailed industries should be quite similar across countries (age earnings profiles are much steeper for German white collar-workers than for blue collar-workers, see Frick 1997).

If the matching argument was true, we should observe significantly flatter age-earnings profiles for workers with 5-20 years of tenure as compared to workers with less than...
five years. This finding should hold irrespective of industry or country under considera-
tion.

Literature

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Conclusion

Although our proposal consists of a number of quite heterogenous projects, we hope to
inform the scientific debate with a number of empirical analyses testing conflicting hy-
potheses that can be deducted from standard labor and/or personnel economics. Our aim
is not only to reproduce findings that have already been published elswhere, but we also
want to take the opportunity to test competing hypotheses using very large and – even
more important – identical data sets from a number of European countries. Compared to
analyses that are based on the ISSP-program we have at least one big advantage: Due to
their enormous sizes, our data sets a distinction between different socio-economic
groups of workers, still leaving a sufficiently large number of cases for hypothesis test-
ing.