

Occupation Growth, Skill Prices, and Wage Inequality

Abstract

Two of the most important trends in developed countries' labor markets over the past decades have been a strong increase in wage inequality and a substantial reallocation of employment across occupations broadly characterized by polarization, i.e., a hollowing out of the middle class. However, previous literature has found it difficult to make a quantitative connection between the two trends. In this paper, we show that selection effects are key to understand why there is hardly a relation at first sight. We develop a new method to separate changes in occupational skill prices from individual skill changes. Using German administrative data with longitudinal information on occupations, we show that selection effects have been strong enough to overturn some of the shocks to occupational demand. Intuitively, workers who leave occupations that pay lower prices for a unit of skilled labor—for example because of automation technology—have much lower skills than those who remain, so that aggregate wages change similarly to those in other occupations. We show that the effect of such demand shocks on wage inequality is large and would have been much larger in the absence of worker selection.

The paper is joint work with Michael J. Böhm (Bonn) and Felix Schran (Bonn)

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