FORMER EAST GERMANS ENJOY RETURNS TO SCHOOLING SINCE 2000: The college-educated have caught up with their Western peers, while low-skilled workers still lag behind

Former East Germans still earn only 70c for each euro earned by former West Germans on average. But those Easterners who took advantage of reunification to invest in schooling have just about caught up. These are among the findings of research by Sang Yoon Lee, Wolfgang Dauth and Sebastian Findeisen, to be presented at the annual congress of the European Economic Association in Geneva in August 2016.

Analysis of German social security data from 1992 onwards shows a rapid wage catch-up for Easterners after reunification, followed by slower progress since 2000. The authors attribute the former to labour market changes, and the latter to the effects of education.

They find that for high-skilled Eastern cohorts, the wage gap vanishes for those below college age at reunification. But low-skilled workers from the former East Germany still earn less than their Western counterparts, though each successive Eastern cohort is still closing the wage gap by about one percentage point.

The authors comment: ‘Understanding the sources of wage convergence and its slowdown are important not only for Germans but also for most East European economies since the fall of the Iron Curtain.’

More...

Twenty-five years since reunification, East Germans’ wages are still well below their Western counterparts. The average wage of East Germans relative to the West rose rapidly from about half in 1992 to 65% in 1997 (Figure 1). But since then, relative wages have risen by only five percentage points to 70% in 2014. Understanding the sources of wage convergence and its slowdown are important not only for Germans but also for most East European economies since the fall of the Iron Curtain.

The researchers report their findings: we find that the rapid initial rise is mostly due to East Germans becoming exposed to the new labour market system, while the slow but persistent rise post-2000 is due to more human capital accumulated by younger East Germans, who were less exposed to socialist schooling. Furthermore, college-educated East Germans have all but caught up with their Western counterparts, while less educated East Germans’ wages are still converging to the West’s.

Our analysis is based on a 30% sample of all German social security notifications from 1992 onwards, the first year that (former) East Germans were included in the data. The approach is simple: we observe the wages of every individual at all times and ages, but only after they start working. So any difference that cannot be explained by time and age is attributed to what happened before labour market entry, namely schooling.

Figure 2 shows the East-West German wage gap for all cohorts in the sample, controlling for time and age. The gap closes by about 1.25 percentage points for every successive birth cohort up to those aged 15 at reunification. These are the cohorts that enter the labour market in the mid-1990s, which partially explains the slowdown in East
relative wages in Figure 1.

Figures 3 and 4 split Figure 2 into Easterners with or without a college degree. For high skill Eastern cohorts, the wage gap vanishes for cohorts at or below college age at reunification. So the slowdown in Figure 1 is partially explained not by high skill Easterners earning more, but younger cohorts replacing older cohorts in the labour market. Among the low skilled, each successive Eastern cohort is still closing the wage gap by about one percentage point.

Figures 5 and 6 show the same wage gaps over time, now instead controlling for age and cohort. Since anything that can be explained by the workers’ human capital would be captured by age or cohort, the gaps here are entirely due to conditions unrelated to the worker, such as differences in the type of firms in the East and West.

The rapid rise in wages we saw in the mid-1990s in the first graph is present for both high and low skill workers, and again we see that Eastern high skill wages have all but converged to the West’s. But for low skill workers, relative wages peaked in 1997 and have been persistently dropping since. Hence, the relative wage increase observed in Figure 1 in later years can only be due to younger cohorts accumulating more human capital.

In further analysis, we argue that much of the existing gap among the less-educated unexplained by human capital is due to location: East Germans who moved to the West have more or less closed the gap and earn almost the full extent of their human capital potential, even controlling for selection.

We also find that more and more younger East Germans went to college despite their college premium no longer increasing, suggesting they went to lesser quality colleges, or that employers discriminate more against high skill than low skill East German workers.

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Figure 1: East Relative Wages over Time

Year

Figure 2: East-West Wage Gap by Cohort

Age at Reunification
0 10 20 30 40 50

All
Figure 3:

East–West Wage Gap by Cohort

Age at Reunification

High

Figure 4:

East–West Wage Gap by Cohort

Age at Reunification

Low
Figure 5:

East-West Wage Gap over Time

Year


High

Figure 6:

East-West Wage Gap over Time

Year


Low