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What drives wage gaps in Europe?

by Jan Drahokoupil and Agnieszka Piasna

This working paper compares wages across Europe in relation to the characteristics of workers and firms. Worker and workplace endowments can be taken as a proxy for labour productivity. We estimate the extent to which wage differences observed at an aggregate level can be related to the different compositions of workforces and workplaces, as well as the types of jobs conducted in separate countries. We also decompose the observed differences in returns on endowments by identifying the sectors and occupational groups that contribute most to the wage gaps observed at the aggregate level.

The wage gaps between high-wage and low-wage countries increase once differences in worker, work and workplace characteristics are taken into consideration. In contrast, the differences in wages between high-wage countries diminish when we control for these endowments. The wage gap between East and West thus seems to be explained by a much lower return on skills and other characteristics rather than by differences in the composition of workforces and firms. There is much less wage disparity across European countries in more labour intensive and lower-paid services sectors, such as accommodation and food service activities.

Key findings

- The research suggests that, in high-wage countries, the positive wage premium can be attributed to the structural differences between economies; wage premiums diminish once productivity-related characteristics are taken into consideration and controlled for
- In most European low-wage countries, controlling for worker and workplace characteristics in fact increases the wage gap
- The study reveals that once productivity-related characteristics are controlled for, wage gaps between East and West are in fact wider than they appear when simply comparing average wage levels across countries
- Negative wage premiums can be related to productivity-determining factors that are unrelated to observed worker and workplace characteristics, but the analysis suggests a scope for wage increases particularly in CEE countries



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Key data

Table 1: Differences in net monthly earnings (in Euro and adjusted for PPP) relative to the north-west group, selected sectors

	North-west	South	CZ HU PL SK	BG RO	EE LT LV	SI HR
Manufacturing	0.0	-368.7	-776.3	-1124.0	-737.6	-840.6
Construction	0.0	-386.7	-667.1	-1165.9	-618.7	-770.1
Wholesale and retail	0.0	-273.1	-508.9	-816.0	-410.1	-644.8
Transport and storage	0.0	-236.2	-621.5	-1035.9	-487.5	-713.8
Accommodation and food	0.0	-148.8	-332.6	-828.2	-314.9	-592.6
Information and communication	0.0	-843.4	-872.6	-620.4	-824.2	-806.1
Finance and insurance	0.0	-150.1	-822.7	-1315.8	-812.0	-713.5
Professional, scientific and tech	0.0	-469.0	-860.2	-1062.5	-832.5	-966.4
Admin and support services	0.0	-242.1	-599.6	-773.8	-290.8	-509.2
Public administration	0.0	-271.7	-782.3	-1200.2	-791.5	-782.8
Education	0.0	-173.5	-689.5	-1030.3	-754.4	-595.7
Health and social work	0.0	-226.5	-790.0	-1047.6	-777.1	-681.2
Arts, entertainment	0.0	-154.4	-224.7	-958.9	-870.9	-468.5
Other services	0.0	-318.3	-383.3	-925.3	-562.3	-445.4
Activities of households	0.0	101.5	-46.1	-632.1	-381.0	-487.4

Note: marginal means estimated from the regression model, adjusted for all control variables. In bold = differences from the negative return in manufacturing that are statistically significant ($p \leq 0.05$).

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Figure 2: Differences in net monthly earnings (in Euro and adjusted PPP) across EU28 countries

