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Firms and wage inequality in Central and Eastern Europe.

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Recent studies show that firms are playing an increasingly important role in shaping wage inequality in advanced economies. We contribute to this literature by analysing wage inequality patterns and their firm dimension in Central and Eastern European countries. We use large, linked employer-employee datasets with data from the 2002-2014 period. All in all, we find that wages were, on average, more unequal in the CEE countries than in the older EU member states. We find that unlike in many other advanced economies, wage inequality levels have decreased in CEE countries, and particularly in those countries that previously had the highest wage inequality levels. The variance of log wages decreased the most in Latvia (from 0.46 in 2006 to 0.31 in 2014), Romania (from 0.42 in 2006 to 0.36 in 2014), and Lithuania (from 0.37 in 2002 to 0.27 in 2014). As the decreases in wage inequality in the CEE countries appear to have been concentrated in the 2006-2014 period, the question of what role the Great Recession and the post-crisis adjustments played in these patterns arises. The differences in the levels of wage dispersion among the CEE countries narrowed considerably in the 2000s and the early 2010s.

We also analysed to what extent wage inequality arises from within-firm wage inequality, and to what extent it may be driven by differences in average wages between firms. The relative size of the between-firm component varied substantially across countries, and was largest in countries with the highest wage inequality levels. In most of the CEE countries, both within-firm and between-firm wage inequality decreased over the study period, but the between-firm component was the main driver of the changes in wage inequality levels between 2006-2014.

We further estimate the recentered influence function (RIF) regression and the Blinder-Oaxaca decomposition in order to investigate the micro-level determinants of wage inequality. In all of the countries studied, we see a strong relationship between the occupation in which an individual works and his/her contribution to wage inequality. We observe that sectoral affiliation was also an important determinant of wage inequality, with financial and insurance services contributing the most (and manufacturing contributing the least) to increased levels in all countries. Finally, we find that peer effects matter a lot: in all of the countries and years analysed, workplaces with large shares of tertiary-educated workers contributed substantially to increased wage inequality, while workplaces with large shares of older workers had lower levels of wage inequality, all other things being equal. We find that changes in endowments – that is, changes in the structure of workers with respect to their own characteristics and those of their firms – contributed to increases in wage inequality, while changes in coefficients contributed to decreases in inequality.

The complete results of our research are published in the article:

Magda I., Gromadzki J., Moriconi S. (2019). Firms and wage inequality in Central and Eastern Europe. IBS Working Paper 03/2019. http://ibs.org.pl//app/uploads/2019/03/IBS_Working_Paper_03_2019.pdf

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