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Abstract

This paper develops a multi-sector job search model that incorporates workers' education choice and firms' hierarchical labor demand to identify and quantify the underlying channel of 'degree-inflation' measured by the share of highly educated workers employed in unskilled positions. Highly educated workers being assumed to not always be qualified for skilled tasks gives rise to a vicious circle whereby (i) the information and communication technology (ICT) shock prompts the creation of vacancies for the highly educated rather than general workforce in both skill-intensive and (general) labor-intensive sectors, (ii) a significant proportion of skilled workers eventually perform unskilled tasks in the latter sectors, (iii) the resulting cross-skill matches crowd out the general workforce and suppress unskilled wages, and (iv) the college premium escalates and the college enrollment rate is self-reinforced. Numerical experiments based on Canadian data from early 1980s to 2000s suggest that without degree inflation, the unskilled, skilled, and overall wages in the Canadian labor market would be higher by (up to) 46, 43, and 56 percent, respectively, in early 2000s. For this extent, resolving the degree inflation problem, for example, through improving the quality of higher education, would induce substantial welfare gains to not only skilled workers but also unskilled workers.

Keywords: Degree Inflation, Cross-skill Match, Returns to Education

JEL Classification: I25, J31, J64, O41