The Reasons for Wage Rigidity: Evidence from a Survey of Firms

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Presentation Outline

- Survey Method
- Theories Tested
- Important Results
- What this means regarding macroeconomics

Survey Methods

- 184 Firms
- Three Categories: White-Collar, Blue-Collar, and Less Skilled
- Most respondents were compensation executives in Business Week 1000 corporations
- 9 Statements
- Replies based on how important a consideration they were in not cutting wages during recessions
  - Rated on a scale of 1 to 4 (not important to very important)

Theories of Wage Rigidity

- Contract Theory
- Implicit Contract Theory
- **Fair Wage-Effort Hypothesis**
- Insider-Outsider
- Efficiency Wage Theory
  - Shirking Model
  - Gift-Exchange Model
  - **Adverse Selection Model**
  - **Turnover Model**

Important Results

- Adverse Selection

	Average score Overall	Business Week	Non-Business Week	Percentage ranking each statement as most important
g. If your firm were to cut wages, your most productive workers might leave, whereas if you lay off workers, you can lay off the least productive workers.				
White-collar	3.27	3.35	3.13	40.8%
	(1)	(1)	(1)	(1)
Blue-collar	3.13	3.16	3.07	26.6%
	(1)	(1)	(2)	(1)
Less skilled[n,s]	3.10	3.13	3.04	34.6%
	(1)	(1)	(1)	(1)

Important Results

- Fairness
  - More important for Blue-Collar and Less Skilled firms
- Turnover
  - More important for White-Collar firms

	Average score Overall	Business Week	Non-Business Week	Percentage ranking each statement as most important
d. A cut in wages would decrease workers' effort, resulting in less output or poorer service.				
White-collar	2.77 (4)	2.77 (4)	2.77 (4)	10.3% (4)
Blue-collar*	2.99 (2)	2.94 (2)	3.12 (1)	15.4% (3)
Less skilled	2.88 (2)	2.86 (2)	2.92 (2)	15.4% (3)
e. A cut in wages would increase number of workers who quit, increasing the cost of hiring and training new workers in the future.				
White-collar**	2.96 (2)	2.95 (2)	2.97 (2)	11.6% (3)
Blue-collar	2.73 (4)	2.68 (4)	2.85 (3t)	11.7% (4t)
Less skilled[s]	2.56 (4)	2.56 (4)	2.55 (4)	9.4% (5)

What this Means

- Not cutting wages in recessions is profit-maximizing behavior
  - Firms lower costs by laying off the least-productive workers instead, keeping the firm's MPL high.
  - Firms fear that wage cuts reduce productivity
  - Firms want to keep training costs low and fear they will lose their most productive workers if they lower wages