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PRESS RELEASE

Downward nominal and real wage rigidity: Survey evidence from European firms

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Based on a unique firm-level survey carried out between late 2007 and early 2008 within the framework of the Wage Dynamics Network, we analyse the flexibility of wages across 14 countries of the European Union (EU). Our objective is to examine the extent and determinants of downward nominal and real wage rigidity. Downward nominal wage rigidity (DNWR) is defined on the basis of the frequency of nominal wage freezes. Downward real wage rigidity (DRWR) is defined on the basis of wage indexation.

Overall, we find that the non-euro area member states of the EU are more likely to experience wage freezes compared to the euro area member states, whereas indexation mechanisms are more widely used in the euro area countries included in our sample. Country-specific factors appear to be significant determinants of downward wage rigidities and that institutional differences between countries are an important factor behind this finding. For example, high collective bargaining coverage is positively related with real wage rigidity, while the estimated relationship with nominal wage rigidity is insignificant. Another institutional aspect that influences wage rigidity is related to how difficult it is for employers to lay off workers. We find that nominal wage rigidity is positively associated with the extent of permanent contracts. In addition, permanent contracts have a stronger effect on wage rigidity in countries with stricter labour regulations.

There seems to be a positive relationship between product market competition and downward nominal wage rigidity, although the results are dependent on the way competition is measured. A possible cause of this empirical result is that in highly competitive industries rents should be low, and therefore so should wages. This leaves smaller margins to reduce wages, because firms paying low wages that are closer to a collectively agreed or legislative minimum level have less flexibility than firms having a so-called wage cushion between the minimum and the actual wage bill.