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PRESS RELEASE

The margins of labour cost adjustment: Survey evidence from European firms

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Using a unique survey of firms from 12 countries of the European Union conducted between the second half of 2007 and the first quarter of 2008 within the framework of the Wage Dynamics Network coordinated by the European Central Bank, we examine the importance and determinants of alternative strategies firms might use to adjust their labour costs. In our survey, we asked firms' managers directly about their use of these policies in the recent past. In this paper we analyse factual responses about the types of margins firms have used in the last five years preceding the survey. Specifically, we are able to identify the incidence of the following six labour-cost saving strategies: reduce or eliminate bonus payments; reduce non-pay benefits; change shift assignments or shift premia; slow or freeze rate at which promotions are filled; recruit new employees at lower wage level than those who left voluntarily; and encourage early retirement to replace high wage employees by entrants with lower wages.

Our contribution to the literature is threefold. First, we document comparable information on labour cost adjustment practices beyond base wages for a large set of EU countries and sectors. This allows us to discuss the relative importance of each individual strategy across countries characterised by different sets of laws and institutions governing their labour markets. Our survey shows that firms fairly commonly use strategies to reduce labour costs other than reducing base wages. We find substantial heterogeneity in the use of these strategies across countries and firms, depending on firm characteristics and labour market institutions. Second, we examine characteristics of firms and the environments in which they operate that determine the relative importance of each type of labour cost adjustment mechanism. In particular, larger firms show greater margin of manoeuvre with respect to using any of these strategies in order to adjust labour costs. Different indicators of the severity of competition suggest that firms in more competitive environments are more likely to use some of these strategies more heavily. Finally, we show how the use of these adjustment practices can be related to firms' experience regarding nominal wage rigidity, as well as to the extent of wage indexation operating in the firms.