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PRESS RELEASE

Why firms avoid cutting wages: Survey evidence from European firms
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The difficulty inherent in reducing nominal wages has recently moved into the spotlight as a result of efforts of a number of European countries, especially within the euro area, to adjust to serious economic shocks through internal devaluation. Even with the severity of the economic downturn experienced across Europe in recent years, cuts in nominal wages appear to be a last resort for firms, and a series of papers have established that wages tend to be sticky downwards. This paper uses evidence from a firm survey conducted in a number of EU countries to investigate a range of different theories as to why firms appear reluctant to lower wages. The authors document the relative importance of eight possible reasons for avoiding wage cuts, with firms being asked about the effect of (1) labour regulations and (2) collective agreements, (3) the existence of implicit contracts, (4) efficiency wage considerations in terms of negative effects on worker morale or effort, (5) whether firms had concerns about losing key staff or (6) causing difficulties in future recruitment, whether (7) the costs of future recruitment and training would be higher, and whether (8) they felt employees would be concerned with how their wage compares to that of similar workers in other firms.

Across all countries and sectors, the two most important causes for avoiding base wage cuts are the belief that this would result in a reduction in morale or effort and the fear that the most productive workers would leave as a consequence. The greatest variation across countries was in the importance attached to labour regulations and collective bargaining, which is found to be almost twice as high in the euro area countries as in the non-euro area countries. The authors find certain firm characteristics to be strongly related to the relevance of different theories. For example, firms that employ higher proportions of blue-collar and low-skilled white-collar workers rank labour regulation highly but are less likely to lay importance on concerns about losing the best employees, or the potential costs of later recruitment and training. Larger firms are more likely to be aware of the potential complications associated with reductions in nominal pay and to assign higher relevance to most of the possible reasons for avoiding wage cuts. Fears about lower effort and lower morale are systematically quoted as highly relevant reasons for avoiding wage cuts across firms of any type.

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