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Workshop: EMU and labour markets, notes

Workshop, 11 December 2012

- Pre-crisis period (2007) evidence: 15,000 firms, 15 countries: AT, BE, CZ, EE, FR, GR, HU, IT, IR, NL, LT, PL, ES, SL.
    - On average firms adjusted wages every 15 months and prices every 9.5 months.
        - Wages change more often with firm-level bargaining and indexation; less often with high coverage and strong employment protection.
        - Prices change more often with higher degree of competition; less often with higher labour cost share.
    - Indexation of wages to inflation
        - 36% of firms declared to have some formal or informal mechanism to adjust wages with respect to inflation.
        - High degree of formal indexation in BE, LU, CY and ES (78%)
    - Even before the beginning of the crisis there was a share of the firms in the sample that cut of froze wages at least once during the previous 5 years.
    - But cutting wages in general is very rare
    - Reasons for not cutting wages: fairness and efficiency wage arguments, labour regulations in euro area countries.
- 2008-2009 period: 5,700 firms, 9 countries: AT, BE, CZ, EE, ES, FR, IT, NL, PL
    - For any negative shock the most used measure was cut costs, but mainly cutting non labour costs.
    - No major differences across countries: for all countries most firms froze wages, only few made cuts on wages.
    - Estonia has the most flexible labour market among the countries in the sample; in the 2009 survey 44% of the firms declared to have cut wages, in all other countries this level was well below 10%.
    - In Austria and Germany the main cost-cutting mechanism is adjustments in hours worked (36% of cost reductions are explained by this variable in the regression analysis); this allows them to keep unemployment at relatively low levels.
    - Whereas countries like Spain adjusted mainly through lay-offs or non-renovations of short-term contracts (23% through permanent employment and 42% through temporary employment).
- Main implications for structural reforms in the EU labour markets: Econometric analysis confirms that institutions matter
    - Centralized collective wage agreements delay wage adjustments
    - Strict employment protection is associated with a higher recourse to layoffs of temporary employees and a lower reduction of hours worked.
- Structural reforms should aim to:
    - Increase wage flexibility
    - Protecting workers rather than inefficient jobs
    - Improving competition in goods and services markets
- Recent changes towards increasing wage flexibility
    - Moving to firm-level bargaining (IT, GR, PT, ES)
    - Several countries have temporarily suspended wage indexation

- Macro picture
    - During the crisis compensation per employee/hour, negotiated wages and hourly labour costs kept increasing in the euro area
    - This is mainly a result of the composition effect (lay-offs of mostly low wage workers, controlling for this variable leads to reductions in compensation in many countries)

Nominal wage rigidity under severe downturn: dysfunctional labour market by Pedro Portugal (Bank of Portugal). The Portuguese case

- According to the OECD, Portugal used to be the most protected labour market among its member states.
- Higher nominal wage rigidity among EU countries (Dickens et at., JEP, 2006)
- Nominal wages reductions forbidden by law since the 50's, this law is still applied.
- There's a minimum wage and the share of minimum wage workers has increased from less than 8% in 2006 to above 14% in 2009, meaning that the minimum wage does bind.
- There are about 30,000 wage floors: minimum wage by occupation category
- Chronic problem: wage rises above labour productivity increases
- Before the euro this chronic problem was solved through nominal devaluations; not possible anymore.
- Currently (2012), over 45% of Portuguese firms have frozen their wages; about 20% in 2009.
- Econometric analysis
    - Wage formation determinants: 66% insiders' wage, 22% collective agreements, 11% minimum wages.
    - Collective agreements and minimum wages proven to significantly increase the probability of firm failure.
- Labour unions with great power; they influence above 90% of the wage setting in the economy, even though only around 10% of the workers are actual member of the unions. Union members can get almost 200% of wage premium over non-members.
- Reforms underway
    - Frozen minimum wages until better market conditions arise
    - A clear criteria to extend wage agreements to all sectors
    - Reductions on severance pay
    - Reductions on overtime pay
    - Flexible work schedule arrangements (bank of hours)
    - Reduction on administrative costs of individual dismissals
- Reforms still needed
    - End the monopoly of wage bargaining by trade unions
    - Promote firm-level wage negotiations (through work councils)
    - Allow firms to opt-out from collective agreements
    - Prepare opting-in options for the future
    - Introduce representation mechanisms that reveal the actual constituency of unions and employer associations (e.g., firm level elections)
    - Independent financing of trade unions and employer associations

Insurance and incentives in a monetary union by Thomas Philippon (NBER, CEPR)

- How to make the euro zone a stable currency area? – Insurance and incentives
- Banking Union
    - Insurance and incentives = Supervision and resolution

- Necessary: yes, but sufficient: probably not
- Fiscal integration – Larger EU budget
  - Risk sharing through unemployment insurance
    - There are asymmetries in unemployment insurance expenditures
    - Sharing the deviations from each country's average unemployment insurance costs
    - Each country could keep its own regulation as long as there are incentives towards labour market improvements
- Shared replacement wage of 50%, above 50% would be paid idiosyncratically by each national government
- Paying for unemployment lengths between 3 and 12 months
  - Below 3 months is frictional unemployment: country specific
  - Over a year: chronic
    - The unemployment insurance advantages
      - Automatic
      - Ex-ante rules
      - No stigma of applying for a program/fund
        - Countries would never apply on time
      - It is possible to design a zero net transfers system
        - Example of Spain paying Germany during the years before the crisis

Guntram Woff intervention (Bruegel deputy director)

- Have we done enough to prevent future crisis? No
  - National fiscal policies are insufficient to manage large persistent shocks
  - Risk sharing is needed
  - But labour markets are too asymmetric to have a unified unemployment insurance system with zero net transfers
    - It would imply unifying labour market institutions
    - But these institutions reflect national preferences
  - A risk sharing system based on transfers indexed to deviations from potential outputs might be an incentive superior choice
    - It has the advantage of being contemporaneously linked with the cycle (unemployment is a lagged variable with respect to the cycle)
      - Therefore it would be a better counter cyclical fiscal tool
      - Centralized unemployment insurance payments would only start arriving once the countries are in deep recession and unemployment start rising
    - The drawback is in the measurement of the output gap
      - It is a non-observable variable subject to important estimation inaccuracies
      - How to adjust the transfers to ex-post revisions of the output gap?
        - Once the money is expended it cannot be returned

Event notes by Carlos de Sousa