

# Nominal Wage Rigidity Under a Severe Economic Downturn

## Pedro Portugal

(Banco de Portugal and NOVA School of Business and Economics)



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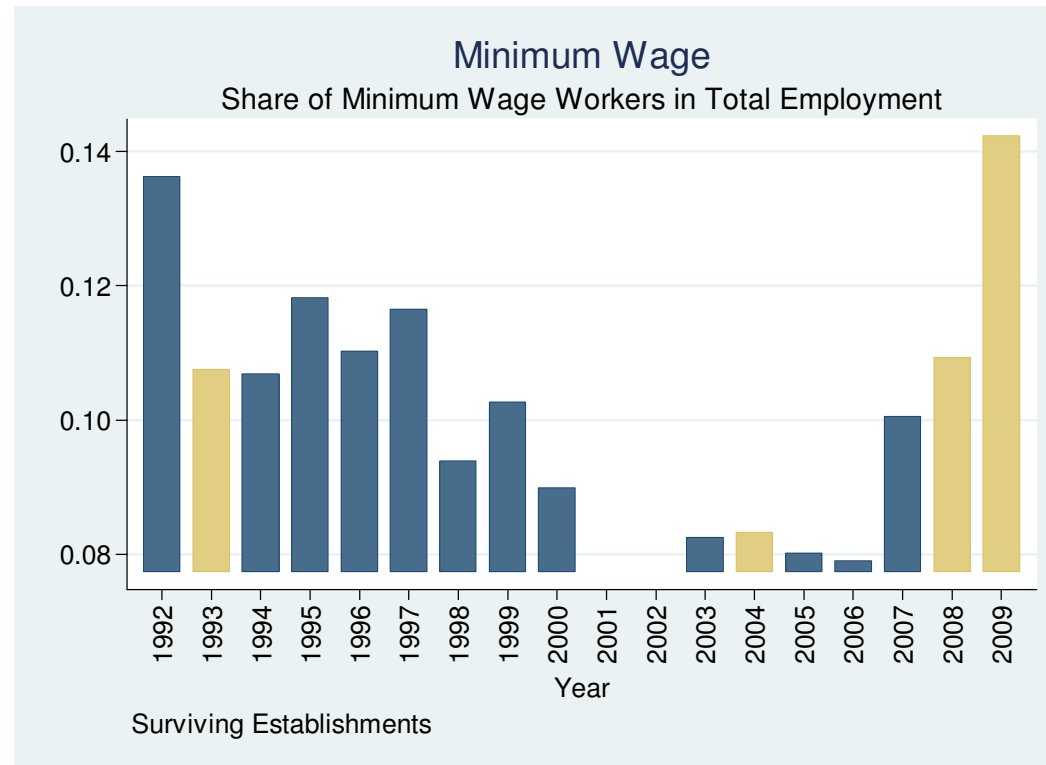
# A dysfunctional labor market

- Poorly designed labor market institutions
  - Extreme employment protection
  - Extreme unemployment protection
  - Extreme labor income protection
  - Extreme nominal wage rigidity
- Generated
  - A sclerotic labor market
  - A chronic productivity problem in the economy
  - A segmented labor market

# The architecture of the wage setting system

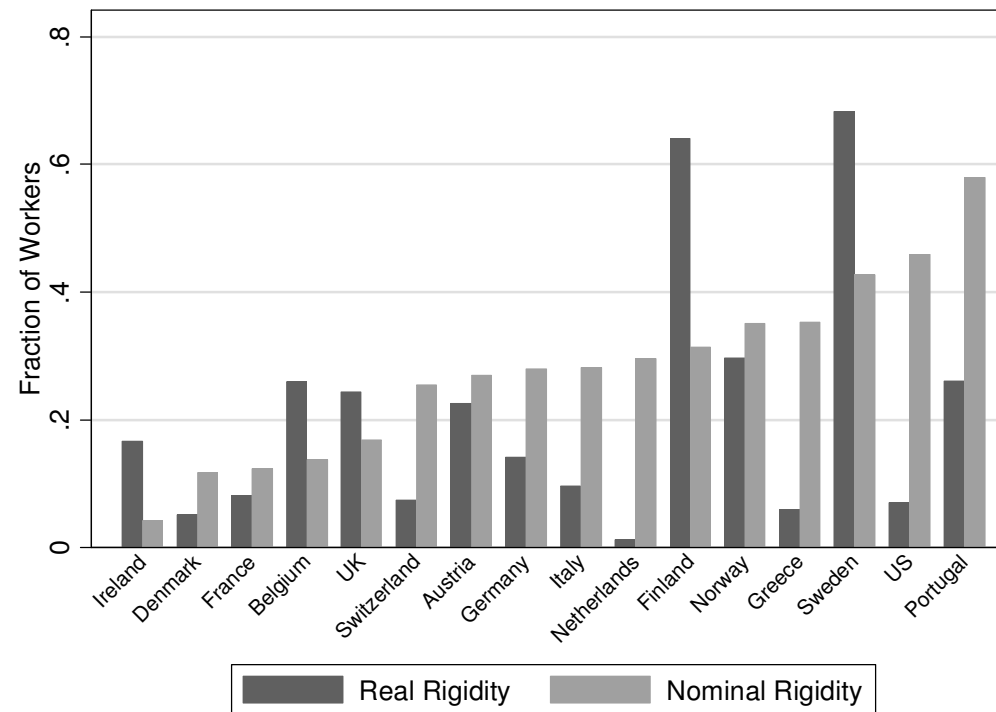
- National mandatory minimum wage
- Nominal wage cuts are forbidden since the 1950s
- Unions have monopoly over wage negotiations
- Wage negotiations between trade unions and employers' associations define wage floors by occupation category (around 30 000 job-titles)
- The wage agreement, by law, solely binds unionized workers and the firms that are members of the employer association
- There are no mechanisms that oblige unions and employers associations to disclose their constituency
- The legal conundrum is circumvented via the use of extension clauses (often to the whole industry) by the Ministry of Employment
  
- It is hard to conceive what kind of incentive mechanisms are at work

# The incidence of minimum wage is strong and doubled in just three years



0.16 in 2010

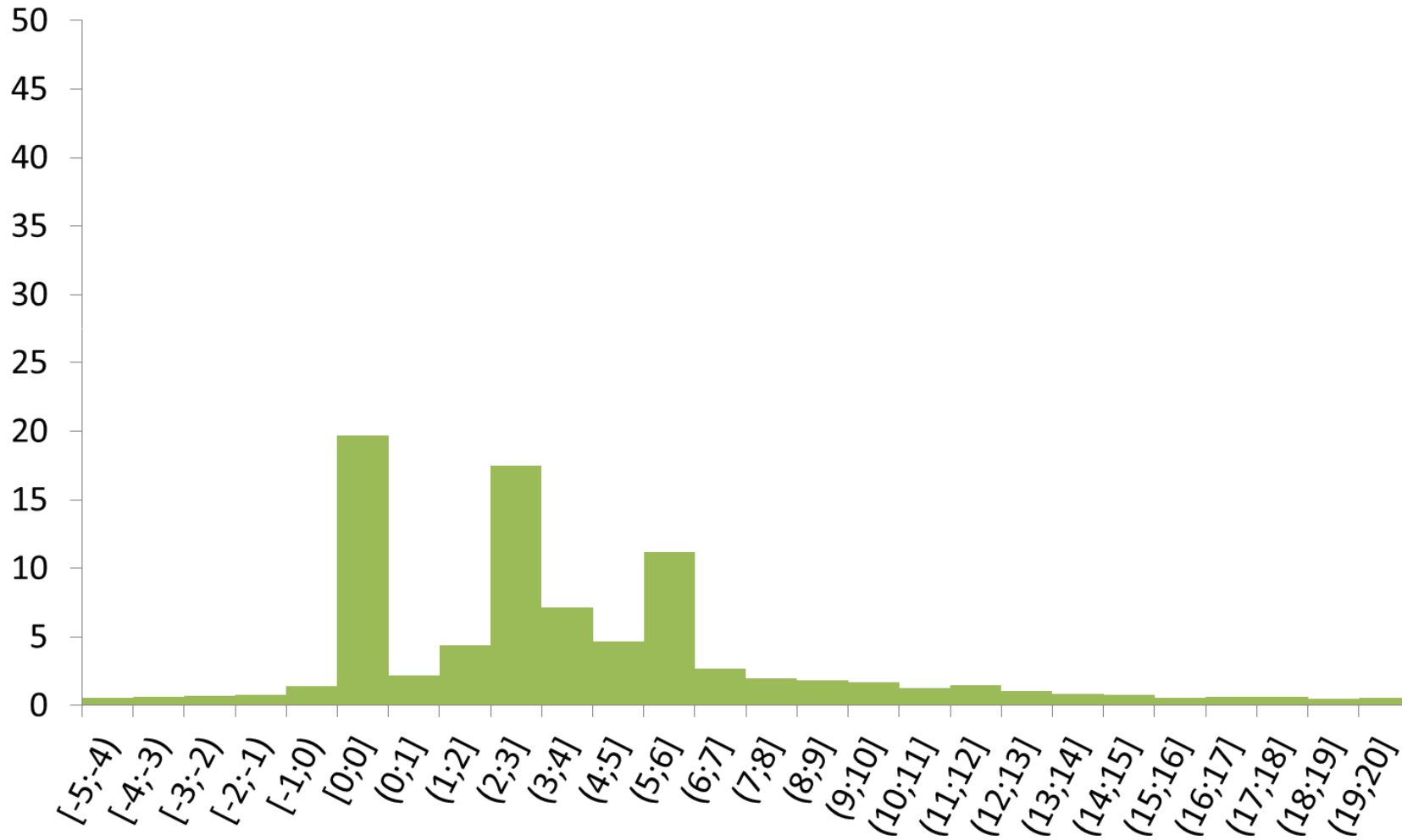
# Nominal wage rigidity is severe



Dickens et al., JEP, 2006

# Wage freezes are widespread

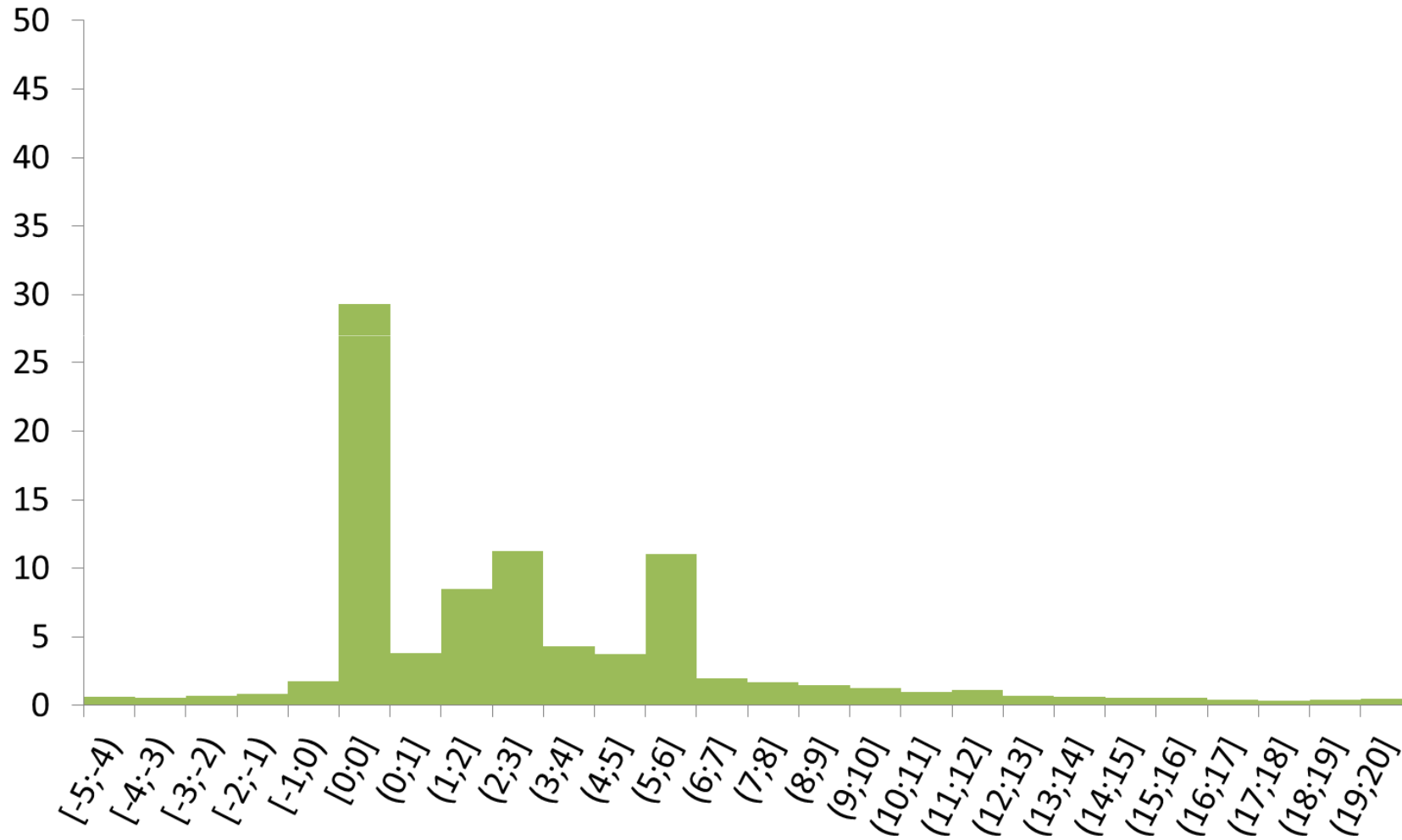
## Changes in wages (%), 2009



SOURCE: II

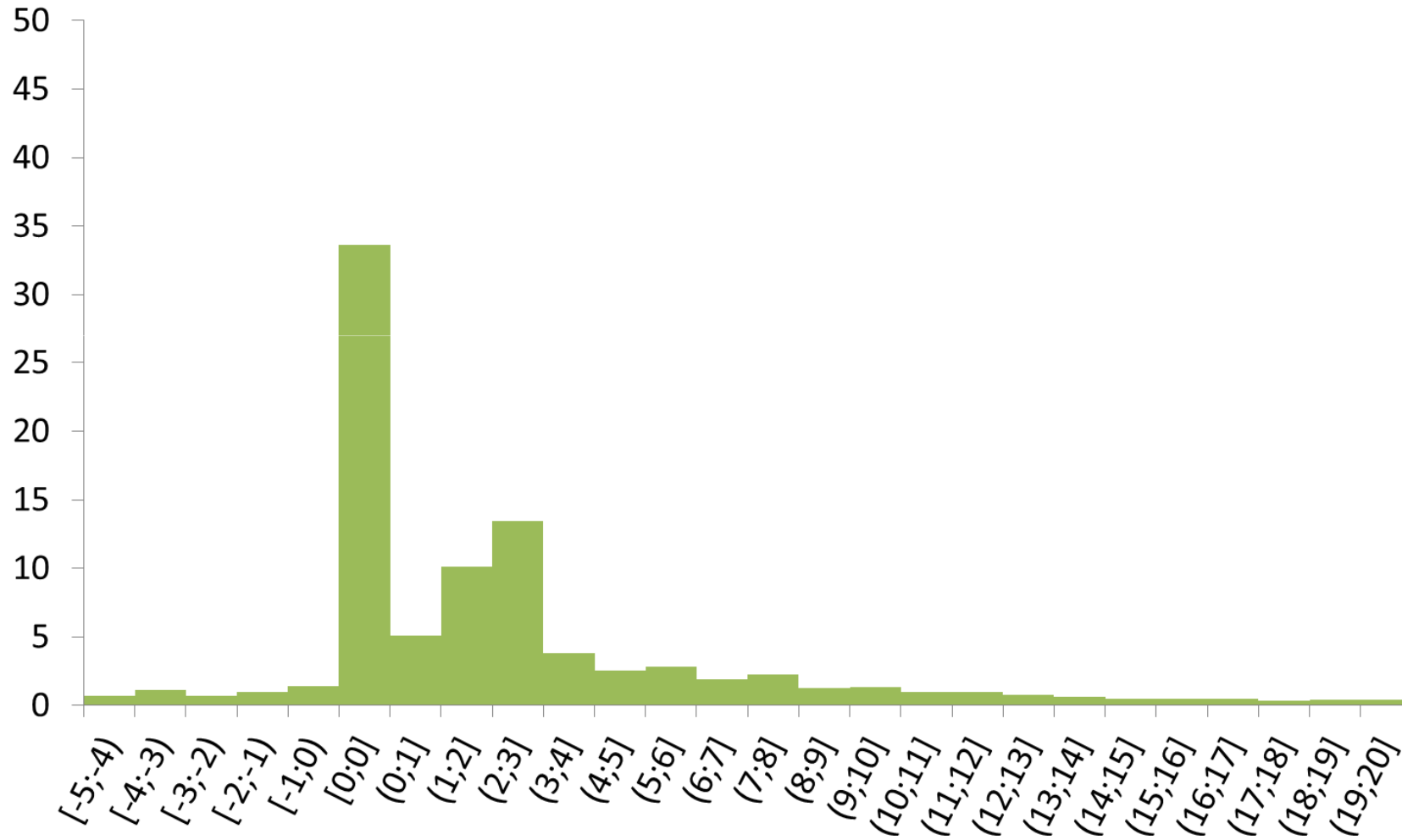
and increased with the downturn

Changes in wages (%), 2010



significantly

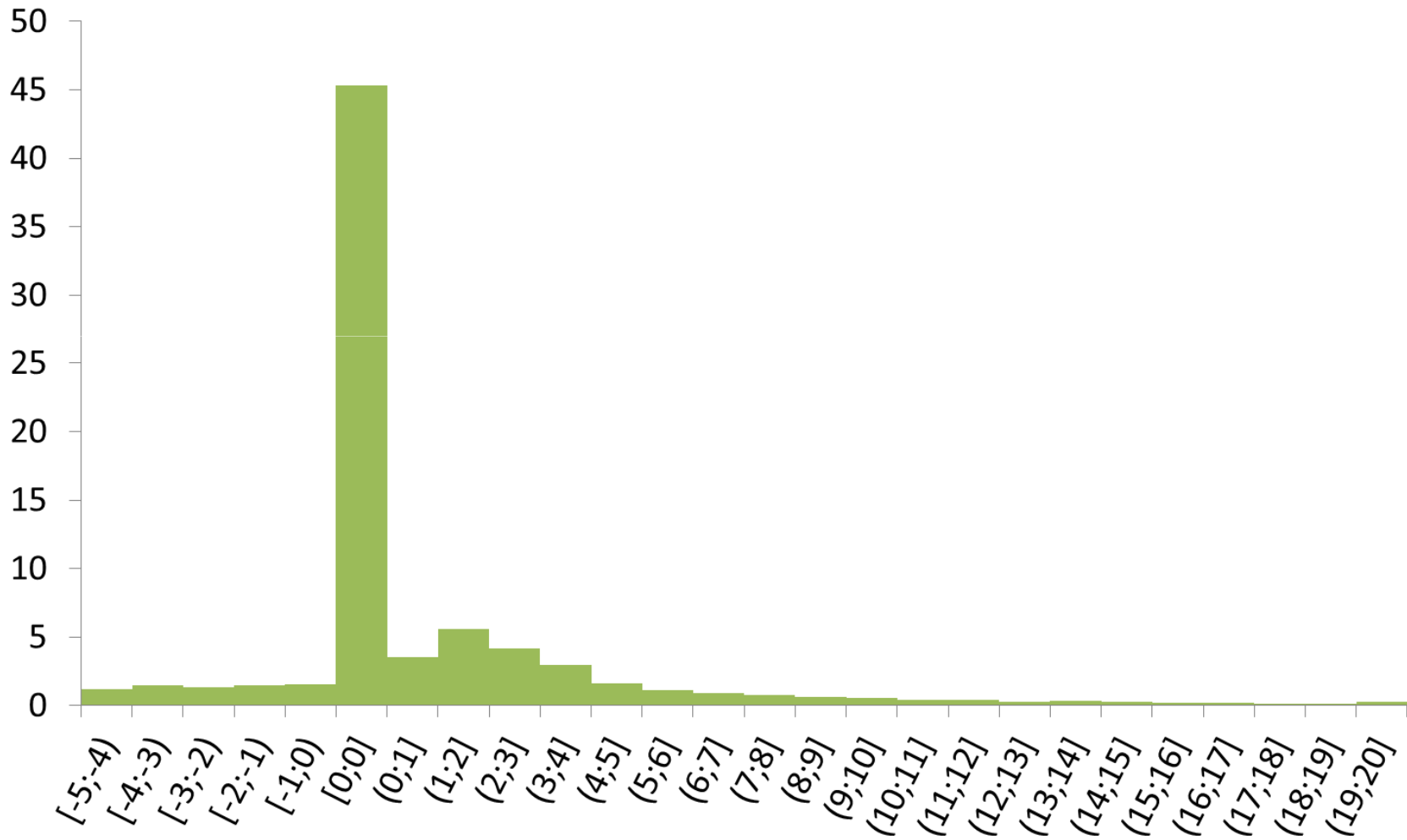
Changes in wages (%), 2011





# Very Significantly

## Changes in wages (%), 2012



SOURCE: II

# Insider Outsider Forces in Wage Formation

Insider wages	66%
Collective agreements	22%
Minimum wages	11%

# Firm Failure and the Role of Insider-Outsider Forces

Insider wages	0.01
Collective agreements	-0.05
Minimum wages	-0.09

# Who Do Unions Represent?

- Super-Insiders
- High wage workers
- With open-ended contracts
- That work in protected sectors or firms:
  - Monopolies
  - Public Sector
  - Non-tradable sectors
  - Large firms
- Employer associations also tend to represent large high wage firms

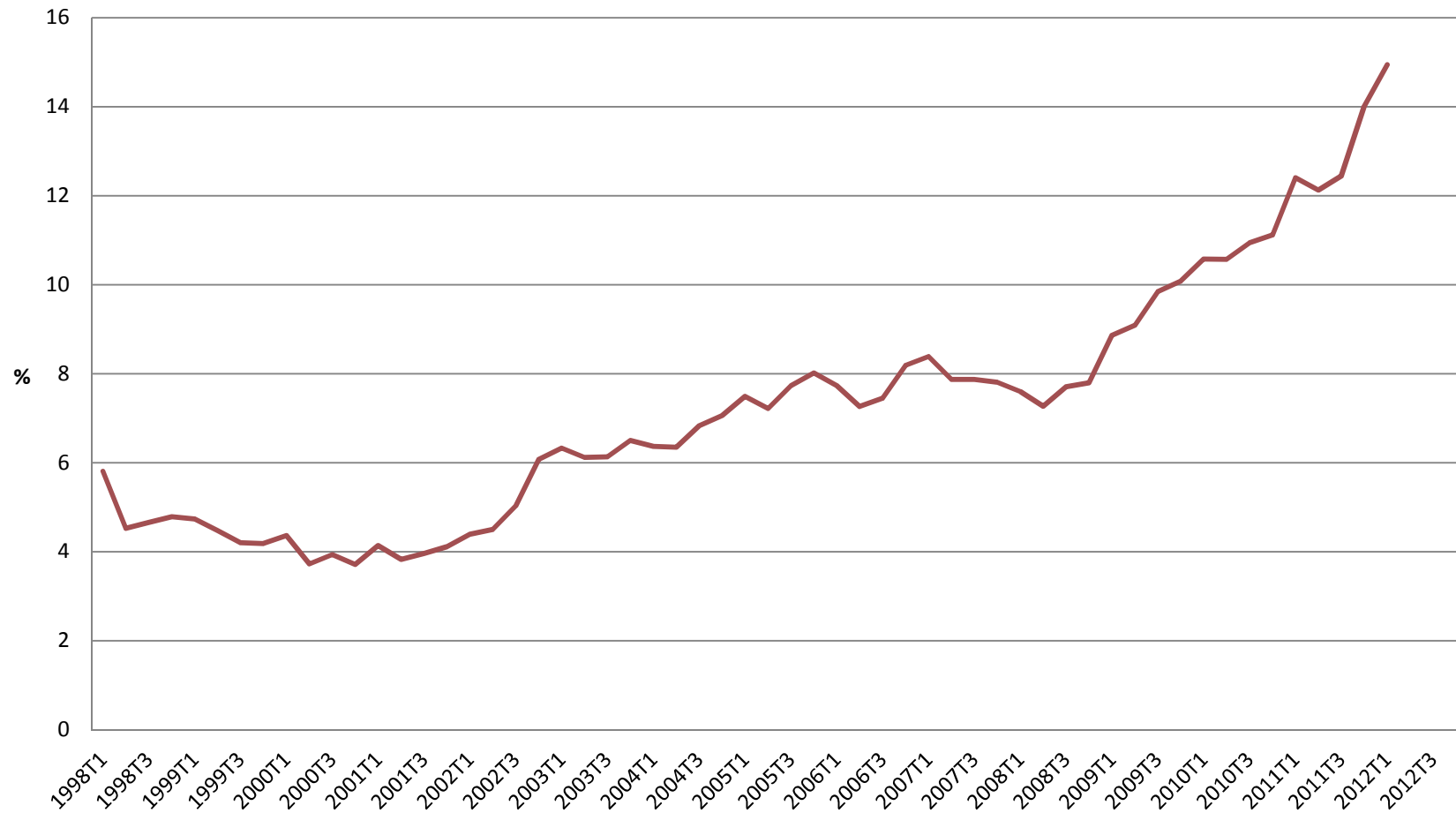
# Union Density (2010)

<b>Total</b>	<b>10.4 %</b>
Males	10.9%
Females	9.8%
Private Sector	8.8%
Public Enterprises	49.8%
Large Firms (larger than 100 workers)	20.6%
Small Firms (smaller or equal to 100 workers)	3.6%

# Union Premium

	Males	Females
Gross wage premium	117.1%	99.4%
Accounting for demographic characteristics	52,2%	39,6%
Accounting for the characteristics of the firm	34.7%	21%

# Unemployment rate



# A glimpse of labour market reforms under way

- Freeze on minimum wages until better labor market conditions
- A clear criteria to extend wage agreements to the all sector
- 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

