Labor Market Adjustments in Eurioe during the Crisis. Evidence from the WDN Survey

Izquierdo, Jimeno, Kosma, Lamo, Millard, Room and Viviano

Comments by Julian Messina

INTER-AMERICAN DEVELOPMENT BANK

The Big Question(s)

- How do firms adjust their labor costs to (negative) shocks?
- Employment
  - Hours vs. workers
  - Fixed term vs. permanent
  - Short tenured vs. long tenured
  - …
- Wages
  - Base wages vs. flexible components
  - Interaction with inflation: DNWR and indexation

IDB

Why do we care? It is important for…

1. … welfare considerations
   - The market is unlikely to produce first best outcomes (e.g. financial imperfections prevent insuring labor income risk). Too much wage/employment volatility
   - Excessive wage rigidity may lead to inefficient job destruction (loss of specific HK, discouragement and negative spillovers to public finances)
   - Excessive employment protection may prevent efficient job destructions and alter the K/L and labor mix. Dual labor markets
2. … monetary policy
   - A rate of inflation that is too low will not "grease the wheels" of the economy (Tobin, 1972)
3. … evaluating models of the labor market: implicit contracts, insider-outsider, poaching models and efficiency wage considerations

Answer depends on nature of the shocks, firm characteristics and environment (market and institutions)

- Permanent vs. Temporary shocks. Wages (GSP, 2005; Cardoso and Portela, 2009; Katay, 2016) and employment (CMNS, 2014) respond more to *permanent* than to *temporary* shocks
- Demand vs. Technology shocks. Employment responds strongly to idiosyncratic demand changes (Pozzi and Schivardi, 2016; CMNS, 2014)
- Purely idiosyncratic shocks or not. The elasticity of wages to TFPQ shocks is three times at high when shock is shared across firms that draw employment from the same labor market (CMNS, 2016)
- Family firms vs. conglomerates. Family firms provide greater employment protection but less wage insurance (Ellul et al. 2014), but conglomerates (Cestone et al. 2016) provide between-firm employment insurance
- Market structure and institutions. Product market competition forces firms to do more frequent adjustments, but these are limited by institutions (Bertola et al. 2012)

IDB

This paper

- Touches upon many of these issues!
- Extremely rich data (and paper) for a large number of countries
- Similar questions for the same countries during the recovery, great recession and the pre-crisis expansion
- Qualitative data
  - Advantages. (i) Potentially allows assessing the importance of factors that typically are extremely hard to observe in other data (e.g. source of shocks: demand vs. credit market shocks) and (ii) allows studying detail adjustment channels that are often unobservable in admin data
  - Disadvantages. Magnitudes are hard to evaluate; measurement error and recall bias

Comment 1

- Presenting a large number of issues with a large number of countries is challenging
- The country grouping is useful for summary statistics. I am not sure it helps in regression analysis, because groups are heterogeneous (e.g. in their shocks labor market institutions).
- Some “strange results” may be due to the grouping (or other factors including the qualitative nature of the data)

Comment 1

Table 2. Changes in labour input and shocks. Probit; marginal effects

	(1)	(2)	(3)	(4)	(5)	(6)
	Reduction in permanent workers		Reduction in temporary workers		Reduction in hours per employee	
Demand shock	0.216***	0.206***	0.123***	0.112***	0.139***	0.130***
	(8.291)	(7.806)	(5.379)	(4.876)	(6.392)	(5.932)
Dem.shock*Group II	0.085**	0.075**	-0.019	-0.015	-0.062**	-0.067**
	(2.305)	(2.015)	(-0.597)	(-0.484)	(-2.340)	(-2.544)
Dem.shock*Group III	-0.034	-0.053	0.035	0.009	0.005	-0.007
	(-0.592)	(-0.936)	(0.602)	(0.150)	(0.098)	(-0.146)
Access finance		0.073**		0.078***		0.065***
		(2.535)		(2.972)		(2.596)
Access fin.*Group II		0.030		-0.037		0.010
		(0.658)		(-0.964)		(0.267)
Access fin.*Group III		0.034		0.058		0.013
		(0.535)		(0.923)		(0.223)
Observations	17372	17372	17372	17372	17372	17372

Robust z-statistics in parentheses; *** p<0.01, ** p<0.05, * p<0.1. Weighted regressions (wl).

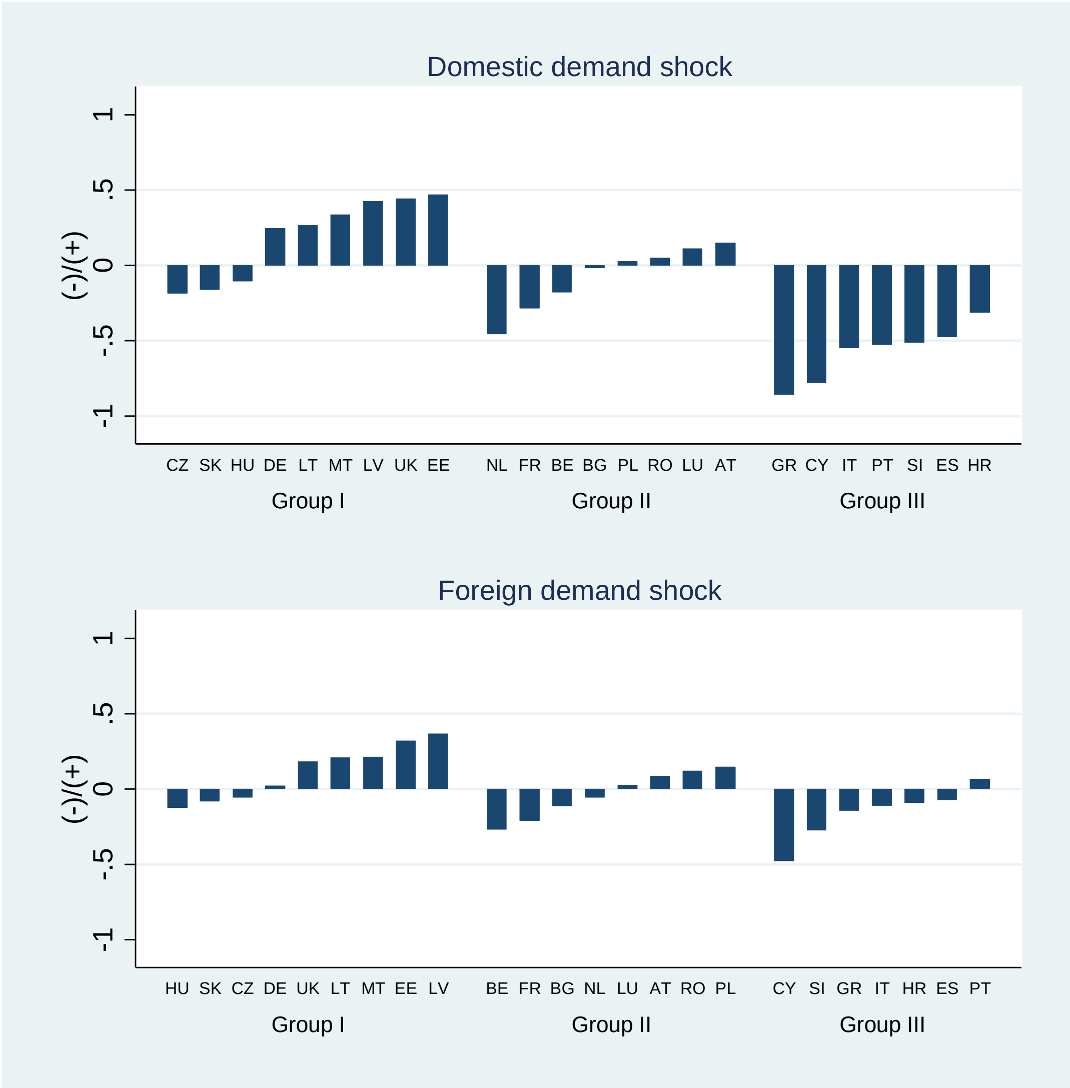
Comment 1

Table 3. Changes in wages and shocks. Probit; marginal effects.

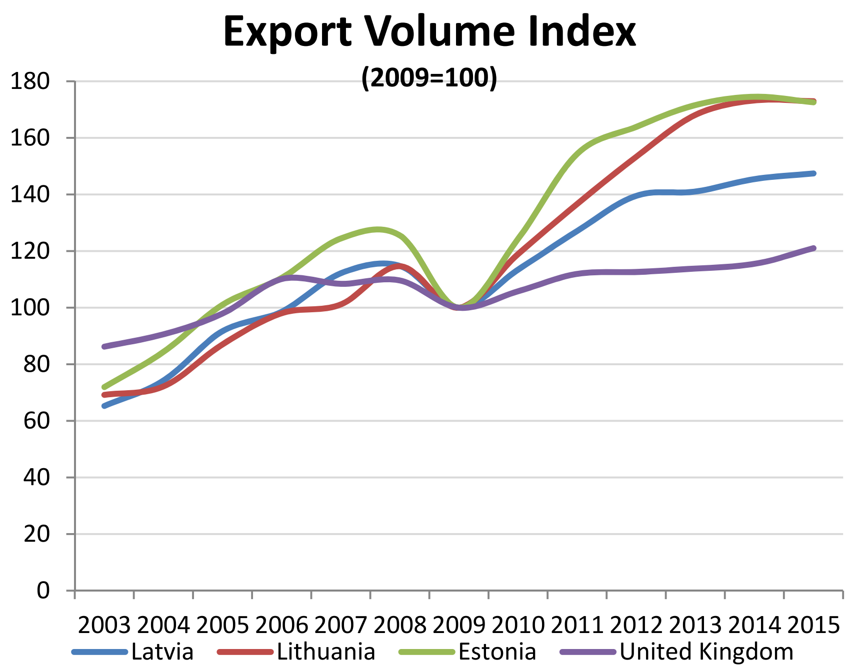
	(1)	(2)	(3)	(4)
	Reduction in base wage		Reduction in flexible wage component	
Demand shock	0.079***	0.072***	0.137***	0.131***
	(5.600)	(5.428)	(6.832)	(6.432)
Dem.shock*Group II	-0.052***	-0.050***	-0.021	-0.031
	(-2.885)	(-3.009)	(-0.760)	(-1.133)
Dem.shock*Group III	-0.100***	-0.106***	0.016	-0.018
	(-2.997)	(-3.035)	(0.306)	(-0.369)
Access finance		0.048***		0.046**
		(3.248)		(2.258)
Access fin. * Group II		-0.018		0.039
		(-0.755)		(1.110)
Access fin.* Group III		-0.004		0.098*
		(-0.115)		(1.718)
Observations	17372	17372	17372	17372

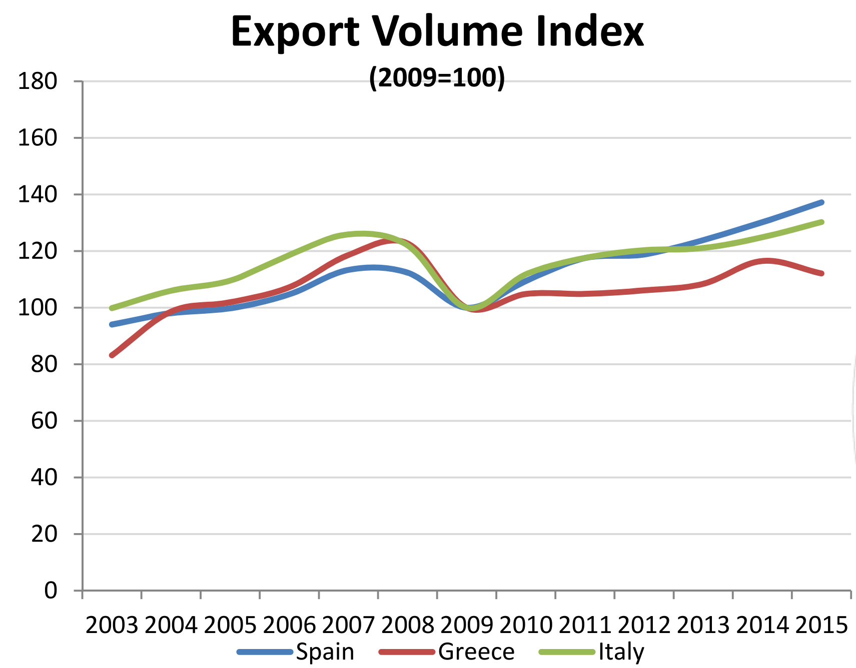
Robust z-statistics in parentheses; *** p<0.01, ** p<0.05, * p<0.1. Weighted regressions (wl).

Comment 2.
How accurate are manager perceptions?



How accurate are manager perceptions?





- Other correlations in the paper are very encouraging
- Maybe worth exploring management literature. Opening Pandora's box: Studying the accuracy of managers' perceptions. Starbuck and Mezias (Journal of Organizational Behavior, 1996)

Smaller points

- What happened to wage indexation?
- Are firms responding to changes in shocks or legislation?
- Add s.d. to summary statistics, and report statistical significance of differences discussed in the text
- DNWR in WDN1 survey is hard to measure because of a timing issue: the question on wage cuts and freezes refers to the last five years.

Some Lessons with Policy Implications

- Wages (in old Europe) are extremely rigid. One needs real GDP declines of 10% or more (i.e., Greece, Cyprus) to observe DNWR substantially receding.
- ES, LV, SV, IRE, LIT display wages somewhat more flexible
- Freezing new hires and reduction of temporary contract workers are first adjustment tools in most countries, but individual dismissals much more common than wage cuts.
- Early retirement schemes are still fairly common in Europe
- Recent structural reforms are associated with perceived easiness to adjust employment and wages in GR, ES, EE
- Moving forward, uncertainty a major obstacle to employment creation

Other Questions?

- Are there differences in responses to demand and credit market shocks? Interactions?
- Move beyond the average firm. Do all firms behave the same way? Is there a typical sequence of adjustment? Does it depend on nature or intensity of the shock? What role for institutions/countries?
- Can we use the different cross-sections to learn how firms hit by idiosyncratic shocks respond depending on the macroeconomic/institutional environment? Is it easier to cut wages/employment when everybody else in the country/sector is cutting?

THANK YOU!