Wages and the Value of Nonemployment*

Simon Jäger
MIT and NBER

Benjamin Schoefer
UC Berkeley

Samuel Young
MIT

Josef Zweimüller
U Zurich and CEPR

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Abstract

Nonemployment is often posited as the outside option in macroeconomic models with wage bargaining and in models of labor market monopsony. The value of this state is therefore a fundamental determinant of wages, and in turn labor supply and job creation. We measure the effect of the value of the nonemployment option on employed workers' wages. Our variation in nonemployment values arises from four large reforms of UI benefit levels in Austria, which we study quasi-experimentally by measuring wage responses in existing and new jobs using administrative data. Our analysis reveals a precisely estimated, low sensitivity of wages to UI benefit levels ranging between 0 and 4 cents on the dollar. This insensitivity holds even among workers with a priori low bargaining power and for workers with low labor force attachment, in areas of high unemployment, with high predicted unemployment duration, and among recently unemployed workers, and despite high take-up and eligibility – factors that either eliminate confounders or ought to render wages even more sensitive to nonemployment values. The insensitivity holds for job stayers and job switchers and persists when we zoom out to the firm or industry as the bargaining unit. This insensitivity of wages to the nonemployment option presents a puzzle to widely used wage setting protocols in macroeconomics and implies that nonemployment scenarios may not constitute a relevant threat point in bargaining. Our evidence supports wage setting mechanisms that largely insulate wages from the value of nonemployment.

*Simon Jäger: sjaeger@mit.edu; Benjamin Schoefer: schoefer@berkeley.edu; Samuel Young: sgyoung@mit.edu; Josef Zweimüller: josef.zweimueller@uzh.ch. We thank Karl Aspelund, Nikhil Basavappa, Carolin Baum, Niklas Flamang, Peter McCrory, Damian Osterwalder, and Nina Roussille for excellent research assistance. We thank Steve Davis, Fatih Karahan and Patrick Kline and seminar audiences at Boston University, MIT, the San Francisco Federal Reserve Matching Workshop, and UC Berkeley. Jäger and Schoefer acknowledge financial support from the Boston Retirement Research Center and the Sloan Foundation.