Sticky Wages on the Layoff Margin

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What We Do

Design and field an innovative survey of unemployment insurance (UI) recipients. **Ask about**:

1. Willingness to accept hypothetical pay cuts to save their lost jobs.
2. Whether they had discussions with their former employers about pay cuts as an alternative to layoffs.
3. If not, why not?
4. Why they refuse hypothetical pay cuts (many do).
5. Wage on lost job, reservation wage, wage on new job, demographics, industry,…

Why We Do It

1. Sticky wages play a key role in many Keynesian theories of fluctuations, unemployment, and stabilization policy.
   - Much evidence of wage stickiness. But does it matter for employment, hours, earnings? Barro (1977) critique.
   - Allocative role of wages remains unsettled.
2. Quantify deviations from the Efficient Separations Benchmark (all separations are bilaterally efficient).
3. Assess received theories of wage stickiness.
4. Is there scope for policies or third-party interventions to reduce the frequency of layoffs and UI claims?

What We Find, 1

1. Most UI recipients express a willingness to accept wage cuts of 5-10% to save their lost jobs.
2. One third would accept a 25% cut.
3. Yet worker-employer discussions about cuts in pay, benefits or hours in lieu of layoffs are exceedingly rare.
4. When asked why employers don't raise the possibility of job-preserving pay cuts:
   - Four-in-ten UI recipients don't know.
   - 16% say cuts would harm morale or lead best workers to quit.
   - 36% don't think wage cuts would save their jobs.
   - For lost union jobs (15% of sample), 45% say contractual restrictions prevent wage cuts.

What We Find, 2

5. Among UI recipients on permanent layoffs who refuse our hypothetical wage cuts:
   - Half point to better outside options as the reason.
   - 38% regard the proposed pay cut as insulting.
   - 21% prefer unemployment to working at the lower wage.
6. An estimated 24% of the layoffs in our sample violate bilateral efficiency.

Survey Overview

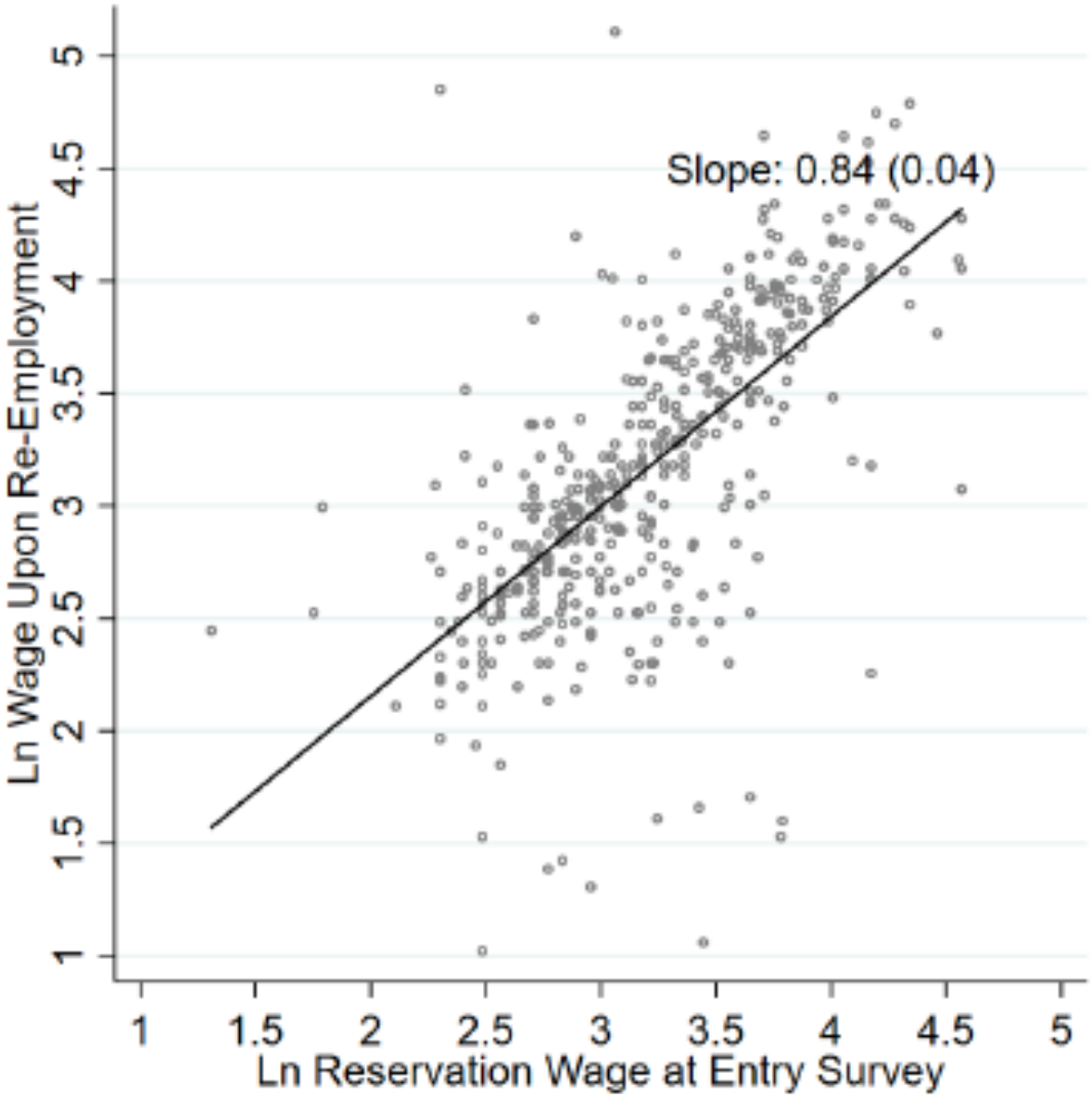
Sample Frame: Persons who began collecting UI benefits in Illinois from 10 September to 24 November 2018.

Entry Survey: Fielded to frame members one day after first UI benefit payment: $10 gift card; 9% completion rate; 2,777 completed surveys; median completion time = 8 minutes.

Two Follow-Up Surveys: Fielded 2, 4, 8, 12 and 16 weeks (randomized) after previous survey completion: Gift card of $5 or $10; completion rates of 51% to 85%; 2,707 additional completed surveys; 5,484 total observations;

Economic context: Low, stable inflation and tight labor markets in a large state with a diversified economy.

How Wages on the New Job Relate to the Reservation Wage Expressed on the Entry Survey (Shortly after Job Loss)



Deflating the re-employment and reservation wage measures by the wage on the lost job and re-rerunning the regression yields a slope coefficient of 0.78 with a standard error of 0.07.

Notes: 26% of respondents were paid on an hourly basis on the lost job. For the rest, we compute an hourly wage using earnings and usual weekly hours on the lost job. 91% of job losers worked at least 35 hours on the lost job. This chart considers persons who were re-employed by the second Follow-Up Survey.

Internal Validity & Predictive Content

- Reservation wages predict re-employment wages.
- Reservation wage ratios are 15 log points lower for those who accept hypothetical wage cuts, as compared to refusers.
- Re-employment wage ratios are 9 log points lower for those who accept hypothetical wage cuts, as compared to refusers.
- Those who accept larger wage cuts have lower reservation wage ratios and lower re-employment wage ratios than those who accept smaller cuts.
- Worker-level rents on the lost job are strong predictors of the willingness to accept job-saving wage cuts.

Willingness to Accept Wage Cuts, 1

Permanent layoffs (80% of sample)**: "***Would you have been willing to stay on your last job for another 12 months at a pay cut of X percent?"*

Temporary layoffs: "*Suppose your employer offered a temporary pay cut of X percent as an alternative to the temporary layoff. Would you have been willing to accept the temporary pay cut to avoid the layoff?*

Randomize over X = 5, 10, 15, 20, 25.

Willingness to Accept Wage Cuts, 2

Percent Who Would Accept Proposed Pay Cut to Save the Lost Job (or to Avoid a Temporary Layoff)

Size of proposed paycut	5%	10%	15%	20%	25%
Permanent layoffs	60.6	52.3	43.7	38.4	32.4
	(2.4)	(2.5)	(2.5)	(2.4)	(2.3)
Observation Count →	404	413	410	419	423
Temporary layoffs	54.5	42.9	35.8	34.3	37.4
	(5.0)	(5.0)	(4.9)	(4.7)	(4.9)
Observation Count →	101	98	95	102	99

Worker-level rents on the lost job, computed as residuals in Mincerian wage regressions, are strong predictors of the willingness to accept pay cuts, conditional on demographics, education, experience, tenure on lost job, industry wage premiums, hourly pay status, and union status.

Employer-Workers Discussions about Pay Cuts Instead of Layoffs Rarely Happen

Permanent layoffs: *"Before your employer let you go, was there any discussion about possible cuts to pay, benefits or hours to save your job?"*

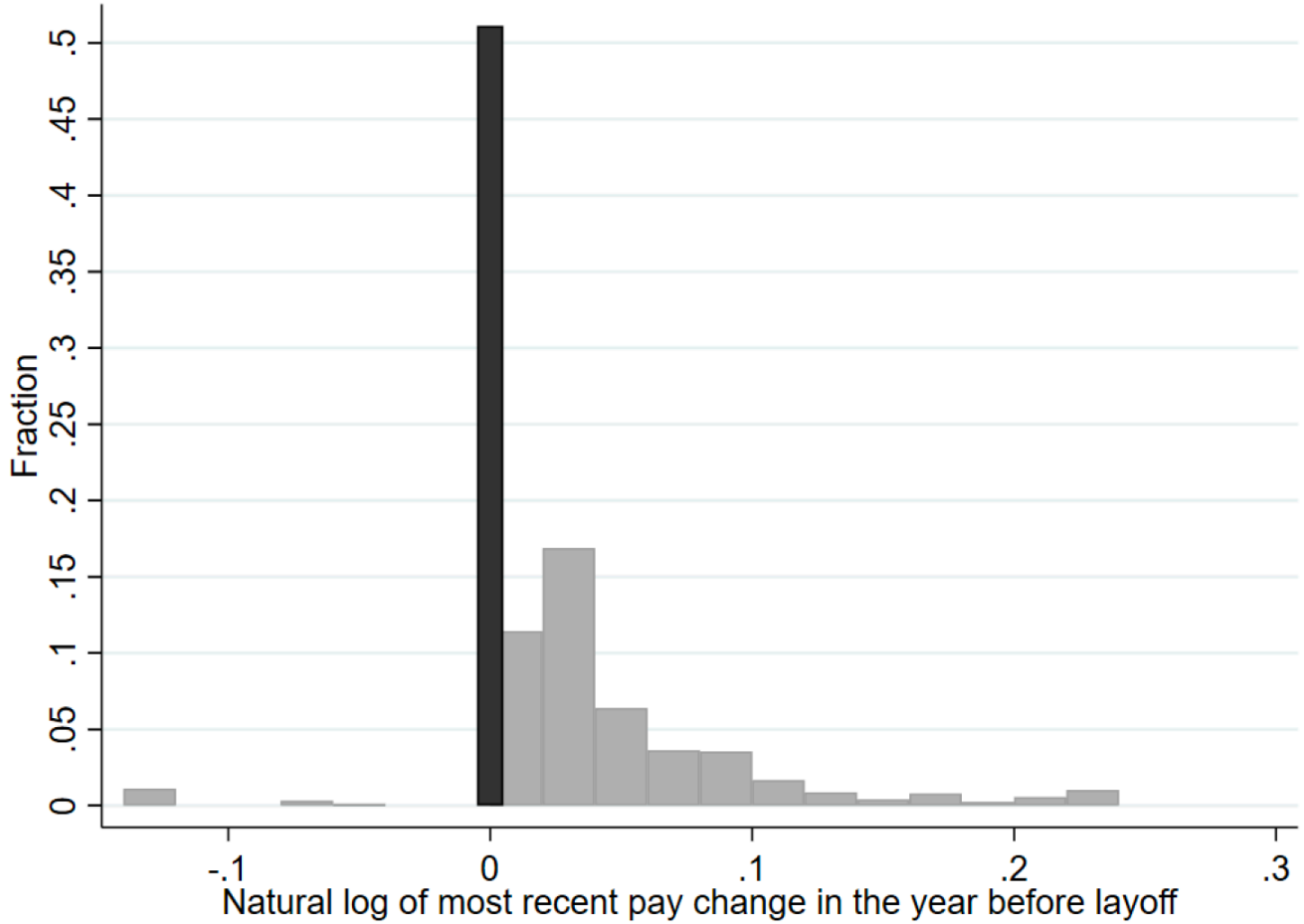
Temporary layoffs: *"Did you and your employer discuss a cut in pay, benefits or hours as an alternative to a temporary layoff?*

Percent of UI recipients who say yes

	Mean	S.E.	Count
Overall	2.8	0.3	2,567
Type of layoff (p-value: 0.03)			
Permanent	2.4	0.3	2,070
Temporary	4.2	0.9	497

Employers Rarely Try Pay Cuts First, Before Resorting to Layoffs

Histogram of log wag changes on the lost job in the prior year



What Job Losers Perceive about the Reasons for Wage Stickiness

"If you had to guess, why do you think your employer did not discuss any kind of cuts in pay, benefits or hours?"

For those on permanent layoff

- 38% believe proposed pay cut would not save lost job
- 9% say it would lead best workers to quit
- 9% say it would undermine morale
- 39% don't know why
- Minimum wage laws, employer pay scales, automation, cost-cutting, bankruptcy, and outsourcing each account for 2% or less.

For union job losers, 45% say it's not allowed under wage contract.

Why Many Job Losers Refuse Wage Cuts

Permanent Layoffs: *"What are the reasons why you would not accept a pay cut of X percent to avoid being laid off?"*

- Half can find another job that pays more.
- 38% say the pay cut would feel like an insult.
- 21% prefer not working to working at the lower pay level.

Temporary Layoffs: *"What are the reasons why you would not accept a temporary pay cut of X percent to avoid being temporarily laid off?"*

- Half can find a job that pays more, or they prefer not working.
- 24% say pay cut would feel like an insult.
- 42% fear the wage cut might become permanent.

Quantifying Deviations from the Efficient Separations Benchmark

Consider job losers who meet two conditions:

1. They would accept the proposed wage cut.
2. They believe the proposed wage cut would save their lost job.

28% of UI benefit recipients in our sample meet both conditions.

- As an estimate of deviations from the Efficient Separations Benchmark, this figure suffers from biases in both directions.
- When we try to address these biases, we estimate that 24% of layoffs in our sample violate bilateral efficiency.

Ideally, we want a two-prong sample design that elicits from job losers their willingness to accept job-preserving pay cuts and from employers their willingness to forego layoffs in exchange for pay cuts.

A Challenge for Theories of Wage Stickiness that Stress Private Information about Outside Options

- Hall and Lazear (1984) and Malcomson (1997) explain how private information about outside options can lead to sticky wages on the layoff margin and to violations of bilateral efficiency.
- Their theories are appealing, because they rest on plausible assumptions (private information, relationship-specific investments).
- But these theories are hard to square with our evidence.
- If private information leads to the dissolution of valuable matches, why don't employers (and workers) make greater efforts to overcome informational asymmetries?
- We see almost no such efforts: There is an almost complete absence of employer-worker discussions about pay cuts in lieu of layoffs.

Challenge, 2

Pay re-negotiation costs don't resolve the challenge:

- 35% of job losers would accept wage cuts of 20-25% to save their lost jobs.
- Not cheap talk: The same job losers see a mean wage drop of 20 log points at re-employment.
- In addition, their mean reservation wage is 15 log points below the lost-job wage. So they have information that, if revealed to their employer, might save their job.
- When at least one party sees that much room for job-preserving wage cuts, it's not plausible that pay re-negotiation costs are big enough to inhibit discussions.
- Bertheau et al. (2022) survey of Danish employers: When asked how large a pay cut could have prevented layoffs, 61% of employers "Do not know."
- Why, then, don't employers raise the possibility of pay cuts as an alternative to layoff? Theories that stress fairness norms, morale effects, collective bargaining, and employer pay scales offer ready answers to that question. Theories based on private information about outside options do not.

On Fairness Norms and Morale Effects

Some job losers point to fairness norms and morale effects to explain why employers don't offer pay cuts, and to explain why they refuse pay cuts. But the frequency of concerns about fairness and morale is typically (much) greater in employer surveys. Why this discrepancy?

Our discussion of the Firestone tire defect study by Krueger and Mas (2004) suggests a reconciliation and insight into how and why bilateral efficiency can fail.

- If product defects (or sabotage) are sufficiently costly, a plan for job-saving wage cuts that is both profitable and acceptable to most employees can be derailed by fears of how a few aggrieved employees might respond/retaliate.
- If those few can be identified in advance and terminated, the best available action may be to fire them and cut wages for others.
- If they cannot be identified in advance, or if it is infeasible to selectively fire them, broad layoffs can be the best feasible action.
- That remains true even when layoffs are bilaterally inefficient for most employer-worker pairs.

Concluding Remarks, 1

The importance of sticky wages on the layoff margin surely varies over time and space, perhaps greatly.

Some hypotheses that warrant attention in future work:

1. Job losers display more openness to job-saving wage cuts during recessions and other periods with slack.
2. High inflation, as in 2021 and 2022, relaxes the bite of wage stickiness on the layoff margin.
3. Collective-bargaining agreements lead to a greater incidence of layoffs that violate bilateral efficiency, other things equal.
4. Company-wide pay structures lead to a greater incidence of layoffs that violate bilateral efficiency, other things equal.

Concluding Remarks, 2

5. Performance-based pay and other flexible forms of compensation (bonuses, tips, equity options, etc.) lead to a smaller incidence of bilaterally inefficient layoffs.
6. Secular trends in collective-bargaining coverage, the use of performance-based pay, and the prevalence of company-wide pay scales have had material effects on the incidence of layoffs that violate bilateral efficiency.
7. Concerns about fairness norms and the morale effects of wage cuts are more common – and a more important force in deviations from bilateral efficiency – when sub-par worker performance is costlier to the employer, harder to detect before negative consequences manifest, and harder to source in specific individuals.

Our survey approach is suitable for addressing all of these questions, and more.

Extra Slides

Figure 3: The Distribution of Wage Changes for Re-Employed Job Losers