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FOCUS PAPER

Wage adjustments in the Great Recession and other downturns: Evidence from the United States and Great Britain

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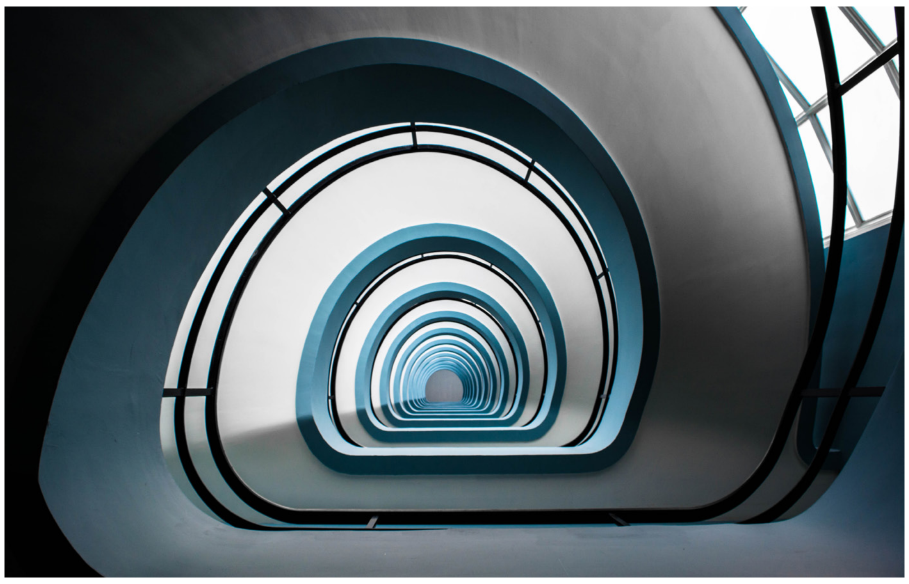

As of a quarter century ago, the conventional wisdom among macroeconomists was that real wage rates are more or less noncyclical, and many macroeconomic models described wage inflexibility as a key contributor to cyclical unemployment. Since then, however, numerous empirical studies based on microdata for workers have found that real wages are substantially procyclical. This was obscured in aggregate wage statistics, which tend to give more weight to low-skill workers during expansions than recessions. Most of the US microdata-based literature does not extend beyond the early 1990s. The question this paper addresses for the United State and Great Britain is what the cyclical wage patterns have been more recently, especially during the Great Recession.

The results replicate and update the finding of previous microdata-based studies that, by and large, real wages are substantially procyclical. The degree of this cyclicality, however, varies over time and place. Real wages in the US took large hits in the recessions of the early 1980s and 1990s, but men's real wages were somewhat less affected in the Great Recession. The picture for US women is less clear, but a tentative impression is that the Great Recession's impact on their real wages was particularly adverse. For Great Britain there are also differences across recessions, with a pattern practically opposite to that for US men. In Great Britain, real wages were not much affected by the recession of the early 1980s, displayed slowed growth in the recession of the early 1990s, and were affected very negatively by the Great Recession. The between-country difference in the evolution of real wage cyclicality over the sample period is all the more striking given that both countries experienced reductions in inflation and unionization.

Motivated by the oft-stated hypothesis that downward nominal wage rigidity is an important contributor to cyclical employment and unemployment fluctuations, the paper also studies the distribution of job stayers' year-to-year nominal wage changes. Like previous studies of US household surveys, a substantial minority of stayers report the exact same nominal wage from one year to the next, but also a substantial minority report nominal wage reductions. Both findings may be distorted by reporting error. This makes the presumably more accurate British data, reported by employers from payroll records, of particularly high interest. These data show a much lower frequency of zero year-to-year nominal wage change, but they show a surprisingly high frequency of nominal wage reductions. The apparent flexibility of British wages is striking. Preliminary payroll-based evidence suggests that US wages also may be less rigid than is often supposed.

However much wage stickiness there is, does it have important effects on employment and unemployment? In particular, did its interaction with an environment of very low inflation contribute to the large upsurge of US unemployment in the Great Recession?

On the surface this story was suggested by the sluggish response of men's real wages to that downturn. But it lines up poorly with many other empirical patterns. Why did the Great Recession appear to have a particularly large effect on US women's real wages? Why didn't the prevalence of zero nominal wage changes rise more precipitously during the Great Recession? The more distinctive aspect of the US labour market's response to the Great Recession has been the extraordinary length of unemployment spells. But it is hard to see why downward nominal wage rigidity would be more constraining for the hiring of new workers from the unemployed than it is for the retention of incumbent workers. Finally, if downward nominal wage stickiness was important in the US experience of the Great Recession, why was it so much less so in Great Britain? In the end, while wages undoubtedly are at least somewhat sticky, it is doubtful that a simple theory based on downward nominal rigidity can accord with the full range of empirical patterns documented for the United States and Great Britain.

Information

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