Wage Setting in the Portugese Labor Market
comment to papers by P. Portugal/A. Carneiro

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The “low-wage” model in Portugal

- Low wage model
  - “one of these common sense notions for which there can be found no grounds in economic analysis”
  - “In microeconomic terms, wages are low if they are set below the value of the marginal productivity and high if they are above”
- But
  - Marginal revenue is endogenous if decreasing returns or downward-sloping demand curve
  - Lower wage leads to higher employment
  - Wage restraint shifts wage curve and reduces equilibrium unemployment

Wage Setting in the Portugese Labor Market: A Microeconomic Approach

- Interesting and useful survey of micro studies of the Portugese labor market
- Brief report of main results of each study
  - The “low-wage model”
  - The minimum wage
  - Contractual wages and the wage cushion
  - Rent sharing, insiders, outsiders
  - Displacement risk and wage determination
  - Cyclical behavior of real wages
  - Wage setting in a low inflation regime

Contractual wages, actual wages and the wage cushion

- Actual wages often 20-40 percent above contractual wages
  - Difference is called wage cushion
  - Wage level, not wage growth (wage drift)
- Wage cushion reflects pay policies by the companies
  - Amplifies effect of worker attributes
  - Increases wage dispersion
  - Gives more flexibility in actual wages
- Questions as to institutions
  - Is there local wage bargaining?
  - Does a rise in contractual wages raise actual wages?
Wage setting under low inflation and low productivity growth

- Nominal wage cuts are forbidden in Portugal
  - Inflation gives scope for real wage cuts
  - “The smaller the wage cushion the more difficult this manipulation becomes”
  - Does this mean that the wage cushion can be reduced?
- Nordic c.: bargaining at two levels
  - Centralised level aims at wage restraint, but difficult under low inflation
  - Local wage bargaining leads to nominal wage growth (wage drift), making problem more difficult
  - Less room for centralised wage restraint under low inflation (Holden, SJE, 1998)

Workers’ Flows and Real Wage Cyclicality

- Data from annual mandatory employment survey
  - Covers all establishments and all workers
  - Can match firms and workers
- Very nice empirical study with great data

Empirical analysis

- Regress log of real wage individual i
  - On
  - Lagged unemployment
  - Time trend and its square,
  - Time varying worker char. (experience)
  - Time invar. worker char (education, etc)
  - Worker fixed effect

Consider four samples of individuals

- All individuals present in all 12 years (long term)
- Individuals present in two consecutive years
- Newly hired worked (tenure <1)
- Recently separated worker (not in register in year t+1) (“soon to be separated”?)
Results:
Find procyclical real wages

- Long-term employees
  - Significant effect of U, coef ≈ -1 for men; coef ≈ -.7 for women (roughly similar to previous findings for the US)
  - Somewhat higher coef in subsample of job stayers, in contrast to US findings
  - Could higher effect for job stayers reflect firm or industry differences?
  - Same results with fixed effects

Results contd.

- Newly hired workers
  - Much larger effects, coef ≈-2 (men); ≈ -1.7 (women)
  - Roughly consistent with previous findings
  - Easier to find high-wage jobs in booms?
  - Higher wage compensation for cyclical fluctuations in employment?
  - Outside forces affect pay when workers are mobile, and mobility is greatest when hiring?

  - Note that fixed-term contracts important for accessions and separations – is there other information about wage levels in such contracts?

Results contd.

- Two-year employees
  - Slightly larger effect of men, slightly smaller for women
  - Effect of age smaller than for long-term employees (age better proxy for tenure for long term employees?)
  - Much smaller coefficient for U with individual fixed effects (in contrast to long-term e.)
  - “unobserved heterogeneity affect composition of workforce magnifying cyclicality of real wages”
  - Is larger coef with OLS driven by job entrants?
  - Why so small coef with fixed effects?

Is it possible to exploit firm dimension of the data?

- Does cyclicality of wages vary across firms and industries?
- Does variation in wage cyclicity across firms reflect differences in turnover, differences in labour market tightness, industry differences
- Test whether large wage cyclicity for newly hired workers reflect differences between firms/jobs (high wage jobs more cyclical), or Labour market situation more important when workers are mobile

- Note that fixed-term contracts important for accessions and separations – is there other information about wage levels in such contracts?
Rent sharing and the role of insiders and outsiders

. The rent associated with replacement costs (recruitment, training) guarantees insider bargaining power in wage negotiations

Table 12: OLS Results (specification 2)
Long-term Employee/Job Stayers
Alternative Wage Measures

<table>
<thead>
<tr>
<th>Wage Measure</th>
<th>Men</th>
<th>Women</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cycle Regressor (U)</td>
<td>-1.20 (-15.8)</td>
<td>-0.85 (-6.7)</td>
</tr>
<tr>
<td>AHE</td>
<td>AHEIOT</td>
<td>AHBW</td>
</tr>
<tr>
<td>AHE</td>
<td>AHEIOT</td>
<td>AHBW</td>
</tr>
<tr>
<td>Women</td>
<td>Cycle Regressor (U)</td>
<td>-0.75 (-7.1)</td>
</tr>
</tbody>
</table>

Notes: (i) t-statistics are in parentheses;

Table 10: OLS Results (specification 2)
Long-term Employee
Alternative Wage Measures

<table>
<thead>
<tr>
<th>Wage Measure</th>
<th>AHE</th>
<th>AHEIOT</th>
<th>AHBW</th>
<th>AMBW</th>
</tr>
</thead>
<tbody>
<tr>
<td>Men</td>
<td>Cycle Regressor (U)</td>
<td>-1.00 (-15.9)</td>
<td>-1.04 (-16.3)</td>
<td>-1.10 (-21.0)</td>
</tr>
<tr>
<td>Women</td>
<td>Cycle Regressor (U)</td>
<td>-0.75 (-7.1)</td>
<td>-0.70 (-6.6)</td>
<td>-1.08 (-11.9)</td>
</tr>
</tbody>
</table>

Notes: (i) t-statistics are in parentheses;