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Title: Downward Nominal Wage Rigidity in Europe - An Analysis of European Micro Data from the ECHP 1994-2001

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Abstract: The paper analyzes existence, extent and causes of downward nominal wage rigidity in the European Union and the Euro Area, which are questions of great significance, both from a theoretical and from a policy perspective. Evidence on existence and extent of downward nominal wage rigidity in Europe has been limited to only a few countries and, if available, has been hard to compare since different data sources and methodologies have been used. The available evidence is extended by the first-time econometric analysis with respect to these questions using employee micro data from the European Community Household Panel (ECHP) for twelve of the EU's current member states. Versions of Kahn's histogram-location approach are applied to this data to obtain national and pooled estimates of the degree of downward nominal wage rigidity. The histogram-location approach exploits variation in the location of the earnings change distributions over the course of years and infers existence and extent of downward wage rigidity from the corresponding variation in the shape of observed histograms. While the estimates for France, Germany and the UK are rather uncertain because of the small amount of variation of location in these countries, the overall impression of national estimates is that downward nominal wage rigidity is a rather widespread phenomenon within the European Union and the Euro Area.

In the literature, psychological or institutional factors are put forward as possible causes of downward nominal wage rigidity. We examine the validity of the institutional approach by regressing national wage rigidity coefficients on a number of variables representing institutional features of European labor markets and by pooled estimates of rigidity coefficients for countries with the same labor market regime. The evidence with respect to the causes of downward nominal wage rigidity is mixed. While national estimates of rigidity cannot be explained by institutions, pooled estimates of rigidity by labor market regime point to systematic differences between labor market regimes with respect to rigidity. According to the pooled estimates, countries with an Anglo-saxon labor market regime exhibit a rather low wage rigidity, Southern European countries are affected by a rather high degree of wage rigidity, and rigidity in the other countries (the "core") lies in between the two extremes. It

remains a task for future versions of this paper to resolve the contradictory evidence regarding the role of institutions as determinants of downward nominal wage rigidity.

Keywords: Downward Nominal Wage Rigidity; Micro Data; ECHP; European Union.

JEL-classification: E24; J30.