Why are wages sticky in a downward direction?

Post-Keynesian theories of the business cycle are related to nominal rigidities. For example, in the labour market, a negative demand shock sees the demand for labour fall relative to supply. If nominal wages were flexible they would fall and the market would return to its original market clearing level as workers price themselves back into employment. Therefore, unemployment is the outcome of a persistent disequilibrium in the labour market due to wage rigidities preventing the labour market from clearing.

There are many reasons touted for wage rigidities. Insiders might block wage cuts, efficiency wage theories may make firms unwilling to cut wages for fear of damaging worker productivity, and the notion of implicit contracts argues that employers tend to insure workers against income fluctuations in exchange for lower long-term average wages.

A book by Truman Bewley published in 1999, *Why Wages Don't Fall During a Recession*, Harvard University Press, tackles this issue 'head-on', by simply interviewing business leaders, union bosses, job recruiters and unemployment counsellors in the North East of the US during the early part of the 1990s recession as to why they did not cut wages to price workers back into employment. The main findings were that it is principally managers who are to blame for wage stickiness- flying in the face of the normal presumption that it is powerful groups of insiders or trade unions that block wage cuts.

On reflection this is not an unreasonable prognosis. Worker power is typically much weaker today than it has been in previous decades, with unionised US firms being in the far minority. Also, there is evidence that in times of high unemployment workers are very concerned about job security, and would be willing to bargain wages for a lower incidence of redundancies.

Firms typically resist cutting wages because the savings made are typically less than the cost of denting workers' morale (a pure efficiency wage theory). Monitoring productivity levels is difficult, so firms tend not to rely on coercion and carrots to induce motivation. Pay cuts tend to harm morale less than lay offs. Generalised pay cuts can cause resentment that lasts for a number of years. It may also encourage the best workers to leave- who feel that the general nature of the pay cut penalises them disproportionately relative to those who are perceived to be less productive. On the other hand, lay offs only dent morale for a short period of time. This is mainly because the majority of the aggrieved workers (i.e. the ones that have lost their jobs) have been removed from the firm and are thus less able to damage its morale.