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Alfred Marshall Lecture

Why not cut pay?

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Abstract

I interviewed over 300 business people, labor leaders, business consultants, and counselors of unemployed people, all in the Northeast of the United States, during the recession of the early 1990's in order to learn why wages and salaries declined in only a few firms. Employers were reluctant to cut pay because they believed doing so would hurt employee morale, leading to lower productivity and current or future difficulties with hiring and retention. It was thought that these effects would in the end cost more than the savings from lower pay. There were few indications that unemployed people had excessive wage expectations. On the contrary, many unemployed were too flexible and found themselves rejected by firms as overqualified. In most companies, pay cuts were not a useful alternative to layoffs, because pay cuts would not make it worthwhile to retain many employees and because layoffs harmed morale less than would pay cuts. The findings support none of the theories of wage rigidity except those of Solow and Akerlof that emphasize morale.



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JEL classification

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