Flexible wages and the costs of job displacement

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Abstract

Does flexible pay increase the costs of job loss? This paper analyzes the role of firm wage premiums in displaced workers earnings losses. We use quasi-exogenous variation in the timing of job loss driven by mass layoffs around the passage of a national wage-setting law that reduced pay flexibility by limiting the growth of firm-level wage premiums across all sectors. We find that flexible pay is associated with larger earnings losses over a 10-year period after displacement. These earnings losses are larger among displaced service sector workers compared to manufacturing workers, consistent with ex-ante heterogeneity in firm-level wage premiums bargained within these sectors. The relative magnitude of the earnings loss from job displacement only partially mirrors individuals' probability of re-employment after displacement, which indicates that employment rates are not the main driver of earnings drops. Thus, reduced pay flexibility may help displaced workers catch-up faster to non-displaced workers' pay premium ladder.

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