WAGE BEHAVIOUR OVER THE CYCLE UNDER EMU:

THE ROLE OF RISK AVERSION

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This paper explores whether the devolution of monetary sovereignty to the European Central Bank (ECB) has modified the opportunity set confronting national wage setters, affecting wage behaviour and outcomes. Theory-generated predictions that built on the Barro-Gordon model (1983) and Olson's logic for collective action (1982) assumed that membership of the Economic and Monetary Union (EMU) was deemed to come with a generalised relaxation in wage moderation, as each national labour union, even if monopolistic, would have been insensitive to the ECB's reaction function because too small to affect average inflation (Iversen and Soskice 1998; Grüner and Hefeker 1999; Cukierman and Lippi 2001).

Grüner (2010) provides a model based on which the incentive for wage moderation is in fact greater under EMU than under autonomous monetary policy. The argument is that risk-averse workers realise that the new central bank is less responsive to national shocks. They in turn exercise wage restraint in response to large negative shocks because they feel directly responsible for avoiding unemployment. Grüner's model is purely theoretical and, as such, does not include an operational definition of what constitutes a risk-averse worker.

This paper offers an empirical test of the role of risk aversion in explaining wage behaviour over the cycle in euro area countries. It is suggested that risk-averse workers are those endowed with firm- or sector-specific skills, for whom there is a lower probability of inter-industry reallocation in case of unemployment. The empirical specification uses sectoral data on bargained wages, skill specificity and education levels to determine whether workers endowed with firm- or sector-specific skills and average-to-high education levels react more strongly to large negative shocks under EMU than under autonomous monetary policy. One important feature of the model is that the form of wage-setting does not bear an impact on outcomes.

The results are innovative. Firstly, a higher share of insiders with specific skills leads to greater downwards wage flexibility, which is in contrast with standard insider-outsider model (Holden 1994). Secondly, in relation to the recent debate on imbalances in the euro area, our results indicate that skill profiles may be one of the reasons for persistent competitiveness divergences in EMU, with wage restraint more pronounced in countries in which there is a high concentration of specialised manufacturing activities and of insiders.

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