From Telework to Flexible Wages?

Lately I've been stunned by reports of nominal wage cuts. They aren't just in the news; several professionals that I personally know have received such cuts. Employers routinely cut total pay during recessions by slashing bonuses and hours. Even in good times, many employers cut *real* wages by freezing pay despite inflation. Yet outright reductions of nominal base pay – hourly wages for hourly workers, base salary for salaried workers – have been *exceeding* rare for as long as we've had data. Economists have debated whether downward nominal wage cuts are *bad*, but virtually all economists agree that downward nominal wage cuts are *rare*.

What on Earth is going on in today's labor market?

The simplest explanation is that the current recession is terrible. Quite right; maybe it's twice as terrible as the Great Recession. But last time around, I heard *zero* first-hand reports of nominal wage cuts, and near-zero such stories in the news. I can understand a doubling of incidents, but not this.

Another tempting tale: Workers today realize that they must take pay cuts or lose their jobs. Alas, this trade-off is on the table during every recession. And in every prior recession, falls in nominal base pay have stayed very rare. What then is really afoot?

Let's begin with a primordial fact: *The best explanation for nominal wage rigidity is psychological.* When employers cut workers' nominal base pay, workers feel robbed and resentful.   This hurts morale, which hurts productivity, which hurts profits. In contrast, when employers start doing layoffs, the fearful remaining workers respond by working *harder*.   Logically, of course, there's no reason for workers to feel more robbed and resentful about a 1% nominal cut in the face of 0% inflation than a 0% raise in the face of 1% inflation. Human beings, however, are not so logical.

Why then are nominal pay cuts suddenly on the table? You could say, "Workers have suddenly become more logical," but as far as I can tell, they're crazier than ever. But psychologically speaking, there is one radical and unprecedented change in the emotional experience of labor in the time of coronavirus: the explosion of telework. Until recently, only 3% of workers teleworked, and a large majority of these teleworkers probably dropped by the office at least every week or two. Now the telework share has plausibly multiplied tenfold, and our former offices are all but abandoned.

Loneliness is only the most obvious psychological effect. Teleworkers have also lost most of their opportunities to complain and hear complaints, to feel bitterness and sow bitterness, to feel aggrieved and seek revenge. As a result, I speculate, the effect of nominal wage cuts on morale has never been lower.

When an employer cuts the pay of a face-to-face work team, the workers constantly remind each other of the perceived affront. They work down the hall from the executive they hold responsible for the pay cuts. They see which fellow workers are standing up for themselves, and who's kowtowing to The Man. *That's* how the classic mechanism – wage cuts –> bad morale –> low productivity –> reduced profits – worked. Now, in contrast, teleworkers are stuck at home with their families. They're juggling childcare, housework, and safety in a chaotic situation. As a result, they have neither the energy nor the forum to kvetch – verbally or otherwise – with coworkers. Today's teleworkers talk to their peers to get the job done, then get back to business. Supervisors who cut your pay now feel more like a tiresome video than a human villain, which quells the urge to settle the score.

Think about it this way: If your firm cut pay three months ago, what would have happened? You would have arrived at work and started griping to your friends. A few would philosophically adjust to the new normal, but a coterie of complainers would have whined, muttered, grumped, and sputtered for months. In so whining, muttering, grumping, and sputtering, they would have disrupted not only their own work, but teamwork itself.

If your firm cut pay today, in contrast, you'd probably just read the email, groan, and resume your duties. You might lament your fate to your partner or close friend. Yet now that you're teleworking, you plausibly won't even *mention* the issue to a single coworker. You almost certainly won't lunch with coworkers to denounce the firm's callousness and greed. Stripped of this social feedback loop, neither morale nor productivity will fall much. At long last, pay cuts finally do exactly what firms desire: mitigate losses by cutting costs.

On top of all this, executives and managers almost surely feel much less *guilty* about pay cuts than they ordinarily would. Out of sight, out of conscience.

How can we test my story? Most obviously, industries that switch to telework will be *much* more likely to impose nominal cuts. To repeat, that means lower nominal base pay for salaried employees, and lower nominal wages for hourly employees. In industries where some categories of workers switch to telework and others don't, I also predict that the switching categories will be more likely to experience cuts. (There, however, horizontal equity norms may get in the way. If 95% of a firm's employees telework, management might cheaply avoid outrage by also cutting pay for the 5% who work on-site).

Note: You don't have to think that wage cuts are *socially desirable* to buy my story. For a tenured GMU professor such as myself, nominal wage cuts are all pain, no gain. That said, thirteen years after the Great Recession started, I remain convinced that nominal wage cuts are a greatly underrated way to alleviate the grave evil of unemployment. Nominal wage cuts don't merely save jobs within the firm; they also save jobs throughout the economy. Keynes opposed wage cuts, but good Keynesians smile upon them.

Think of it this way: Suppose you have $1M total to pay workers. Which is better for Aggregate Demand: Retaining your whole workforce and cutting pay 10% – or keeping wages constant and laying off 10% of your employees? The latter route, though timeworn, reduces workers' spending because the marginal propensity to consume falls with income – and reduces firm's profitability in the process.

Does this make me optimistic about the economy? Hardly. We're already in the midst of a second Great Depression, and even perfect nominal wage flexibility won't restore normalcy anytime soon. Still, when word of nominal wage cuts reaches my ears, I feel a glimmer of hope. Unemployment will skyrocket. Without nominal pay cuts, however, unemployment would have been worst yet. Unemployment will take years to subside. Without nominal pay cuts, however, unemployment would have lingered longer still. As I wrote a decade ago:

> *Is labor market rigidity a market failure? I'm afraid so. But strangely enough, this market failure is largely caused by* anti-market bias*! The main reason workers hate wage cuts is that they imagine that wage-cutting employers are satanically "unfair." If workers saw wage cuts for what they are – a* full-employment mechanism *– they'd sing a different tune. While they wouldn't be happy to see their wages cut, they'd grudgingly accept that a little wage variability is a fair price to pay for near-total employment security. Once this economically enlightened perspective took hold, employers would eagerly cater to it – and the market failure would largely go away.*
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> *According to* Peter Pan*, "Everytime a child says 'I don't believe in fairies,' there's a little fairy somewhere that falls down dead." As far as I know, he's wrong about fairies. But if Peter had warned, "Everytime a person says, 'I don't believe in markets,' there's a worker somewhere that loses his job," he wouldn't have been far from the truth. Scoff if you must! People can and do cause market failure by believing in it.*

Teleworkers still don't believe in markets, but at least they're less likely to tell each other, "I don't believe in markets" – or act on their resentment. Thank goodness for small miracles.

P.S. Disclaimer: The best predictor of future data is past data- and we should never say, "This time it's different" lightly. So I wouldn't be shocked if aggregate data ultimately revealed continued severe nominal wage rigidity despite my current impressions of drastic change. If so, consider this piece an imaginative yet regrettable attempt to explain "facts" that barely happened…