

Title: Downward Nominal Wage Rigidity, Fixed Exchange Rates, and Unemployment: Evidence from a Quasi Natural Experiment

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Abstract:

We evaluate the role of exchange rate regimes in external adjustment during the 2014-2016 oil price collapse accompanied by a substantial appreciation of the US dollar, in the presence of downward nominal wage rigidity (DNWR). Using customs data, we show that Colombian exporters operating under a floating exchange rate regime were able to adjust export prices and restore international competitiveness, whereas Ecuadorian exporters under dollarization were unable to do so. Evidence from Ecuadorian administrative payroll data indicates that DNWR—induced by binding minimum wage regulations—prevented internal devaluation. As a result, Ecuadorian exporters experienced a loss of international competitiveness and responded by reducing employment, leading at the aggregate level to a prolonged economic recession accompanied by rising unemployment.