

Downward Nominal Wage Rigidity, Fixed Exchange Rates, and Unemployment: The Case of Dollarization with a Binding Minimum Wage

JaeBin Ahn*

Jaerim Choi[†]

Ivan Rivadeneyra[‡]

Seoul National University

University of Hawai'i

University of Hawai'i

May 2, 2022

Abstract

This paper explores a tale of two neighboring oil exporters to evaluate the role of exchange rate regimes in external adjustment. Transaction-level customs data from two countries reveal that, unlike Colombian exporters under a floating exchange rate regime, Ecuadorian exporters under full dollarization could not adjust export prices to absorb negative external shocks during the 2014-16 oil price collapse, which was accompanied by a substantial appreciation of the US dollar. Ecuadorian administrative payroll dataset further provides evidence of downward nominal wage rigidity induced by stringent minimum wage regulations, which explains the lack of internal devaluation in Ecuador. Moreover, we confirm that a combination of dollarization and the minimum wage policy eventually led Ecuadorian exporters to reduce employment, especially through a decrease in hiring; the result was a prolonged economic recession with rising unemployment.

Keywords: Downward Nominal Wage Rigidity, Fixed Exchange Rates, Minimum Wage, Dollarization, External Adjustment, Internal Devaluation

JEL Code: E24; F16; F31; F32; F41; F45; J31

*Graduate School of International Studies, Seoul National University. E-mail: jaebin.ahn@snu.ac.kr.

[†]Department of Economics, University of Hawai'i at Mānoa. E-mail: choijm@hawaii.edu.

[‡]Department of Economics, University of Hawai'i at Mānoa. E-mail: irivaden@hawaii.edu.