

# Fluctuations in Unemployment and Industry Labor Markets<sup>1</sup>

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## **Abe, Masahiro, and Ohta, Souichi**—Fluctuations in Unemployment and Industry Labor Markets

Throughout the 1990s, and particularly in the mid- to late-1990s, the Japanese employment situation went from bad to worse. We investigate the causes of rising unemployment in Japan, using data on individual workers from the “Special Survey of the Labor Force” between 1988 and 1999. This research focuses on the effect of labor market segmentation by industry on labor flows. Our findings reveal that unemployment in the construction industry and, more recently, in the service industry has contributed greatly to the national unemployment rate. We also find that most successful job transfers occur within the same industry, even though workers may experience some periods of unemployment. Finally, our results show that labor market conditions in each industry affect the probability that a worker will fall into unemployment as well as the probability that an unemployed worker will find new employment. These findings suggest that the Japanese labor market is segmented by industry and this segmentation contributed to the worsening unemployment in Japan. *J. Japan. Int. Econ.*, December 2001, **15**(4), pp. 437–464. Department of Economics, Dokkyo University, 1-1 Gakuen-cho, Soka-shi, Saitama 340-0042, Japan;

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## 1. INTRODUCTION

What explains the sudden rise in unemployment in Japan in the mid- to late-1990s? Until now, the dominant view of the Japanese labor market was that the unemployment rate remained low because Japan was blessed with an extremely flexible labor market resistant to occasional shocks.<sup>2</sup> Specific examples and studies of this flexibility include the annual spring wage offensive (*shunto*) when wage negotiations take place, the elasticity of wages through the bonus system, cooperative enterprise-level unions, the dual labor market with a secondary sector in which wages are determined competitively, mechanisms that kept unemployment from actually appearing such as transfers to other firms and offices, and the discouraged worker effect on female labor force participation in times of low labor demand. In all these cases, most labor economists began with the assumption that the Japanese labor market is very flexible and their research centered on discovering why the market was so flexible. In fact, faith in the Japanese labor market was particularly high during the 1980s.

But then the bubble burst and the Japanese employment situation suddenly took a turn for the worse. In 1990, the total unemployment rate was only 2.1%, but by 1995 it had increased to 3.1%, by 1998 it was 4.1%, and it reached a high of 4.9% in February and March in 2000. That is to say, the second half of the 1990s was characterized by a sharp rise in the unemployment rate. Furthermore, the number of people in the labor force, which had been increasing annually, began to decrease in 1998. The deteriorating Japanese employment situation prompted labor economists to investigate the reasons why the Japanese labor market had lost its flexibility and to re-examine the causes of unemployment. Teruyama and Toda (1997), for example, argued that both macro and allocative shocks are sources of unemployment fluctuation in Japan. They also suggested that the recent rise in unemployment might not be a temporary phenomenon. Using a disequilibrium model, Tsukuda and Miyakoshi (1999) argued that the Japanese labor market has been caught in a Keynesian regime of surplus labor supply and a surplus in the commodity goods market.

Some of the factors that contributed to the unfavorable employment situation were the curtailment of public investment and the subsequent recession in the construction industry, and stagnation in small and medium-size firms resulting from the credit crunch and financial instability. Using a VAR model of the relationship

<sup>2</sup> Tachibanaki (1987) provides a useful survey of this.

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