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Labor-market adjustment in open economies Evidence from US states

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Abstract

In this paper we analyze whether regional economic integration across US states conditions local labor-market adjustment. We examine the mechanisms through which states absorb changes in labor supplies and whether industry production techniques are similar across states. There are two main findings. Firstly, states absorb changes in employment primarily through changes in production techniques that are common across states and through changes in the output of traded goods, with the former mechanism playing the larger role. In contrast, state-specific changes in production techniques, which are one indication of state-specific changes in relative factor prices, account for relatively little factor absorption. Secondly, industry production techniques are very similar across states, especially for neighboring states and states with similar relative labor supplies. Both sets of results are consistent with productivity-adjusted FPE across either large states or groupings of related states. © 2002 Published by Elsevier Science B.V.

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1. Introduction

Recent literature on US labor markets identifies two important changes in

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national labor supplies, rising educational attainment of the labor force (Johnson, 1997) and rising immigration of individuals with low education levels relative to US natives (Borjas, 1994). Both of these labor-supply shifts have varied across regions. For instance, immigration ‘gateway’ states, such as California, have attracted a large share of new immigrants, and the increase in the relative supply of more-educated workers appears to have been strongest in the Northeast.

How do regions absorb differential changes in relative labor supplies? We delineate four adjustment mechanisms: changes in regional relative factor prices, interregional migration of labor and/or capital, changes in the regional output mix, and changes in underlying production technology. While the first mechanism may occur in either closed or open economies, the other three depend on regional openness to factor, trade, or technology flows. In this paper, we examine the mechanisms through which US states absorb changes in relative labor supplies, with an emphasis on how economic openness conditions regional labor-market adjustment.

Research on regional labor-supply shocks focuses almost exclusively on closed-economy settings. An important strand of this literature assesses the impact of immigration on native wages in US regions.¹ The standard approach is to regress the change in native wages on the change in the stock of immigrants across US metropolitan areas. Most studies find that immigration has a small negative impact on local native wages. Adjustment mechanisms besides wage changes are ignored, except in a small literature on whether native migration responds to immigrant inflows. Borjas et al. (1997) find that immigrant inflows to a region contribute to native outmigration, while Card (1997) finds that they do not.

To our knowledge, no study has examined the role of the third adjustment mechanism, changes in regional output mix, in regional absorption of labor-supply changes. By the logic of the Rybczynski Theorem (1955), a region may absorb a factor-supply shock without factor-price changes by shifting production towards sectors that employ relatively intensively factors whose supplies are expanding. Openness to trade is essential for this mechanism to work, as it implies that changes in regional outputs are absorbed by changes in regional exports and imports.

There is a large literature on the fourth adjustment mechanism, technological change, but most of this research focuses on whether national shifts in production technology have been biased towards skilled workers and thus may have contributed to national increases in the relative demand for and wages of skilled labor (Katz and Murphy, 1992; Berman et al., 1994; Autor et al., 1998). We know of no work on the impact of such skill-biased technical change (SBTC) on

¹For recent work see Borjas et al. (1997), for a survey of the literature see Borjas (1994), and for work on interregional migration and labor-market adjustment see Blanchard and Katz (1992) and Topel (1986).

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