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Regional labor market adjustment to structural shocks: An international comparison

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Abstract

Previous research indicates that local industry composition significantly influences unemployment in the American Rust Belt. This paper uses a dual market model to compare evolutions of structural joblessness in German regions with those of a Rust Belt area in the United States. Results indicate that German labor markets exhibit both intriguing similarities and differences to the US benchmark case. In particular, the contrasts between the two areas highlight the less distinct labor supply flexibility of Western European labor markets as demonstrated by unemployment responses to changes in regional employment prospects.

Differences in local rates of unemployment have long been noted in the United States and Western Europe (e.g., McCormick & Sheppard, 1992), but consistent explanations have been elusive (Summers, 1990). Seminal findings in sectoral wage and employment studies suggest a cohesive basis for understanding related local unemployment issues. Inter-industry wage differential research shows that similar workers earn significantly different wages based on their industry affiliation (Dickens & Katz, 1987; Katz & Summers, 1989). These differences indicate that systematic incentives exist for "wait" unemployment, where workers queue for jobs in high-wage industries. Is it therefore possible that decreased employment in high-wage sectors may reduce long-term unemployment rates in a region?

Previous research has found that the sectoral composition of regional employment, or "industrial structure," strongly influences local jobless queues in the American Rust Belt (Weiler, 2000, 2001), leading to potentially stubborn structural unemployment based on the types of local jobs. Most of such unemployment comes from less-skilled workers queuing for more

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attractive positions available at their skill level (Topel, 1993). A simple bifurcation of the labor market into high-wage primary and lower-wage secondary employment sheds considerable light on short- and longer-term unemployment patterns by highlighting jobless queues for more attractive primary jobs.

The current paper extends the noted previous results from such a restructuring area in the United States to the local labor markets in western Germany to further explore the impact of industrial structure on unemployment. The results from time series of regional cross-sections corroborate previous findings that labor supply flexibility in particular appears to be less pronounced in the European context. This greater inflexibility may help explain the longer-term problems with European structural unemployment, as less mobile jobless workers adjust more slowly to changing labor market prospects. The findings from both countries indicate that a simple segmented labor market perspective, which proxies for a region's industrial structure through high- and low-wage industries, can yield insights into regional joblessness based on queues for higher-wage positions.

1. Background

1.1. Labor market adjustment in the United States and Europe

In Blanchard & Katz's (1992) seminal paper on labor market adjustment, employment demand shocks drive labor supply responses. This paper adopts such a perspective in understanding labor market adjustment to evolutions in local structure. Changes to local firms' employment demand change the region's employment prospects. Workers must in turn decide whether and where to supply their labor; excess supply yields unemployment. Such joblessness may persist in the long run if sticky wages do not drop to market-clearing levels. Such non-clearing labor markets are the basis for this paper's perspective, detailed in Section 2.

Both the labor demand and labor supply contrasts between the United States and Europe are potentially revealing. The mix of European industries is considerably less concentrated geographically than in the United States, and the process of structural change has been slowed by greater barriers to entry and trade (Krugman, 1991). Given these barriers and the geographic dispersion of particular sectors, the demand side of European labor markets may be characterized by less variation across subnational regions and less change over time. Structural unemployment may then persist due to slow local industry adjustment to changing global industry fortunes.

On the supply side, a key difference between the supply sides of European and American labor markets is their relative flexibility. European workers tend to be less mobile than their American counterparts, and employment contracts are more rigid (Bean, 1994; Pencavel, 1994). Supply-side adjustments to the demand shocks that do occur may thus also be slower in Europe. This paper's analyses allow insights into regional unemployment through these demand and supply patterns by identifying the magnitude of structural demand shocks and the ensuing labor supply responses to changing employment prospects.