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# Regional wages and subjective measures of employment opportunities

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## Abstract

We utilise a rich set of regional labour market variables to explain regional variation in Norwegian manufacturing wages. In particular, regional indicators of labour market conditions are computed from survey data in which respondents are asked to evaluate local employment opportunities. We find that average reported satisfaction with local job prospects and other survey-based indicators perform better in regional wage equations than traditional labour market variables, including the regional unemployment rate. Our results suggest that subjective measures of employment opportunities provide useful information about wage pressure.

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## 1. Introduction

The present paper shows that ‘subjective’ measures of regional employment opportunities successfully explain regional variations in Norwegian manufacturing wages. The study uses six waves (1993–1998) of an annual survey conducted by the Norwegian Gallup Institute (NGI) in which respondents report how satisfied they are with job prospects in their resident municipality and the surroundings. The survey dataset comprises about 75,000 respondents. Regional measures of employment opportunities computed from the dataset have

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a positive and significant impact on regional wages, also when controlling for the regional unemployment rate and other ‘objective’ measures of regional labour market tightness. Our results suggest that analyses of wage determination should use subjective measures of labour market conditions in addition to traditional labour market variables.

Theories of wage bargaining and efficiency wage theories predict that wages depend on the outside options of workers where outside option depends on labour market pressure. Most empirical studies of wage formation use the unemployment rate as the key labour market tightness indicator.<sup>1</sup> The unemployment rate is a proxy for the duration of unemployment and therefore affects the utility loss suffered by workers losing their jobs. However, the unemployment rate is an imprecise measure of the duration of unemployment. Empirical studies of individual unemployment spells have established that spell duration depends on a number of individual characteristics such as age, education level, previous work experience, family situation and benefit entitlement.<sup>2</sup> Because the composition of the unemployment pool varies across the business cycle and between regions, and because the effects of individual characteristics on duration depend on the state of the labour market, there is no stable relation between the unemployment rate and the employment prospects of any given person.<sup>3</sup>

One possible solution to this problem would be to compute transition rates from unemployment using microdata about individual unemployment spells and use this indicator as proxy for labour market pressure instead of the unemployment rate, cf. Carlsen et al. (2003) for an attempt on this road. In this paper, we propose an alternative set of labour market indicators that provide direct information about the outside options of workers and that can be calculated almost without delay. We utilise information from surveys in which respondents present their beliefs about the state of the regional labour market. The individual responses from the surveys are then aggregated to regional labour market indicators.

We can think of several reasons why ‘subjective’ measures of labour market conditions calculated from survey data would explain wages well. *First*, surveys provide direct information about the beliefs of the insiders, i.e. the agents who determine wages. Subjective measures may therefore reflect characteristics of labour markets considered relevant by insiders but which may not be observable to outside observers. *Second*, since subjective measures assign weights to different aspects of labour markets according to the beliefs of insiders, changes in the importance of factors relevant to wage determination will automatically be incorporated. *Third*, insiders sometimes make mistakes. For instance, employers may incorrectly believe that job prospects of a particular type of workers have improved and therefore make generous wage offers to these workers. In such cases, subjective measures, although wrong in an absolute sense, may predict wages accurately. *Finally*, survey-based

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<sup>1</sup> Following the seminal contributions by Blanchflower and Oswald (1990, 1994), a large literature has examined the relation between regional wages and the regional unemployment rate. Contributions include Edin et al. (1994), Manning (1994), Wagner (1994), Bratsberg and Turunen (1996), Winter-Ebmer (1996), Partridge and Rickman (1997), Wulfsberg (1997), Baltagi and Blien (1998), Janssens and Konings (1998), Pannenberg and Schwarze (1998), Turunen (1998), Baltagi et al. (2000), Dyrstad and Johansen (2000), Kennedy and Borland (2000) and Raaum and Wulfsberg (2000).

<sup>2</sup> See, e.g. Bover et al. (2002), Røed and Zhang (2003) and the references therein.

<sup>3</sup> Gaure and Røed (2003) use microdata to study the relation between spell duration and the unemployment rate.

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