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# Intra-national labor market adjustment in the candidate countries

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This paper analyzes the evolution of regional unemployment rates, wages, participation rates, migration and employment in seven candidate countries for accession to the European Union (EU) in the 1990s. We compare these countries to a core set of EU member states and find persistent regional disparities in both regions. However, persistence of unemployment rates is lower in the first-round candidate countries than in the member states. Furthermore, in both first-round and second-round candidate countries, persistence in participation rates is lower. Migration seems to be an ineffective labor market adjustment mechanism. Wages react more strongly to regional unemployment developments in first-round candidate countries than in member states but they are slightly less responsive to national unemployment. *Journal of Comparative Economics* 32 (2) (2004) 248–264. Austrian Institute for Economic Research (WIFO), Arsenal, Objekt 20, 1030 Vienna, Austria.

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## 1. Introduction

Membership in the European Union (EU) places several challenges before the candidate countries. These countries will have to adopt the EU's *acquis communautaire*. In addition, they will become eligible for support from the structural funds and will benefit from the freedom of movement of goods, services, labor and capital in the common market. Each of these changes will have regionally asymmetric implications. For example, transfers from the Common Agricultural Policy will benefit agricultural regions primarily and the effects

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of adopting competition and environmental policy are likely to impact more on regions in which non-competitive and sheltered industries or environmentally hazardous productions are located. Similarly, the freedom of movement of labor and services will affect border regions more significantly due to commuting possibilities and the limited transportability of many services.

This paper investigates the adjustment of regional labor markets of candidate countries to asymmetric shocks. Hence, we add to the literature on labor market adjustment in the United States (Blanchard and Katz, 1992) and the European Union (Decressin and Fatas, 1995; Fatas, 2000; Jimeno and Bentolila, 1998) in two ways. First, we provide evidence on labor market adjustment and investigate to what extent candidate countries are already market economies. Second, by analyzing different forms of regional labor market adjustment, we provide an empirical background against which the effects of EU-enlargement on regional labor markets can be discussed in countries that have been characterized by different institutions than those in established market economies.

Analyzing labor market adjustments is particularly relevant with respect to the EMU membership of the candidate countries because joining a monetary union results in a country losing its autonomy over exchange rate policy. Hence, labor market mechanisms must be used to adjust to permanent shocks. To the extent that a loss in the real value of income denominated in foreign currency is socially or politically more desirable than increased unemployment, real wage losses denominated in national currency, migration or reductions in participation rates, there are risks of joining the EMU. Furthermore, to the extent that these forms of labor market adjustments differ amongst each other in their social or political desirability, the exact form of labor market adjustment will be relevant.

The motivation of our analysis is that any adverse region-specific shock that is not accommodated by regional transfers or borrowing from other regions must be absorbed by wages adjusting to new equilibrium levels, by increased unemployment or by reduced labor supply in the region. The last form of adjustment can be achieved either by emigration from the region or by lower participation of residents. After a short description of the data and the results of previous research in the next section, section three focuses on the short run dynamics of regional labor markets by analyzing the persistence of region-specific shocks and considering the reaction of inter-regional migration to disparities in unemployment rates and wages. Section four considers wage adjustments and section five concludes by drawing some policy conclusions.

## 2. The data

We consider seven accession countries, namely Bulgaria, the Czech Republic, Estonia, Hungary, Poland, Romania, and Slovenia. Data for the period from 1992 to 1998 are taken from regional statistical yearbooks.<sup>1</sup> Similar data have been used in a number of studies on labor markets in accession candidate countries (Burda and Lubyova, 1995; Boeri and Scarpetta, 1996; Traistaru et al., 2002). From these countries we form two subgroups

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<sup>1</sup> A detailed description of the data is provided in Appendix A.

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