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Unemployment in East and West Europe

Abstract:

In this paper, we use new data to address this issue, while advancing the theoretical and applied econometric literature on matching functions. In particular, we use 1991-2005 district-level panel data on the unemployed U , vacancies V , inflow S into unemployment, and outflow O from unemployment in five former communist economies that are now members of the EU (the Czech Republic, Hungary, Poland, Slovakia, and eastern part of Germany) and in the western part of Germany (a benchmark western economy) to examine the three hypotheses in the context of inflows into unemployment and the efficiency of matching of the unemployed and vacancies. Hypothesis 1, namely that high unemployment implies that restructuring is at work, is consistent with the observation that inflow S (presumably from old jobs) is high. The manifestation of this situation would be that U is high because S is high and the policy implication would be that restructuring needs to be completed. In the case of West Germany, the phenomenon would not represent the transition but rather restructuring brought about by globalization and other forces. Hypothesis 2 is that high unemployment is caused by low demand for labor (e.g., due to restrictive macroeconomic policies, overvalued exchange rate, or globalization shocks). The manifestation of this would be low V relative to S and U , and the policy implication would be that macroeconomic policies are key. Hypothesis 3 is that high unemployment is caused by inefficient matching, brought about for example by inadequate labor market institutions or geographical or skill mismatch (see also Jurajda and Terrell, 2006). Here we would observe both U and V being simultaneously high, but not necessarily in the same districts or skill groups. In this case, the policy should focus on labor market institutions and measures to foster labor mobility, create appropriate skills, and stimulate job search effort.