Does Hysteresis in Unemployment Occur in OECD Countries? Evidence from Parametric and Non-Parametric Panel Unit Roots Tests

VENUS KHIM-SEN LIEW^{a,*}, RICKY CHEE-JIUN CHIA^b AND CHIN-HONG PUAH^a

 ^a Faculty of Economics and Business, Universiti Malaysia Sarawak, 94300 Kota Samarahan, Malaysia.
^b Labuan School of International Business and Finance, Universiti Malaysia Sabah, Jalan Sungai Pagar, 87000 Labuan, Malaysia.

ABSTRACT

This study tests the hysteresis hypothesis of unemployment in fourteen OECD countries by examining the stationarity of unemployment rates using several panel unit root tests. Empirical results show that the hysteresis hypothesis cannot be rejected for majority of the OECD when the tests are conducted on the basis of individual countries. However, rejection is obtained when cross-country interdependence in unemployment rates is incorporated in the estimation. Therefore, it is crucial to consider the cross-country labor markets interdependence when testing the hysteresis hypothesis as the labor market institutions and the stabilization policy of the labor markets in these OECD countries can play an important role in maintaining the unemployment to sustainable levels.

Keywords: Unemployment, Hysteresis Hypothesis, Panel Unit Root Test, Parametric Test, Non-Parametric Test, OECD

INTRODUCTION

Hysteresis in unemployment hypothesis postulates that cyclical fluctuations have permanent effects on the level of unemployment. According to Blanchard and Summers (1996), the proponent of this hypothesis, recessions can have a permanent impacts if they change the characteristics or altitude of those who lost their jobs as a results of recessions. According to this hypothesis, persistent high unemployment leads to an increase in the long-term natural rate of unemployment, which is

^{*} Corresponding author: Tel.: +6082-582145, Fax: +6082-671794, E-mail: ksliew@feb.unimas.my