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Asymmetric information and employment: evidence from the U.S. banking sector

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ABSTRACT

The goal of this paper is to analyze and assess the role of asymmetric information for employment performance in the case of the U.S. banking industry. To this end, the analysis performs a number of methodological approaches, such as panel cointegration and long- and short-run panel causality, spanning the period 2000–2013. The findings provide evidence that asymmetric information exerts a negative effect on employment. The results remain robust after the implementation of further checks.

1. Introduction

The ongoing banking problem faced by banks across the U.S. and Europe has renewed the interest of exploring the relationship between banks' information asymmetry and economic activity. At the same time, it emerges a greater concern in relevance to the impact asymmetric information has on employment levels. Therefore, this paper focuses on the investigation of the relationship between asymmetric information and employment fluctuations in the U.S. banking industry. The analysis plans to shed further light on the association between asymmetric information in the U.S. banking industry and employment. Given that the research in this field has been inadequately explored, the better understanding of the way information asymmetry in the U.S. banking affects employment levels might help to extract useful recommendations on how to manage it and, thus, enhance employment performance. Therefore, for the first time in the relevant literature (to the best of the authors' knowledge), the analysis seeks to investigate the following main hypothesis: whether higher levels of asymmetric information in the U.S. banking sector contribute to lower employment.

The remainder of the paper is structured as follows. Section 2 reviews briefly the literature in the field, while Section 3 discusses in detail the model developed and the hypotheses tested. Section 4 describes the data sources, while Section 5

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presents the empirical analysis and discusses the findings. Finally, Section 6 concludes the paper.

2. Literature review

The presence of asymmetric information in the banking system is a long-standing issue. There have been ample research efforts on the effects of asymmetric information on the various dimensions of banks' performance and the products they offer. Furthermore, there is extensive research on the impact of asymmetric information on the broader economic activity (Banerji & Basu, 2012; Djankov, McLiesh, & Shleifer, 2007; Japelli & Pagano, 2000; Stiglitz & Weiss, 1981). However, despite the presence of various studies on the role played by asymmetric information in the banking industry, along with a large number of micro- and macro-economic variables, there is limited research on the impact of asymmetric information on employment performance.

According to Ordine and Rose (2008), the relationship between credit institutions and labor markets can be a crucial driver that could explain employment fluctuations efficiently. In this vein, Kahn (2009) suggests that asymmetric information can be considered as the key determinant for inefficiencies, both in allocating workers to jobs and investing in human capital. Moreover, other scholars indicate that investment decisions by banking institutions may change under the high intensity of information asymmetry, thus, leading to restricted growth opportunities and to lower employment levels within the banking sector (Devereux & Schiantarelli, 1990).

It is worth noting that the majority of the current research efforts mainly concern with the role played by the role of information asymmetry between employers and employees, either in relevance to the firm's performance or to the employees' conditions in the labor market. In particular, Waldman (1984) examines a situation where firms competing for labor use the job assignment of a competitor's employee as a signal of his ability to work efficiently. Because an employer does not wish to signal the true capacity of a good employee to potential competitors of his, employees might not necessarily be assigned tasks which maximize their contribution to the firm's profits. Such allocation of labor within firms might be optimal for an individual firm in a labor-competitive situation, but results in social inefficiencies. Bernhardt (1995) develops further these arguments into an analysis of promotions' systems. According to this analysis, an employer who needs to hide his private information about employees from a competing employer has an incentive not to promote competent workers. For a promotion to be profitable, a low-educated worker, therefore, has to be sufficiently capable of compensating for higher wages the firm is forced to pay to retain its workers whose competence is revealed to potential competitors. Milgrom and Oster (1987) suggest that such discrimination leads to social inefficiencies when workers are assigned to the wrong jobs or are not given sufficient incentives to become better educated.

In their empirical analysis of firing in a labor market with asymmetric information, Gibbons and Katz (1991) test the relevance of adverse selection and signaling effects. If firms can freely decide which employees should be fired, other agents in the labor market will conclude that the ability of fired workers is below average. Based on a large sample of redundant workers, they find empirical support for such predictions. Furthermore, Acemoglu and Pischke (1998) suggest that asymmetric information about workers' ability can explain the on-the-job training in firms. The mechanism employed resembles that reported by Waldman (1984) and Gibbons and Katz (1991). Informational asymmetries, concerning a trained worker's productivity, generate a monopsony (a buyer's monopoly) in the local labor market, implying that firms can successively pay for training with wages which fall short of the competitive wage. The predictions are empirically supported when confronted with data from the German apprentice system (Lofgren, Persson, & Weibull, 2002). Other attempts undertaken to test for the predicted effects of asymmetric information have generated ambiguous results. One difficulty with such tests is to distinguish, in practice, between adverse selection and moral hazard, while another issue is associated with that of screening and signaling (Ahuja, 2013; Van Ness, Van Ness, & Warr, 2001).

Overall, a number of factors may influence the labor market in various industries; however, the issue on the effects of asymmetric information on employment still remains open. To this end, this paper focuses on the examination of the relationship between information asymmetries in banking and employment across time and in a country-specific setting to capture potential differential effects.

3. The model and hypothesis tested

In this section, we infer the testable hypothesis of our empirical study. This hypothesis is related to the presence of asymmetric information. In particular, higher levels of asymmetric information contribute to lower or higher employment in the banking sector? We also consider a number of control variables described below. The empirical model takes the following form:

$$EB_{it} = \alpha_i + b_1 ASYM_{it} + b_2 FIN_t + b_3 SIZE_{it} + b_4 E_t + b_5 RATE_t + b_6 Y_t + b_7 CYCLE_t + b_8 EPL_t + b_9 DCR + e_{it}$$

where $i = 1, \ldots, N$ for each bank in the panel and $t = 1, \ldots, T$ refers to the time period. EB is employment in the banking institution, ASYM is the definition of asymmetric information, FIN is a financial development indicator, SIZE is the size of the banking institution, E is the real exchange rate, RATE is the short-term interest rate, Y is GDP in the banking sector per