



IZA

COMPACT

CONSIDERING THE FUTURE OF LABOR

Overtime Reduction: A Successful Concept to Increase Employment? - New IZA Research Findings

As part of the discussion about policy options to solve the German unemployment problem, there has been an ongoing debate on the redistribution of work. A potential way to achieve this redistribution is to encourage early retirement and a shorter working week through work sharing and a reduction of overtime hours. The subject of overtime reduction recently appeared on the agenda of the *Bundesanstalt für Arbeit* (Federal Institute of Labor) and the „*Bündnis für Arbeit*“ (Employment Pact) talks of the German Federal Government with the trade unions and employers' association. The general view is that the redistribution of a given amount of work leads to more employment. This idea is based on the observation that, despite high and persistent unemployment, overtime hours have not decreased in the last few years. A new IZA study analyzes overtime work in Germany between 1984 and 1997.

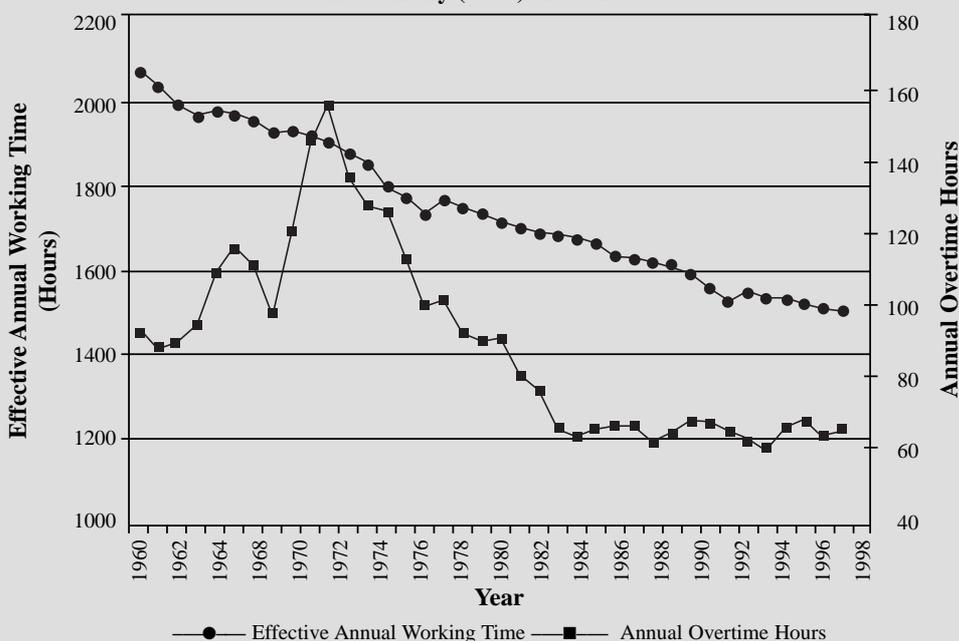
(For a detailed analysis see: Bauer, Thomas/Zimmermann, Klaus F., *Overtime Work and Overtime Compensation in Germany*, IZA Discussion Paper No. 48).

Overtime and Annual Working Hours: Stylized Facts

Over the last 40 years, effective annual working hours per worker followed a strong downward trend - from 2,081 hours in 1960 to 1,593 hours in 1997. Only the boom years of 1964, 1976, and 1992 interrupted this trend briefly. Compared to actual working time, overtime hours developed along a completely different line.

In the 1960s, annual overtime hours increased with respect to the actual working time, both in absolute and relative terms. This development reached its peak in 1970, when annual overtime amounted to 157 hours - or 8.3% of overall working hours. As a result of the oil crisis in the early 1970s, overtime fell to a mere 66 hours in 1982

Effective Annual Working Time and Annual Overtime Hours
in Germany (West): 1960-1997



Source: IAB: „Arbeitszeit und Arbeitsvolumen in der Bundesrepublik Deutschland“. Overtime hours do not cover transitory overtime hours.

(4% of effective working time). Apart from small changes related to the business cycle, annual overtime hours have since then remained at a relatively constant level of 4% of effective working time.

Theoretical Considerations

One of the reasons given in economic theory to explain the phenomenon of overtime work is the notion of quasi-fixed employment costs. These costs are only related to the level of employment in a company, not to the number of actual working hours. Examples are hiring and training costs and administrative expenses. Whether companies react to short-term changes in demand by adjusting the level of employment or the number of working hours depends on the cost of hiring an additional

worker in relation to the cost of extended working hours. When the quasi-fixed employment costs are at a high level, companies will tend to compensate changes in demand by adjusting working hours. On the other hand, when the cost of overtime work rises relative to the cost of hiring an additional worker (e.g. due to higher overtime pay), companies will try to reduce overtime hours and increase employment. According to this simple framework an increase in overtime pay could yield positive employment effects.

For various reasons, many economists are rather skeptical about the employment effects of a policy that is based on overtime reduction. Higher overtime pay or a legally imposed reduction of maximum overtime hours cause an increase in average labor costs because

companies have to carry the quasi-fixed employment costs for every additional worker. If these higher costs encourage companies to switch to more capital-intensive production, a reduction of overtime work could have a negative impact on the labor market. This kind of policy could also have negative effects on employment if companies cannot easily substitute unemployed workers for those who are working overtime.

The unemployment problem in Germany mainly affects unskilled workers. Supposing that skilled workers do most of the overtime, it would be difficult to convert overtime work into jobs for the unskilled unemployed. Where the relationship between skilled and unskilled workers is of a complementary nature, an overtime decrease would reduce the effective working hours of skilled workers and, as a result of this complementarity, would further decrease the demand for unskilled workers.

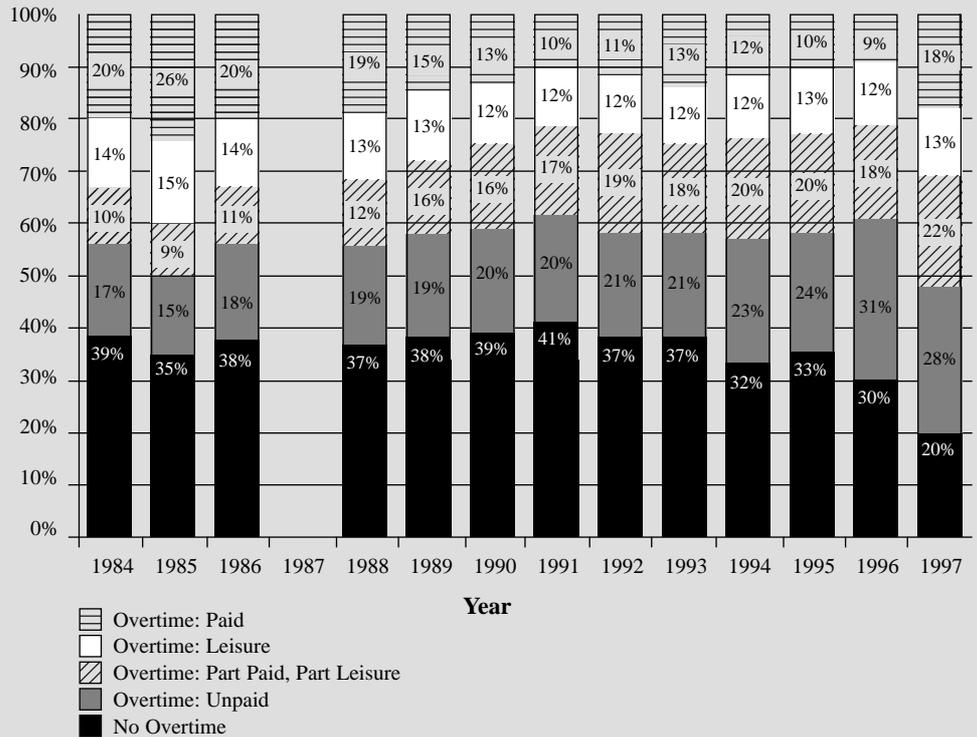
A final aspect to consider in the discussion about overtime reduction is the method of compensation: Are we dealing with so-called *transitory overtime* with compensatory time off, or *definitive overtime*, which is either paid or unpaid? This differentiation is highly significant when it comes to evaluating the employment effects of overtime reduction. Since transitory overtime is merely a flexibility reserve, i.e. a temporary redistribution of working hours, we cannot expect that a reduction of this sort of overtime would lead to more employment. But a ban on paid overtime (which could also be included in wage negotiations), paired with the guarantee to leave transitory or unpaid overtime unregulated, may turn out to be a viable policy option to encourage employment.

Empirical Analysis

The following characteristics mark the development of different types of overtime for male full-time workers in West Germany between 1984 and 1997. During recession years (1984-86), the number of workers who did no overtime was higher than in years of relatively high economic growth (1991-1994). Transitory overtime gained importance compared to paid overtime. The percentage of workers who receive compensatory time off rose from 17% in 1984 to 28% in 1997. Workers who did paid overtime amounted to 39% in 1984 - compared to 20% in 1997.

The differentiation between skilled and unskilled workers yields some important results. On the one hand, the per-

Overtime Compensation in Germany (West): 1984-1997



Source: Socio-Economic Panel (SOEP), 1984-1997 (no data available for 1987); IZA calculations.

centage of unskilled workers who do not work extra hours is higher in almost every year than that of skilled workers. On the other hand, a larger share of unskilled workers (compared to skilled workers) does paid overtime, and a significantly lower percentage receives no compensation at all. For both groups, there is a strong positive trend from paid toward transitory overtime in the period under study. This underscores how relevant the discussion about „working time accounts“ has become.

The IZA study suggests that the strategy of general overtime reduction fails to cure the problem where it does the greatest damage: the employment of unskilled workers. Whether this strategy can be applied to create jobs is therefore highly questionable. Among blue- and white-collar workers alike, the unskilled are considerably less likely to work overtime than their skilled colleagues. According to the estimates, the probability to work overtime is 2.9% higher for skilled blue-collar workers, 10.8% higher for unskilled white-collar workers, and 14.9% higher for skilled white-collar workers than for unskilled blue-collar workers. Compared to the latter, skilled blue-collar workers do 9.6%, unskilled white-collar workers 35%, and skilled white-collar workers 49% more overtime work.

An empirical analysis of the overtime compensation types also produces interesting results. The probability to work overtime increases over time. This increase, however, is mainly confined to transitory overtime, whereas the

probability to do paid overtime has decreased over the past years. The worker's qualification level is an important determinant for the type of overtime compensation: The probability to do unpaid overtime or to receive compensatory time off increases with the level of qualification. Paid overtime is mostly done by unskilled workers. It comes as no surprise that more overtime work is done during periods of economic growth. But the influence of the business cycle on the different types of overtime work varies. While the probability to do paid overtime is acyclical, transitory overtime changes in a cyclical manner. This observation points to the fact that companies tend to react to changes in demand with a temporal shift of their employees' working time rather than an increase in paid overtime work. It also implies that paid overtime drops persistently in the case of long-term positive economic growth.

Conclusion: General Overtime Reduction Is the Wrong Concept

According to the IZA analysis, the thesis that a general overtime reduction has favorable effects on employment seems highly questionable. Skilled workers do most of the overtime work, which is usually unpaid or compensated with time off. These facts lead to the conclusion that a general overtime reduction is unlikely to create a considerable number of new jobs for the group that suffers most from the unem-

ployment problem on the German labor market: the unskilled workers. On the contrary, this kind of policy runs the risk of causing a shortage of skilled workers. Where the relationship of skilled and unskilled workers in the production process is complementary, this

shortage would reduce the demand for unskilled workers, and it would therefore only aggravate the existent employment problems.

A policy of overtime reduction has to concentrate on measures to reduce

overtime work of unskilled workers. But it has to be confined to paid overtime (which admittedly improves low earnings in many cases) because overtime with compensatory time off serves as an important instrument for companies to adapt to demand fluctuations.



Illegal Immigration and the Labor Market

Since the EU countries have become increasingly hostile toward legal immigration over the last decades, they are now facing growing problems with illegal immigration. The labor market plays an important role with regard to the causes as well as the effects of this development.

In the mid-1990s, IZA Director *Klaus F. Zimmermann* started a research project that takes a closer look at the economic aspects of illegal immigration. This project was conducted under the auspices of the London-based Centre for Economic Policy Research (CEPR) and with support from the European Commission. The internationally renowned *Journal of Population Economics* has now provided this research team a forum for some of its scientific output. A recently published special issue of this journal covers many facets of illegal immigration (see box next page).

Illegal Immigration: Cause or Result of Existing Labor Market Problems?

There are no basic differences in the causes of legal vs. illegal immigration. From an economic point of view, the latter is associated mainly with higher migration costs and more insecurity. In practice, however, these two factors have a significant influence on the decision whether or not to migrate at all. Aside from political motives, the decision to migrate is usually made when the potential migrant values the better economic conditions and opportunities in the destination country higher than the migration costs. The major economic factors in this regard - for legal and illegal immigration alike - are wages and employment prospects.

Although reliable statistics on the subject naturally do not exist, the number of illegal immigrants who engage in criminal activities to make a living is relatively small. There is no doubt that the observed (or assumed) scope of illegal immigration would be much lower if companies as well as individual households did not provide illegal work.

So the actual problem is not illegal immigration per se, but much rather

the illegal employment opportunities in the underground economy. Many countries have witnessed an increase in illegal jobs for quite some time now. This is mainly a result of an ever widening gap between gross and net earnings, which has made illegal work more attractive to employers and employees alike. An additional incentive to employ illegal workers is the low flexibility of the labor market. This institutional problem applies especially to the initiation and termination of employment contracts.

There are a number of explanations for the fact that relatively more foreigners (in particular illegal aliens) than natives participate in the underground economy:

- Illegal jobs tend to be for less qualified workers.
- Workers who expect little or no government benefits because they are only temporarily, or even illegally, in the country have less incentive to pay taxes and social security contributions.
- If illegal aliens are caught, in most cases they „only“ face deportation whereas citizens and legal aliens are subject to fines and prison sentences.

But above all, illegal immigration and employment of foreigners are symptoms of the widely known problems of the labor market. The heavy burden of taxes and social security contributions that labor has to bear and the lack of flexibility are a fertile ground for the underground economy, paving the way for illegal immigration.

Illegal Immigrants: Competition for Native Workers?

It is a common view that illegal immigration has negative effects on wages and employment of the domestic workforce. As with legal immigration, however, the first question should be: In what segments of the market do illegal aliens offer their labor? They usually

perform simple tasks. Since most illegals stay in the country for a short time only (whether or not on a voluntary basis), there are hardly any incentives for them to undergo further training. For the same reason companies do not invest in the training of illegal workers.

Alessandra Venturini analyzed the effects of illegal immigration on the employment of native workers in Italy. Although she found negative effects, these were largely confined to a few sectors, such as agriculture, and the overall effect was fairly small. In the service sector, on the other hand, illegal immigration even had a positive impact on the employment of Italian workers. The study also showed that native workers in the underground economy had a considerably higher impact on their legally employed compatriots than illegal aliens. This underscores the fact that the real problem is illegal work itself, no matter whether it is done by domestic or foreign workers.

Like Italy, Greece has also become a net immigration country in the past decades. *Alexander H. Sarris* and *Stavros Zografakis* found that illegal aliens in Greece only compete with native workers who have no vocational training. This, however, applies to as much as 37% of all Greek households. Although the overall impact of illegal immigration on the Greek economy has been positive, such strong distributional effects are always an explosive sociopolitical subject. The impact of illegal immigration, on Greece as well as on other countries, depends largely on the flexibility of the individual labor market segments.

Does the Labor Market Exploit Illegal Immigrants?

An important question in the context of illegal immigration is whether the status of illegality leads to exploitation and discrimination of workers. In fact, the average earnings of illegals range far below those of legal workers. Providing for errors due to the lack of relevant data, the available studies on the sub-

ject (most of which examine the United States only) arrived at the conclusion that the wage differential can be attributed to the lower productivity of illegal aliens. This in turn was seen as a result of insufficient education and language skills.

Drawing on a far more comprehensive data set, *Francisco L. Rivera-Batiz* now proves that only about half of the wage differential in the United States can be explained with lower productivity. The other half must be attributed to discrimination and other non-ascertainable features, such as lower employment stability. In order to rule out the latter, the analysis examined how the wages of formerly illegal workers changed after the Immigration Reform and Control Act (IRCA) of 1986 had legalized a great number of aliens. The study found that the observable wage increases as a result of the IRCA are mostly unrelated to changes of the income determinants. This proves that the workers were discriminated against when they still had illegal status.

Immigration Policy: Laissez-Faire, Control, or Closing the Borders?

It is an undisputable fact that economically motivated migration is a result of existent market forces and therefore generally advantageous, from an individual as well as a macroeconomic perspective. But given the obvious flaws of the market that we often have to deal with in practice, a control of migration flows might be more favorable than the laissez-faire approach.

Paul Levine created a model that resembles the current situation in Europe. In the preliminary stages of EU expansion, this scenario was supposed to show if unlimited mobility, immediately granted to the new EU members, would lead to overall welfare increases. It had to take into account that both the Eastern European source countries and the destination countries in Western Europe are facing an often enormous unemployment rate. Considering the large differences in the standard of living and the insufficient wage flexibility in Western Europe, immediate unlimited mobility appears not to be the perfect solution. An efficient control of migration could be a potential alternative. But if this method turns out to be too costly, we should, from an economic stand, discard it altogether.

A more restrictive immigration policy usually causes more illegal immigration. On the other hand, a laxer policy

can have the exact same effect if, for instance, temporary visa-holders extend their stay illegally. In addition, legal immigrants who keep in touch with their families and friends abroad could encourage more immigrants to follow illegally.

The decision how and to what extent immigration should be controlled therefore has to be based on the price of control as well as the costs of the inevitably arising illegal immigration.

Measures to Curb Illegal Immigration

Where immigration control is deemed necessary, the question is: What kind of method is best suited to serve this purpose? *Gil S. Epstein, Arye L. Hillmann, and Avi Weiss* examined different approaches to ensure the return of foreign workers to their home countries. They considered the idea to have companies post bonds for their foreign workers. When the workers have returned to their home countries, the companies would be reimbursed. The study showed, however, that this method only produces the desired results when the workers themselves have no incentive to remain in the host country illegally. If companies were to pay the workers higher wages or a premium for leaving the country, they could only reduce, not eliminate, this probability. Companies would therefore be less inclined to recruit foreign workers, while at the same time they have more incentive to offer illegal employment.

Slobodan Djajić analyzed the dynamics of immigration control. An important aspect in his study is the differentiation between illegal entry and illegal stay. More stringent border controls would certainly curb the influx, but eventually they may still lead to a higher number of illegal aliens in the country. The reason is that illegals who are already in the country, knowing that reentry would be much more difficult, might try harder not to get caught. More effective controls and inspections, along with a stricter deportation policy, will not be successful when the demand for illegal foreign workers remains high. In this case, the only effect is a higher frequency of illegal entry. Another potential method is to impose harsher sanctions against companies who employ illegal workers. This would raise the cost of employing illegals and reduce the demand for them accordingly. The influx as well as the number of illegal aliens in the country would go down. It is important, how-

ever, to apply these measures to all industries and regions in order to rule out evasive actions that would lead to an increase in illegal immigration. From an economic perspective, sanctions against companies seem to be the most appropriate method to fight illegal immigration.

Journal of Population Economics

Special issue **'Illegal Migration'**
(Volume 12, Issue 1)

Editors:

Louka Katseli, Thomas Straubhaar,
Klaus F. Zimmermann

Articles:

Gil S. Epstein, Arye L. Hillmann
und Avi Weiss

„Creating illegal immigrants“

Paul Levine **„The welfare
economics of
immigration control“**

Slobodan Djajić **„Dynamics of
immigration control“**

Barry R. Chiswick und Paul W. Miller
**„Language skills and earnings
among legalized aliens“**

Francisco L. Rivera-Batiz
**„Undocumented workers in the
labor market: An analysis
of the earnings of legal
and illegal immigrants in the
United States“**

Ira N. Gang und Robert C. Stuart
**„Mobility where mobility
is illegal: Internal migration
and city growth in the
Soviet Union“**

Alessandra Venturini
**„Do immigrants
working illegal reduce the
natives' legal employment?
Evidence from Italy“**

Alexander H. Sarris und Stavros
Zografakis **„A computable
general equilibrium assessment
of the impact of illegal
immigration on the
Greek economy“**

CURRENT RESEARCH

Employment Thresholds and the Business Cycle

Based on its research for the German monthly „Capital“ in June 1998, IZA is currently preparing the publication of its study on the connection between business cycles and employment thresholds. This research contradicts the popular theory that, given a certain rate of economic growth, a fixed employment threshold may be breached and a reduction of unemployment is possible. „This rigid model cannot be sustained,“ says IZA Director *Klaus F. Zimmermann*. „An employment threshold is not a fixed quantity, but it stands in delayed inverse relation to the business cycle. Economists have to take this into account in order to develop more accurate employment forecasts.“



IZA DISCUSSION PAPERS

Empirical Evidence on German Labor Market Flows

Using a retrospective monthly calendar of individuals' major economic activities, this study by IZA Fellow *Christoph M. Schmidt* (University of Heidelberg) characterizes the monthly employment and unemployment rates and the monthly transition intensities between employment, unemployment, and out-of-the-labor-force for the German labor market between 1983 and 1994. The analysis provides a detailed portrait of various demographic groups, and it concludes that there is a high level of persistence with only minor changes across time. The German labor market appears less rigid than the French market, for instance, but it shows considerable disadvantages when compared to the flexible U.S. labor market. (IZA DISCUSSION PAPER NO. 31)



Price Dynamics and Production Lags

This paper by *Assar Lindbeck* (University of Stockholm) and IZA Fellow *Dennis J. Snower* (Birkbeck College, London) provides a new explanation of why inflation is sluggish in response to aggregate demand shocks, and why aggregate output changes as a result of such shocks. According to this study, these phenomena are related to lags between inputs and outputs in the pro-

duction process. Empirical analysis suggests that the interaction of inflation persistence and unemployment persistence may offer a possible explanation for the high unemployment rate in Europe. (IZA DISCUSSION PAPER NO. 33)



Labor Mobility - an Adjustment Mechanism in EMU?

In this study, IZA Affiliate *Patrick A. Puhani* (ZEW Mannheim) examines whether labor mobility is likely to act as a sufficient adjustment mechanism for asymmetric shocks in the European Monetary Union (EMU). He estimates the elasticity of migration with respect to changes in unemployment and income using regional panel data for Germany, France, and Italy. The study shows that Germany has the highest degree of labor mobility, but the country needs several years to accommodate an unemployment shock through migration. Labor mobility does not appear to be a sufficient adjustment mechanism. (IZA DISCUSSION PAPER NO. 34)



Reorganization of Production and Work

This discussion paper by *Assar Lindbeck* (University of Stockholm) and IZA Fellow *Dennis J. Snower* (Birkbeck College, London) notices a shift from the „Tayloristic“ organization of work (characterized by a high degree of specialization) to a „holistic“ organization (job rotation, integration of tasks, and learning across tasks). In addition, this analysis helps to explain the effects of wage gaps and unequal job opportunities for certain groups of the labor market. (IZA DISCUSSION PAPER NO. 39)



Anatomy of Labor Market Policy Complementarities

J. Michael Orszag and IZA Fellow *Dennis J. Snower* (both Birkbeck College, London) provide a new explanation for two widespread problems for European policy initiatives to fight unemployment: the disappointingly small impact of many past reform efforts and the apparent difficulties in implementing more extensive reform programs. The authors argue that the failure of

many European governments to implement comprehensive policy changes lies at the center of these problems. In addition, the success of implemented measures depends on economic and political complementarities that are often overlooked. The growing number of incremental, small-scale adjustments of existing policy packages are therefore doomed to failure and should be replaced by comprehensive strategies that realize and make use of the complementarities. (IZA DISCUSSION PAPER NO. 41)



Job Satisfaction

This paper by IZA Fellow *Daniel S. Hamermesh* (University of Texas, Austin, USA) examines how job satisfaction among young Americans is correlated with changes in wage inequality and how these results compare to findings in Germany. Worker satisfaction in both countries has increased in the high-wage groups, while it stagnates for low-wage workers. The study presents different hypotheses on the determinants of job satisfaction. (IZA DISCUSSION PAPER NO. 42)



Overtime Work in an Unregulated Labor Market

Based on data supplied by the British New Earnings Survey for 1996, this study by *David N. F. Bell* and IZA Fellow *Robert A. Hart* (both University of Stirling, UK) examines the correlation between overtime hours and the average premium pay. The major questions tackled are: what effects do regular working hours and pay have on overtime hours and pay; and what is the correlation between premium pay and the amount of overtime hours? In addition, the study examines the influence of collective bargaining, and whether overtime work contributes to the wage differential between covered and uncovered workers. The findings are compared to the situation in the United States where overtime work is subject to strict regulations. (IZA DISCUSSION PAPER NO. 44)



Cyclical Wage Factors

Using U.S. production data from 1962 to 1997, IZA Fellow *Robert A. Hart* (University of Stirling, UK) and *James R.*

Malley (University of Glasgow, UK) analyze the cyclical factors of wage structures. They divide average hourly wages into their straight-time hourly pay and overtime components. The study finds that the wage rate is generally acyclical and stable, whilst overtime components are highly cyclical and relatively stable. (IZA DISCUSSION PAPER NO. 45)

Development and Migration

Empirical studies on the determinants of international migration have often neglected an important aspect: the complex relationship between development and migration. There is reason to believe that progress in development of less developed regions leads to more migration, even if the income differen-

tials to the potential destination regions decrease. A discussion paper by IZA Affiliate *Ralph Rotte* (University of Munich) and *Michael Vogler* (IZA) presents these arguments and tests them for the case of migration to Germany from Asian and African countries between 1981 and 1995. (IZA DISCUSSION PAPER NO. 46)

SHORT REPORTS

+++ IZA Director Klaus F. Zimmermann nominated for DIW presidency +++

As reported in the last issue of IZA COMPACT, IZA Director *Klaus F. Zimmermann* is also nominated for the position of President of the German Institute for Economic Research (Deutsches Institut für Wirtschaftsforschung, or DIW) in Berlin as of January 1, 2000. This provides both institutes with new perspectives for research and policy advice. The renowned DIW, which has a high profile in active economic policy advice, will continue to place its emphasis on the central topics of macroeconomics and business cycles, as well as industrial organization and social policy. It therefore supplements the IZA research program in an ideal manner. Although both institutes remain independent, they will cooperate closely on labor market issues. Through a common effort, IZA and DIW intend to establish an influential think tank within Europe's economic research community.



+++ European Summer School in Labor Economics +++ Application Deadline December 31, 1999 +++

This year's European Summer School in Labor Economics with lecturers and participants from 13 European countries has just taken place. In his opening speech, IZA Director *Klaus F. Zimmermann* stated that the large number of applications proved how quickly the Summer School has established itself in the academic community. Under the direction of *Thomas K. Bauer* (IZA), the participants engaged in a lively discussion of current research topics. Two internationally renowned economists, IZA Fellow *Dennis J. Snower* (Birkbeck College, London) and *Costas Meghir* (University College, London), lectured on „The Macroeconomics of Employment“ and „Labor Supply and Consumption over the Life Cycle“. The third European Summer School in Labor Economics will take place again in the Bavarian town of Buch am Ammersee (May 29 - June 4, 2000). It is supported by the Centre for Eco-

nomic Policy Research (CEPR), the European Economic Association (EEA), the European Association of Labor Economists (EALE), and the European Society of Population Economics (ESPE). For detailed information on the program and application procedures, please visit the IZA website at www.iza.org. Applications are due by December 31, 1999.



+++ IZA Workshop: „Labor Market Effects of the European Monetary Union“ +++

On the occasion of an IZA-organized expert meeting entitled „Labor Market and Monetary Union,“ the German Institute for Economic Research (Deutsches Institut für Wirtschaftsforschung, or DIW, Berlin), the Institute of World Economics (Institut für Weltwirtschaft, or IfW, Kiel), the Center for European Economic Research (Zentrum für Europäische Wirtschaftsforschung, or ZEW, Mannheim), and the Bonn-based Institute for Finance and Taxes presented sometimes controversial research findings. The experts considered wage policy to be of great importance. Higher flexibility, they claimed, is best suited to accommodate asymmetric economic shocks. There was wide consensus among the participants of the IZA meeting that appropriate action, on the part of all players in the labor market, is necessary for the European Monetary Union to yield the positive effects that have been forecast by many experts prior to the start of the EMU. IZA Director *Klaus F. Zimmermann*: „The monetary union poses an enormous challenge to the European labor market, to individual workers and companies alike. What is called for is a careful reconciliation of harmonization, liberalization and decentralization. More flexibility and mobility has to go along with a Europe-wide minimum standard of social security. Politics will face difficult tasks, which are only going to increase in importance with the EU expansion“.



+++ IZA Lunchtime Meeting: „Illegal Immigration“ +++

IZA recently published a special report on illegal immigration in the *Journal of Population Economics* (see page 4 of this issue). To present this report, IZA organized a lunchtime meeting in cooperation with the Centre for Economic Policy Research (CEPR). During this meeting, which took place in Bonn, IZA Fellow *Thomas Straubhaar* (University of the German Armed Forces, Hamburg) and *Alexander H. Sarris* (University of Athens) lectured on the labor market policy dimension of illegal immigration and the particular Greek experiences. IZA Director *Klaus F. Zimmermann* led the discussion.



+++ IZA Concrete: „Employee Stock Ownership - a Model for the Future?“ +++

At irregular intervals IZA organizes discussion forums entitled „IZA Concrete“. In May, *Michael Lezius* of the „Study Group for Partnership in Business“ (Arbeitsgemeinschaft Partnerschaft in der Wirtschaft, or AGP), who is a distinguished expert in the field of employee stock ownership, gave a presentation on the subject. A growing number of German companies are introducing employee stock ownership plans in order to increase capital and to help employees identify with their company. The relevance of both aspects for labor market policy cannot be overstated. Lezius underscored, however, that the success of employee stock ownership depends on a good company culture and cannot be introduced by force „from above“.



+++ Celebration of IZA's 1st Anniversary +++ Official Opening of the IZA Building +++

In honor of IZA's first anniversary and the official opening of the new IZA building by its sponsor, the German Postal Service (Deutsche Post AG), the

institute invited a number of VIPs from the fields of science, politics, and public life to a reception that took place on May 11, 1999. Deutsche Post Chairman and CEO Dr. Klaus Zumwinkel, who is also IZA President, gave the opening speech. The new IZA building provides ideal working conditions in a beautiful setting, right on the bank of the river Rhine.



+++ Klaus F. Zimmermann Gives Lecture at the John G. Diefenbaker Award Ceremony in Vancouver +++

For the official presentation of the John G. Diefenbaker Award (see last issue of IZA COMPACT), IZA Director *Klaus F. Zimmermann* recently traveled to Vancouver, Canada. At the Harbour Centre Campus of Simon Fraser University, he lectured on the labor market effects of the immigration of Ethnic Germans to Germany in the 1990s. According to IZA research, Ethnic Germans performed successfully on the labor market in earlier years. More recently, however, they have experienced the same problems with economic and social integration as foreign immigrants. At the same time, the relatively low average age of Ethnic Germans alleviates the problems associated with demographic change. Zimmermann called for an effective immigration law that regulates the influx of Ethnic Germans and all other groups of immigrants. His Diefenbaker Award Lecture is available in both English and German as IZA Discussion Paper No. 50.



+++ Thomas K. Bauer new IZA Research Director for „Mobility and Flexibility of Labor“ +++

Research projects on the „Mobility and Flexibility of Labor,“ which play a central role in the IZA agenda, are now under the direction of *Thomas K. Bauer*. After receiving his degree in economics from Ludwig Maximilian University (Munich) in 1993, he stayed with the

university to work for its SELAPO Institute for Labor and Population Economics as a research assistant until 1997. In 1998, Thomas Bauer received his doctoral degree for his dissertation entitled „Labor Market Effects of Migration and Immigration Policy: An Analysis of the Federal Republic of Germany,“ for which he also earned an award from the University of Munich Alumni Association. In 1997 and 1998, he visited Rutgers University in New Brunswick, New Jersey, to conduct research with support from the Alexander-von-Humboldt-Foundation’s Feodor Lynen Fellowship. Since then, he has been with IZA as its senior research associate. Apart from directing IZA’s research on labor flexibility and mobility, Thomas Bauer is currently working on his postdoctoral thesis. He has published various papers in collected volumes and scientific journals, including *International Migration Review*, *Jahrbuch für Wirtschaftsgeschichte*, *Quarterly Review of Economics and Finance* and *Vierteljahrshefte zur Wirtschaftsforschung/Quarterly Journal of Economic Research*. „Mobility and flexibility are the basis for the working world of tomorrow. That’s why this subject is so important to us at IZA,“ says Thomas K. Bauer.



Thomas K. Bauer



+++ New IZA Staff +++

Rob Euwals has joined IZA as a research associate. In 1997 he received his doctorate from the University of Tilburg, the Netherlands, for „Empirical Studies on Individual Labour Market Behaviour.“ In 1998 he received support from the European TMR program and stayed at the University of Mannheim, Germany for the research project on „Savings and Pensions“. His research interests at IZA include microeconomic models for individual behavior in training and work.



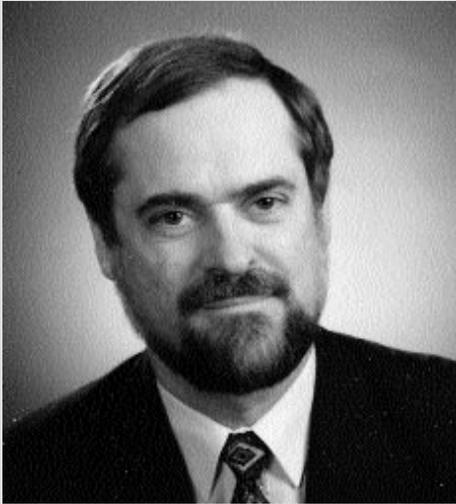
Rob Euwals

IZA Visitors Program

IZA has again been able to invite a number of renowned economists to Bonn. A lively exchange of research findings within the visitors program has now developed. Recent guests include:

- *David A. Jaeger* (Hunter College, New York)
- *Rüdiger Soltwedel* (University of Kiel, Germany)
- *Joachim Schwalbach* (Humboldt-University, Berlin, Germany)
- *Kostas Mavromas* (University of Newcastle, UK)
- *Efraim Sadka* (University of Tel Aviv, Israel)
- *Bernd Raffelhüschen* (University of Freiburg, Germany)
- *Boris Blumberg* (University of Maastricht, the Netherlands)
- *Victor Steiner* (ZEW Mannheim, Germany)
- *Oivind Nilsen* (University of Bergen, Norway)
- *Bernd Fitzenberger* (University of Mannheim, Germany)
- *Maarten Lindeboom* (University of Amsterdam, the Netherlands)
- *Andrew J. Oswald* (University of Coventry, UK)
- *Jan C. van Ours* (University of Tilburg, the Netherlands)
- *Markus Pannenberg* (DIW, Berlin, Germany)
- *Michael Funke* (University of Hamburg, Germany)
- *Alan Barrett* (ESRI, Dublin, Ireland)
- *Regina Riphahn* (University of Munich, Germany)

O P I N I O N

Macroeconomics and the Labor Market

With their ambitious proposal to reduce the fiscal 2000 federal budget by DM 30 billion, the German government has sent a remarkably strong signal. If you consider that federal debt has accumulated to over DM 1.6 trillion and that one fourth of the budget is now spent on servicing that debt, the budget proposal seems like a measure that restores the government's room to maneuver. Achieving a balanced budget in the medium run is becoming more likely. The budget cuts are already praised as a political about-face that will put a definite end to the discussion on the revival of an anticyclical, Keynesian approach to economic policy - a discussion that started when the new government assumed office last fall.

This conclusion is too hastily drawn. The Keynesian policy of the past was not flawed in a factual, scientific sense, but proved difficult to implement. This was mainly due to long, uncontrollable delays in the effect of measures undertaken by the government, combined with the inability of political institutions to reduce the national debt during periods of economic upturn. The temptation to increase debt led to the

euphoric belief that a stimulating fiscal policy would keep all economic problems under control.

For more than a decade, macroeconomic policy has therefore primarily been anti-inflationary. It cannot be disputed that the monetary policy of the German Bundesbank, with its money-supply oriented ideology, did produce positive results. However, these results must be attributed more to the moral power of the well publicized announcements of monetary goals rather than to either the achievement of these goals or the hard facts of demonstrable policy effects. The correlation between changes in money supply and inflation ceased to exist long before the introduction of the Euro.

With the Maastricht Treaty, we left a large part of our macroeconomic instruments in the cloakroom of economic history. We handed over monetary policy to a group of European experts whose sole obligation is to fight inflation. In addition, the European Stability Pact, keeping national fiscal policies on a tight rein, is almost a testimony to the victory of conservative economic policy and an instrument for its reinforcement. That this was possible despite high and persistent unemployment is absolutely astonishing.

The difficult labor market situation, which has come to be the central economic policy issue of our time, is a problem that mainly affects unskilled workers. They are becoming increasingly redundant in the course of technological progress because they are not adaptable enough and their wages are too high. Trained and otherwise qualified workers enjoy almost full employment in Germany and across Europe. A macro-oriented labor market policy has to be shaped from this starting point.

Concessions to the development of employment and other economic factors in Europe were made at the end of

last year, when the European central banks loosened the interest rate screws, and this spring, when the newly established European Central Bank cut interest rates. This demonstrates that an anticyclical monetary policy, carefully executed, is possible. Interest rate cuts are certainly not the wrong policy to alleviate the negative effects of the business cycle. The same is true for German budget policy, which has become less stability-oriented in 1999. This leads to a welcome demand stabilization, from which employment could gain new momentum, although this effect will certainly take time.

The labor market is, as the last recessions in Europe have proved, very sensitive to changes in demand. Nothing points to a separation of economic growth and changes in employment - in fact, the opposite is the case. Unskilled workers are more heavily hit in recessions. Creating more stable demand therefore makes sense in terms of labor market policy. It also creates opportunities for a structurally oriented approach.

The planned 2000 fiscal budget cuts will come in a period of economic upturn. They are therefore being made at the right time. In the medium run, this policy may unload some of the burden from the economy and German society. This in turn would spur economic growth and lead to a more favorable development of the business cycle. A cautious, business-cycle oriented macro policy remains necessary and possible, if it keeps a long-run balanced budget in sight.

K. F. Zimmermann



IZA

Forschungsinstitut
zur Zukunft
der Arbeit

IMPRESSUM:

Herausgeber: Prof. Dr. Klaus F. Zimmermann
Redaktion: Holger Hinte
IZA, Postfach 7240, D-53072 Bonn
Tel. (02 28) 38 94 222, Fax (02 28) 38 94 210
e-mail: compact@iza.org
Grafiken/Fotos: IZA
Layout/Druck: Verlag Erik Dynowski,
Köln