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COMPACT

CONSIDERING THE FUTURE OF LABOR

## EU Eastward Enlargement, Immigration, and the Labor Market

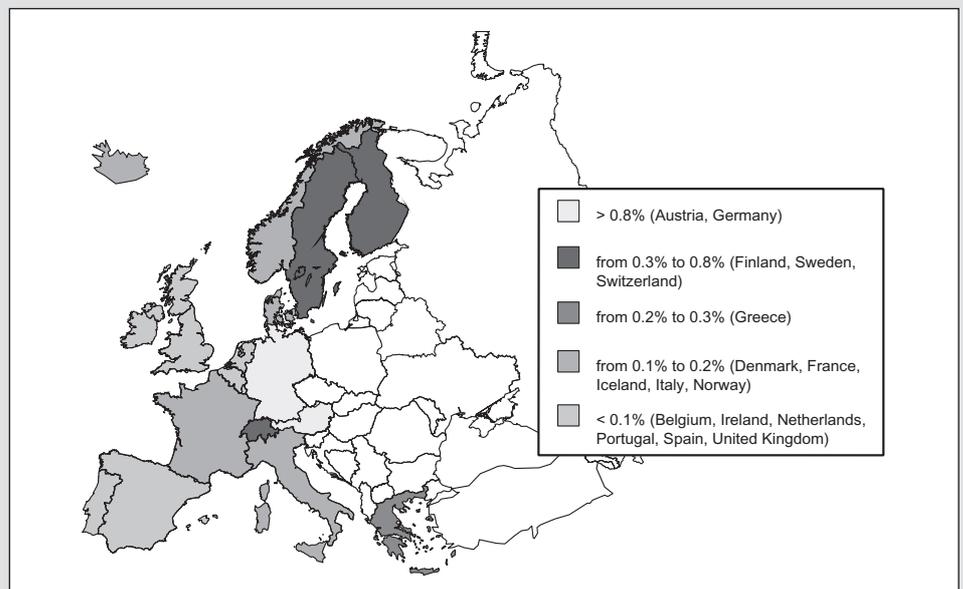
In 1998, the European Union opened negotiations with six Central and Eastern European countries seeking membership. This group consists of the Czech Republic, Estonia, Hungary, Poland, Slovenia and Cyprus. A second group of countries has been asked to bring their economies closer to EU standards before opening talks. This second group consists of Bulgaria, Latvia, Lithuania, Romania and Slovakia. In principle, all EU members favor the idea of extending the EU to incorporate all six of these countries. Some of the current members fear, however, that they will be on the losing end of this expansion. A new IZA report analyzes the widespread concern that cheaper workers from Central and Eastern European countries seeking EU membership will flood across the current EU, thereby reducing the wages of native workers or even pushing them out of their jobs.

For a detailed analysis see: Thomas Bauer/Klaus F. Zimmermann, *Assessment of Possible Migration Pressure and its Labor Market Impact Following EU Enlargement to Central and Eastern Europe. A Study for the Department for Education and Employment, UK, 1999.*

### Potential for Migration

A review of the theoretical and empirical literature shows that migration flows react to differences in living standards and unemployment rates as well as existing networks. Currently about 1.1 million migrants from Central and Eastern Europe live in the EU. About 67% of all immigrants from Central and Eastern Europe are resident in Germany, followed by Austria, Italy, France, the United Kingdom and Greece. About 41.2% of all Central and Eastern European migrants come from Poland, 20.7% from Romania, 8.4% from the former CSFR and Hungary, and 7.5% from Bulgaria. Germany and Austria have the largest shares of foreigners from Eastern Europe, followed by Sweden, Finland, and Switzerland. These numbers do not include immigrants of

Share of Eastern European Population in EU Member Countries, 1993 (% of the total population)



Source: Eurostat (1995), IZA calculations.

German origin from Eastern Europe. In total, between 1950 and 1993, 3.068 million *Aussiedler* migrated to West Germany. Adding this number to the total stock of migrants from Eastern and Central Europe living in the EU, it appears that about 91% of all Central and Eastern European migrants in the EU live in Germany.

It is very difficult to estimate the potential migration flow from East to West. The IZA study applied four different procedures to assess the potential for migration after an eastward enlargement of the EU. In a first step, the economic and demographic situations in Eastern and Western Europe are compared to facilitate an estimation of the potential impact the most important determinants of migration can have. Secondly, assessments of East-West migration carried out in the early 1990s are expanded to the present. Thirdly, opinion polls in the potential emigration countries are evaluated. Fourthly, regression analyses are carried out on the

basis of previous migration experiences in the context of the EU admission of Spain, Portugal (1986) and Greece (1981). The results of this analysis are applied to simulate the potential East-West migration flows after an eastward enlargement of the EU.

One of the most important determinants of individual migration are income differences. A comparison of the gross domestic product of the Eastern and the Western European countries shows that the average income in all EU countries has been higher than in the Eastern European countries seeking EU membership. Comparing the income differential between the richest and the poorest EU countries (Portugal and Greece) with the income differential between the richest EU countries and the richest Eastern European countries reveals only small differences.

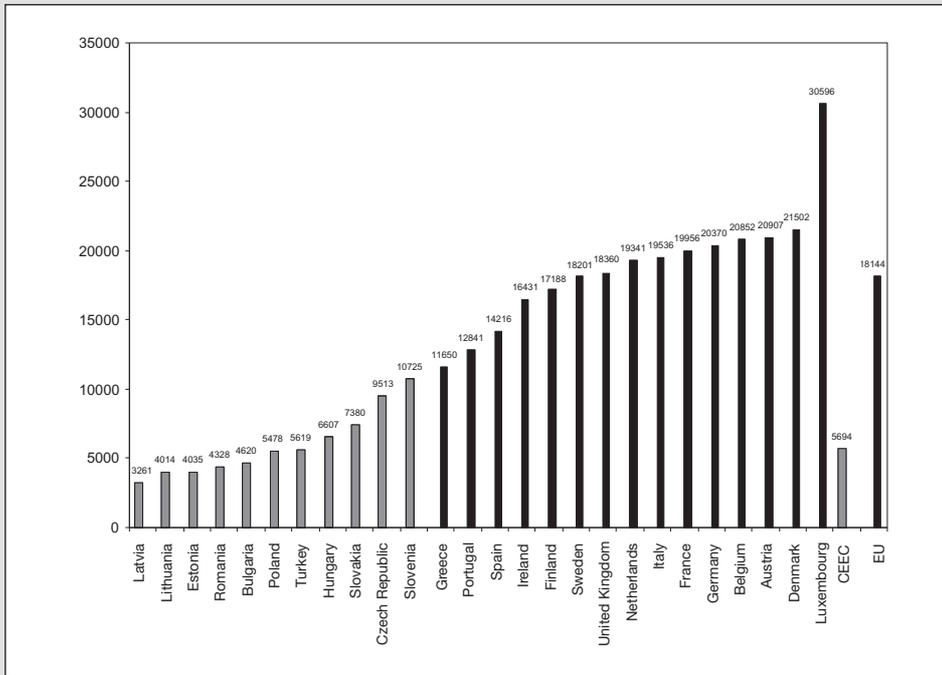
Previous migration experience within the EU suggests that labor mobility is rather slow in adjusting wage and unem-

ployment differentials. Given this experience, the lower bound of the predictions described above seems to be the most likely scenario of future migration pressure from the East to the West. It is difficult to predict the future

In 1998 the International Organization for Migration carried out a comparative study of the migration potential in 11 countries of Central and Eastern Europe. It confirms the assumption that the migration potential, as a result of

simulation shows that in a scenario of limited migration possibilities, between 0.22% of the Slovenian and 1.3% of the Polish population will emigrate to the West. In a scenario of free migration, the probable migration flows increase significantly. For example, the simulated emigration rates from Poland would increase from 1.3% in a scenario of limited migration possibility to 6% in a situation of free migration flow.

### Gross Domestic Product per capita (in purchasing power parities US \$)



Source: United Nations (1997), IZA calculations.

economic development in the Eastern European countries seeking EU membership. However, it is very likely that the decreasing dependence of the Eastern European economies on the economic development in Russia and improved economic relations with Western European countries will have a positive impact. In the long run, the shrinking population and the ageing labor force in Western Europe, coupled with a growing population in Eastern Europe, may make migration from the East to the West even desirable.

The studies that are available so far have arrived at very different conclusions. Estimates based on opinion polls in the sending countries suggest that between 13 and 27 million people are planning a move to the West, whereas more modest predictions expect about 5 million people to migrate to Western Europe. According to some estimates, at least 3% of the Eastern population can be expected to migrate to the West within the next 15 years. This would imply an immigration flow from these countries of about 3 million people, or about 0.81% of the population of the EU in 1995. Given the fact that the yearly immigration to Germany in the last decade had always been around 1%, this number does not seem dramatic.

EU eastward enlargement, will be far lower than is commonly believed. The likely pattern of migration is short-term labor migration to improve household earnings. Even though there is a huge disparity between the potential new EU members and the current EU members, the migration potential will very likely decline with improving living standards in the Central and Eastern European countries. Migration from the East to the West is most likely to become a problem only for Germany and Austria, the favored destination for most of the potential migrants. On the whole, these conclusions are confirmed by the results of the IZA study.

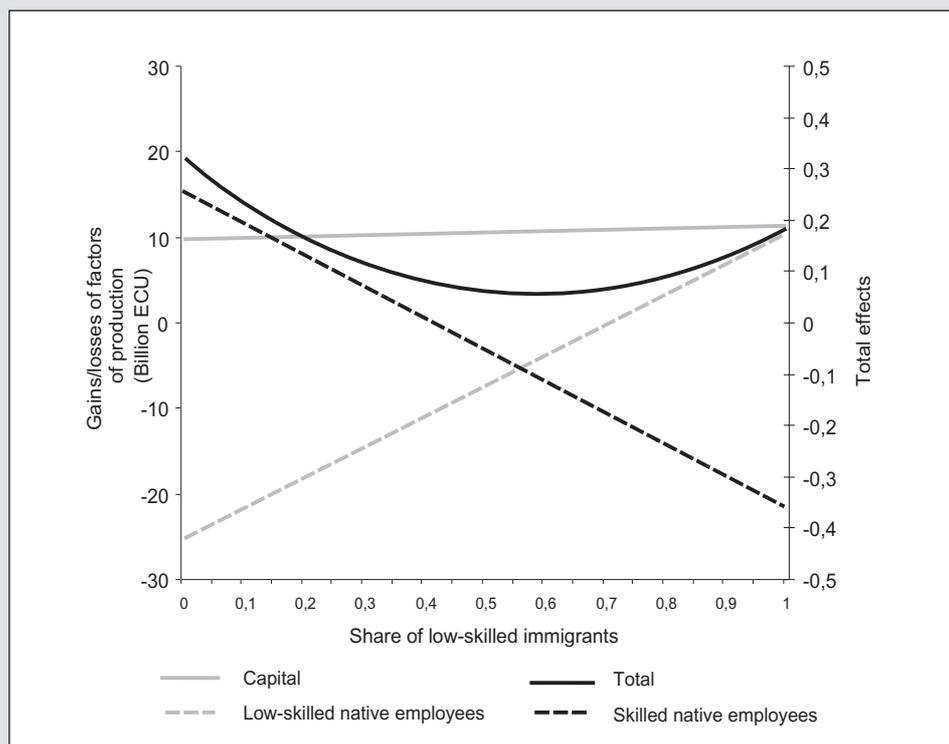
In view of the EU's experience with the admission of Greece, Spain and Portugal it is not evident whether the current EU members have to fear a mass migration from East to West once the Eastern European candidates join the EU. The IZA study takes the admission of these Southern European countries as a case of reference for an eastward enlargement of the EU. In an empirical analysis the determinants of the migration from Greece, Spain and Portugal to the other EU countries were established. The resulting estimations were applied to simulate the probable migration flows from Eastern to Western Europe. The outcome of the

In total, the assessment of the potential migration flows after an eastward enlargement of the EU shows that in the long run 2-3% of the population in the candidate countries will migrate to the West. In the first years after enlargement, however, this number may be considerably higher. Due to existing networks Germany and Austria will be the most important receiving countries for these migrants. It is very likely that these migrants will mainly be skilled workers and come to the West only temporarily. This conclusion is generally confirmed by an empirical analysis of the DIW (*Herbert Brücker/Parvati Trübshwetter/Christian Weise, Migrationseffekte der Europäischen Integration. Lehren aus der Süderweiterung für eine Ost-erweiterung der Europäischen Union. Studie im Auftrag der Bundeskammer für Arbeiter und Angestellte, Wien, Österreich, 1999*). According to this study, an eastward enlargement of the EU will result in an initial annual increase of the foreign population in Germany of about 220,000 people and in the total EU of about 350,000 people. But the level of immigration will most probably decrease very soon.

### Labor Market Effects of East-West Migration

A theoretical analysis of the labor market effects of immigration suggests that there are complicated issues determining whether one can expect gains from immigration and which group will receive these gains. In a competitive (equilibrium) framework differentiating between a labor market of low-skilled and one of high-skilled workers, natives will receive total gains, but those workers who can be substituted by immigrants will lose. In a model where labor markets are assumed to be rigid, the effects of immigration are similar in nature. If low-skilled labor immigrates, there will be gains for skilled natives, but less skilled natives will receive lower wages and face higher unemployment. To what extent natives still gain in total depends on the particular situation. In the case of skilled labor immigration, both wages of skilled natives and unemployment of less skilled natives will decline, and the total income

### Gains from Immigration Concerning Local Factors of Production



Source: IZA calculations.

of natives will increase (including the income of capital owners).

Empirical studies of the impact of immigrants on natives' wages show either small effects or none at all. In some cases, the effects are even positive. The IZA study assumes that within 15 years after EU eastward enlargement, about 3 million people will migrate from East to West, including 200,000 Eastern Europeans immigrating to the "old" EU countries each year. The results of econometric studies on the wage effects of immigration show that the wages of workers in the current EU countries will decrease at most by 0,81% of current wage levels in the first year after an enlargement. Taking the available per capita average annual income from dependent work in the EU in 1996 (9,094 ECU), this would be equivalent to an income reduction of 74 ECU at most in the first year after the enlargement.

Even though the empirical evidence on the employment effects of immigration is more mixed than that on the wage effects, the bulk of the evidence indicates that employment effects of immigration in Europe are very small. As an upper benchmark, the annual immigration of 200,000 workers from the EU membership in the next 10-15 years will increase unemployment in Europe by about 0,54 percentage points in the first year after enlargement. As in the case of

the wage effects of immigration, this number represents an upper bound and will most likely be much smaller.

Simulating an economic model of the labor market effects of immigration using data for the EU, the UK, and Germany has results similar to the empirical studies. The simulations carried out by IZA show that immigration of 1% of the EU population in one year would imply income losses for the EU member countries of about 34.461 billion ECU, or about 0,7% of EU GDP in 1993. In the case of the UK this number is simulated to reach 2.027 billion ECU (or 0,26% of UK GDP in 1996), and for Germany the maximum loss is simulated to reach 8.975 billion ECU (0,65% of German GDP in 1996). This case would occur in a scenario of rigid wages and the immigration of exclusively unskilled workers. In a scenario where most immigrants are skilled workers, one could even expect income gains from immigration. A 1% increase of the EU labor force in one year due to the immigration of skilled workers could be expected to increase the income of natives by about 367.092 billion ECU or about 6,9% of EU GDP in 1993. A similar increase of the UK and German labor force due to the immigration of skilled workers could be expected to increase the income of natives by about 4.205 billion ECU (0,53% of UK GDP) in the UK, and by 19.192 billion ECU (1,38% of the German GDP) in

Germany. However, simulations also show that immigration always has large effects on the (unequal) income distribution in the receiving country.

### Policy Options

It is difficult to predict the EU's options regarding immigration policies towards the candidate countries, particularly looking from a foreign policy point of view. In the face of Article 8a of the Single European Act, a *laissez-faire* system of unrestricted labor mobility between the old and the new member countries seems to be unavoidable. However, as in the case when Spain and Portugal became members of the EU, a temporary restriction of migration from the countries seeking EU membership might be a possible option. Even in this case, a selection of migrants which favors the higher skilled seems to be necessary. If unskilled and skilled workers are complements in production, substantial profits may be reaped from improving the employment possibilities of low-skilled native workers, particularly in the main immigration countries. This result, coupled with the current excess supply of qualified workers in Eastern Europe and the need for further improvements in their human capital in the process of transformation, suggests that a temporary, selective immigration policy towards the new member countries should be taken into consideration. From an economic point of view, an auction system where temporary immigration visas are auctioned off to native firms is superior to all other policy options. However, from a political view the most feasible strategy would be bilateral agreements between "old" and new EU countries, especially since a unified EU migration policy is not foreseeable at the moment.

### Conclusion

If politicians decide to delay the granting of the full rights of free mobility to the new EU member countries, it is crucial to develop a practicable system to control the potential migration flows. However, in the medium and long run it is very likely that the East-West migration resulting from EU eastward enlargement will be limited. Consequently, the labor markets of the Western EU immigration countries will not have to face serious problems. On the contrary, they may even be able to benefit from this East-West migration.

## “Evaluation of Labor Market Programs” IZA-CEPR Workshop – New IZA Research Area

A two-day workshop was IZA's first activity within its new research area “Evaluation of Labor Market Policies and Projects”. The main goal of this workshop was to create a platform for leading economists in the field to exchange ideas and compare experiences from different countries. Another important goal was

to relay to German policymakers the importance of a systematic evaluation of labor market policies which has too often been omitted so far.

*Christoph M. Schmidt* (University of Heidelberg) presented a general overview of the scientific evaluation of labor market

policies. A thorough assessment of the costs associated with government intervention in the market is necessary. Facilities for the administration of interventions are often readily available, but costly. Effective administration and control of intervention is important – simple statistics provided by administrative bodies are often not sufficient for a good evaluation. The latter, however, is crucial in attributing program effects to their underlying causes and in assessing the actual value of measures carried out. Politicians should not shy away from scientific evaluation. On the contrary, they should push it forward and take it as a yardstick for future labor market policies.

*Joseph Zweimüller* (University of Zurich) gave a presentation on the evaluation of Active Labor Market Policies (ALMPs) in Switzerland. Until the end of the 1980s Switzerland had a low unemployment rate, but in the early 1990s unemployment grew fast. The Swiss government reacted by implementing ALMPs, with the result that Swiss unemployment has recently started to decrease again. Can this decrease be attributed to the success of the ALMP programs? In his study, Joseph Zweimüller used administrative records on unemployment to analyze the effect of programs on individual unemployment duration. He found that ALMP participation tends to shorten the unemployment duration slightly for women, but not for men. *Patrick Puhani* (University of St. Gallen) confirmed that participation in ALMPs in the Swiss model does not result in an extension of unemployment compensation. However, he critically remarked that the decision to participate in an ALMP might be influenced by the expiry of benefit entitlement.

### Active Labor Market Policies in Canada and Europe

*David Card* (University of California, Berkeley) discussed the Canadian “Self-Sufficiency” Project, a large-scale social experiment evaluating the effects of an earnings supplement. This supplement is granted to single parents on long-term welfare (mostly single mothers) who, after receiving income assistance for some time, have become independent of government support by finding a full-time job. As the supplement is smaller than the welfare benefits, the government profits from each single parent who successfully moves from

### IZA-CEPR Workshop: Evaluation of Labor Market Programs

November 29th -30th, 1999  
Berlin, Germany

#### Program Chair and Organization:

*Juan J. Dolado* (University Carlos III, Madrid, IZA and CEPR)

*Rob Euwals* (IZA and CEPR)

*Christoph M. Schmidt* (University of Heidelberg, IZA and CEPR)

*Klaus F. Zimmermann* (IZA, Bonn University and CEPR)

#### Monday 29th November

15:00 - 16:30

#### Evaluating Policy Interventions

*Christoph M. Schmidt* (University of Heidelberg, IZA and CEPR)

Discussant: *Olaf Hübler* (University of Hannover and IZA)

17:00 - 18:00

#### The Impact of Active Labour Market Policies and Benefit Entitlement Rules on the Duration of Unemployment in Switzerland

*Joseph Zweimüller* (University of Zurich, IZA and CEPR)

Discussant: *Patrick Puhani* (University of St. Gallen, IZA and CEPR)

#### Tuesday 30th November

09:00 - 10:30

#### Reforming the Financial Incentives of Welfare: Evidence from a Large Scale Social Experiment.

*David Card* (University of California and IZA)

Discussant: *Michael Lechner* (University of St. Gallen and IZA)

11:00 - 12:00

#### Do Active Labour Market Policies Help Unemployed Workers to Find and Keep Regular Jobs?

*Jan van Ours* (CentER, Tilburg University, IZA and CEPR)

Discussant: *Denis Fougere* (CREST-INSEE, Paris)

12:00 - 13:00

#### Evaluation of Labor Market Programs in the Netherlands

*Gerard van den Berg* (Free University Amsterdam, IZA and CEPR)

Discussant: *Rob Euwals* (IZA and CEPR)

14:00 - 15:00

#### Estimation in a Duration Model for Evaluating Training Programs

*Kurt Brannas* (Umeå University and IZA)

Discussant: *Peter Jensen* (University of Aarhus)

15:00 - 16:00

#### The Impact of Differential Payroll Tax Subsidies on Minimum Wage Employment

*Françis Kramarz* (CREST-INSEE, Paris, IZA and CEPR)

Discussant: *Jennifer Hunt* (Yale University, DIW, IZA and CEPR)

being a welfare recipient to receiving a supplement. Preliminary analysis shows that this program encourages single parents to accept a job. Whether the availability of supplements induces new welfare recipients to remain on welfare long enough to become eligible for the supplement is a critical issue, however. In a separate experiment, new recipients were informed that they would already become eligible for the supplement after staying on welfare for a year. This experiment shows only a small delayed-exit effect with regard to abandoning welfare. In light of these conclusions, the implementation of such a program appears to be plausible and profitable. Another finding, however, shows that wage growth for supplement recipients has been as small as that for low-skilled workers, which constitutes an incentive to fall back to welfare if the supplement ends after three years.

In the 1990s, the Slovak government introduced a wide range of ALMPs, including temporarily subsidized jobs. Using administrative data, *Jan van Ours* (CentER, Tilburg University) analyzed unemployment and employment durations after participation in such a program. He concluded that short-term subsidies seem to be a more effective policy than long-term subsidized jobs

that have a negative impact on the job finding rate.

In the Netherlands, the unemployment insurance agencies use counseling and monitoring to encourage unemployed workers with good labor market prospects to find a new job. Based on a social experiment in two major Dutch cities, *Gerard van den Berg* (Free University Amsterdam) concluded that counseling and monitoring have no significant effect on reemployment. *Rob Euwals* (IZA and CEPR) pointed out that the insignificant effect of counseling and monitoring for this group of unemployed workers comes as no surprise given that the Dutch economy experienced a strong upswing in the period under consideration (the years 1998 and 1999).

Sweden has a long history of ALMPs and of the evaluation of such programs. *Kurt Brannas* (Umeå University) analyzed the periods of unemployment for adults without a three-year secondary school education. He compared this group with participants in the Swedish Adult Education Initiative and participants in a labor market training program. Brannas concluded that the latter show significantly longer periods of employment and that there are strong indicators of selection effects.

The experience in France is unique: Besides the usual growth in minimum wages over the last decades and an increase in costs associated with these wages, there have been some years for France during which costs have actually decreased. *Françis Kramarz* (CREST-INSEE, Paris) analyzed the employment probability of workers affected by these minimum wage arrangements. By looking at statistical data on the French labor market, he found that in years of increasing minimum wage costs workers affected by these cost changes were more likely to become unemployed than workers who earned slightly more, and were therefore not affected by the minimum wage changes. For the years of decreasing minimum wage costs he noticed substitution effects between workers at the minimum wage level. He also found that more jobs were created during these years.

IZA director *Klaus F. Zimmermann* summed up the results of the workshop: "Politicians would be well advised to take advantage of the instruments of scientific evaluation in order to recognize when they are on the wrong track, to leave the wandering path and to choose the right direction of an active labor market policy."

## SHORT REPORTS

### +++ Ralf Messer new Administrative Director of IZA +++

In January 2000 *Ralf Messer* became Administrative Director of IZA. Until



Ralf Messer

then he was academic advisor to the president of the German Institute for Economic Research (*Deutsches Institut für Wirtschaftsforschung – DIW*) and thus played a significant role in shaping the work of Germany's largest economic research institute. Ralf Messer studied Political Science, Geography and

Economics at Free University, Berlin. IZA will benefit from his diverse experience in management and marketing as well as his excellent contacts in the area of science and research policy. Besides conducting the management of the central scientific and administrative work of IZA, Ralf Messer will take the lead in intensifying the cooperation between IZA and DIW.



### +++ Hartmut Lehmann new IZA Research Director for "Labor Markets in Transformation Countries" +++

Since the beginning of this year, *Hartmut Lehmann* is the new IZA Research Director to lead and coordinate research projects on "Labor Markets in Transformation Countries". After receiving his M.A. in statistics from the University of California, Berkeley and his Ph.D. in economics from the London School of Economics and Political Science, Lehmann was director of the Department for Central and Eastern Europe at the Ifo Institute in Munich, already

concentrating in his research on labor markets in transition countries. Having been consultant to the World Bank and to the OECD, he is currently a tenured member of the Economics Department



Hartmut Lehmann

of Heriot-Watt University in Edinburgh, teaching courses on labor economics and econometrics. He is also Research Fellow of the William Davidson Universiät Michigan und Senior Research Fellow am Centre for Economic Reform and Transformation (CERT) der Heriot-

Watt-University where he directs the labor market program. Since 1999 Lehmann is Research Fellow at IZA. His recent work includes papers on labor market issues in transition countries published in various journals, such as *Journal of Comparative Economics*, *European Economic Review* and *Labour Economics*. “Western economies can learn from the reform efforts in transformation countries – from mistakes and successes – how to react to the necessity of adaptation and change,” says Hartmut Lehmann, referring to the importance of intensive research in this area.



**+++ Christoph M. Schmidt new IZA Research Director for “Evaluation of Labor Market Policies and Projects” +++**

Research projects on “Evaluation of Labor Market Policies and Projects” are now directed by *Christoph M. Schmidt*. He received his diploma in economics in 1987 from the University of Mannheim and his M.A. and Ph.D. in 1989 and 1991, respectively, from Princeton University. Schmidt was awarded a Princeton University Fellowship, 1987-1990, and the Alfred P. Sloan Doctoral Dissertation Fellowship, 1990-1991. From 1992 to 1995 he was a fellow of the Deutsche Forschungsgemeinschaft (DFG). In 1995 he received the degree of Dr. rer. pol. habil. from the University of Munich. Since then he teaches econometrics and labor economics as a Full Professor at the University of Heidelberg. Since 1996 Schmidt is Research



Fellow at the Centre for Economic Policy Research (CEPR), London and since 1998 also at IZA. His research interests include applied econometrics, particularly in labor and population economics. He serves as co-editor of the

*Journal of Population Economics*, and he has published articles in journals such as *Review of Economics and Statistics* and *Journal of Public Economics*. In the IZA research area “Evaluation of Labor Market Policies and Projects” Schmidt analyzes the different policies and projects that are carried out in different countries to fight unemployment. “The evaluation of labor market policies is crucial in assessing the actual use of single programs and projects and to draw conclusions for government measures,” says Christoph M. Schmidt, summing up the relevance of the IZA research projects in this area.



**+++ Rainer Winkelmann new IZA Research Director for “The Future of Labor” +++**

Research projects in the program area “The Future of Labor” are now under the direction of *Rainer Winkelmann*. He studied economics at the Universities of Konstanz (Diplom-Volkswirt, 1989) and Paris, at the Washington University in St. Louis (M.A., 1990) and at the University of Munich (Dr. oec. publ, 1993). From 1993 to 1995 he was Visiting Assistant Professor at Dartmouth College, New Hampshire and from 1995 to 1999 Se-



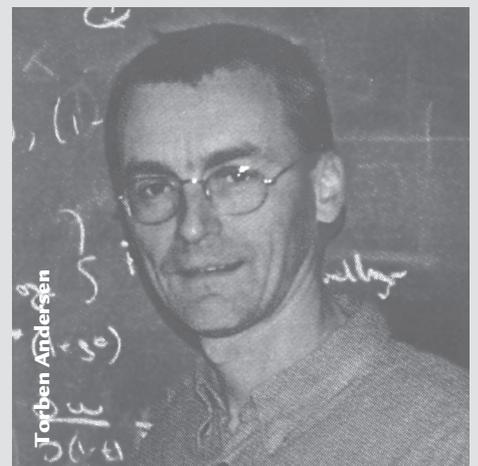
nior Lecturer in Economics at the University of Canterbury, Christchurch, New Zealand. He acted as an advisor to the New Zealand government on issues of immigration policy, the economic position of the Maori, and the effect of trade liberalization on income distribution. Winkelmann joined IZA in December 1999 as a Senior Research Associate. His research interests include empirical labor economics, particularly unemployment, migration and income

distribution; and econometric models for count and panel data. He published “Econometric Analysis of Count Data” and numerous papers in journals such as *Economica*, *Industrial and Labor Relations Review*, *Journal of Business and Economics Statistics*, *Journal of Econometrics* and *Journal of International Economics*. In his research at IZA on “The Future of Labor” Winkelmann will concentrate on the impact of modern developments like information technology, globalization and demographic change on the labor market. “Increasing competition and technological change will lead to new forms of labor. What is the social impact of these developments? Who are the winners, and who the losers? What are the resulting opportunities for the equal treatment of men and women? These are some of the questions that will be addressed within this program area”, Winkelmann says.



**+++ Torben M. Andersen new IZA Research Director in the Program Area “Internationalization of Labor Markets” +++**

*Torben M. Andersen* will lead research at IZA in the program area “Internationalization of Labor Markets”. He is professor of economics at the University of Aarhus. Andersen studied at the London School of Economics, the University of Aarhus and the Université Catholique de Louvain (Belgium). His research focus is on the impact of European integration and globalization on international labor markets, but also



on macroeconomic aspects of labor market research and on the structures of product markets. Andersen is co-editor of many journals, among others *Journal of Macroeconomics*, *European Economic Review*, *Scandinavian Journal of Economics*, *Nordic Journal of Political Economy*, *Recherches Economiques de*

Louvain, and he has published important essays in reference books and international journals. He acts as a policy advisor and is research fellow of CEPR and IZA. Describing his ambitious goals for his research area at IZA, he says: "The face of labor markets is changing daily due to growing internationalization. This poses big challenges for politics, business, and unions, as well as employers and employees. IZA will offer scientifically sound advice to contribute to dealing with these challenges."



Ulrike Maurer

**+++ Ulrike Maurer new IZA Project Manager +++**

Since December 1999 *Ulrike Maurer* has been secretary of IZA. From now on, she will be IZA Project Manager to organize and coordinate IZA events and workshops. *Ulrike Maurer* studied English and Music at Bonn University. Afterwards she worked in the news departments of various radio and TV stations. From 1995 to 1999 she was part of the public relations staff of a parliamentary group in the German Bundestag and as such responsible for the marketing of events and publications.



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**IZA VISITORS PROGRAM**

From November 1999 until February 2000 a number of renowned economists stayed at IZA to discuss issues of labor market research and policy, including:

- Wolfgang Schwerdt* (CREST/INSEE, Paris, Frankreich)
- Christian Belzil* (Concordia University, Montreal, Kanada)
- Michael Shields* (University of Leicester, England)
- John Haisken-DeNew* (DIW, Berlin)
- Anders Björklund* (University Stockholm, Schweden)
- Don J. DeVoretz* (Simon Fraser University, Vancouver, Kanada)
- Patricia Apps* (University of Sydney, Australien)
- Frank Windmeijer* (Institute for Fiscal Studies, London, England)
- Heinz P. Galler* (University Halle)
- Kurt Brannas* (University Umea, Schweden)
- Hartmut Lehmann* (Heriot-Watt University Edinburgh, Schottland)
- Arthur van Soest* (University Tilburg, Niederlande)
- Torben M. Andersen* (University Aarhus, Dänemark)
- Reinhold Schnabel* (University Mannheim)
- Scott M. Fuess* (University of Nebraska, USA)
- M. Pilar Diaz-Vasquez* (Santiago de Compostela, Spanien)
- Dennis Snower* (Birkbeck College, London England)
- Hector Sala* (Freie University Barcelona, Spanien)
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# O P I N I O N

## Hostile Takeovers – Do They Hurt Employment?



The victory of British cellular phone operator Vodafone in the takeover battle against Mannesmann, a large German company rich in tradition, is unprecedented in German economic history. Valued at DM 400 billion, this coup is also the largest *de facto* hostile takeover in the world.

In the face of globalization, corporate takeovers are not at all unusual. In a hostile takeover, the corporate raider either buys shares of the target firm on the stock market (openly or secretly) or makes the firm's shareholders an attractive offer to purchase their shares. An alternative method to avoid cash transfers is the exchange of shares. In the short run, this whole process does not necessarily affect employees. Friendly mergers, however, generally offer greater opportunity for employees to influence the conditions of the takeover.

The shareholders' perspective depends on their motivation. A hostile takeover changes the power structure of the company and diminishes the shareholders' influence. Those who are

primarily profit-oriented might prefer a hostile takeover, as it drives up stock prices over those of a friendly merger. When shares are exchanged, the holder gains ownership but also carries the entrepreneurial risk.

Why should we accept hostile takeovers? They are, one might argue, not only an inevitable by-product of international economic integration, a necessary means for keeping pace with globalization, but at the same time they guarantee an optimal allocation of resources. International corporate takeovers are difficult to conduct in a friendly manner because they involve highly organized firms and fundamentally different cultures of corporate management.

There is still the danger that corporate raiders and shareholders are primarily looking for short-term profits. As the American experience shows, hostile takeovers often result in corporate cannibalization and disintegration of the target firm. Acquiring a company in order to take advantage of its production facilities, technological developments, or distribution networks does not necessarily lead to an optimal allocation of resources in the long run. While building a business is an extremely difficult task, its destruction is swift and not always creative. Not every corporate raider is a Schumpeterian entrepreneur.

The takeover battle itself (as in the case of Vodafone vs. Mannesmann) may bring about an absurd display of muscle-flexing and the use of vast sums of money for advertising campaigns – with questionable effects on the companies' performance. "Powerful corporate strategies" must be demonstrated in order to convince shareholders. These efforts seem to focus more on shifting the public mood than on helping shareholders to form a rational opinion.

The suggested perspectives may later turn out to be risky. Asymmetric information about the potentials of a merger poses a serious problem. Who protects all the small shareholders, including employee-shareholders?

Employees represent the long-term component of an enterprise. Effective employee protection can regulate this element adequately. The potential buyer should have to specify the short- and mid-term employment effects of the acquisition. This might adjust the costs of a "bad" takeover upwards. Prohibiting takeovers that are solely based on an exchange of shares would have the same result.

In what ways will the German economy change if it becomes a bigger target for hostile takeovers? A steadier integration in global competition would be the consequence – certainly a positive one. But frequent takeover campaigns also mean that creative managerial minds will be busy conquering and defending, instead of developing new ideas and markets – which is a negative effect. If a takeover has so many convincing advantages, then why doesn't it occur by full mutual agreement after examining all the tangible facts involved?

In the long run, we can expect hostile takeovers to lead to a less efficient allocation of resources on the national level. The likely result will be job losses rather than new jobs. In terms of employment, the speculative element inherent in hostile takeovers is not exactly promising. The proper response would be to regulate hostile takeovers. An appropriate anti-takeover law is definitely overdue.

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