



IZA

COMPACT

CONSIDERING THE FUTURE OF LABOR

Unemployment Traps: Do Financial Disincentives Matter?

Many industrialized countries face the same dilemma concerning certain groups of unemployed individuals. Through extensive unemployment insurance, it is for some workers more favorable not to work at all and live on unemployment benefits rather than taking a low paid job.

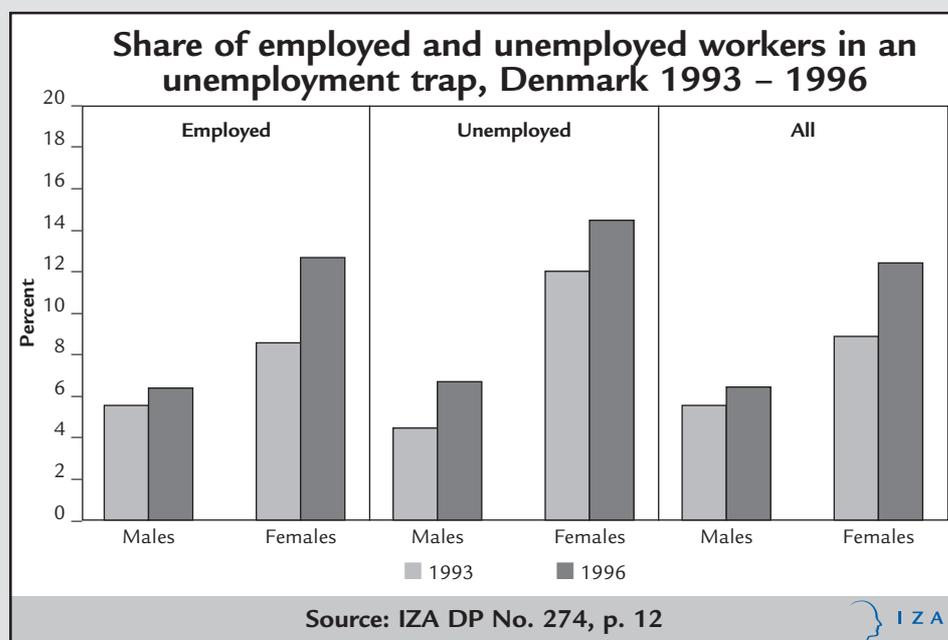
A recent IZA study analyzed the importance of financial disincentives for workers in Denmark (for details see: *Peder J. Pedersen/Nina Smith, Unemployment Traps: Do Financial Disincentives Matter?, IZA Discussion Paper No. 274*). The figure to the right shows that more and more Danish employed and unemployed individuals got caught in the so-called "unemployment trap" during the nineties. Based on a panel survey, which was merged to a number of administrative registers, the study arrived at precise measures of the economic incentives for labor force participants between employment in a full-time job and being on unemployment insurance benefits. The fixed costs of work (such as commuting costs and child care) were also taken into account. In 1996, six percent of Danish men and 13 percent of women had a lower disposable net income when working in a full-time job compared to being on unemployment benefits. The effect of these financial disincentives is analyzed in simple reduced form models of on-the-job search, unemployed search behavior, unemployment risk, and transition out of the labor force.

If the disposable income when unemployed or outside the labor force is higher than, or close to, the disposable income from a potential job, the incentives to search for a job are reduced. At the same time, there are strong economic incentives to quit a low-paid job and become voluntarily unemployed for a shorter or longer period.

The disincentive problems for low-skilled workers and the possible existence of unemployment traps may help to explain the high levels of structural unemployment in many OECD countries. Thus, efforts have been made in recent years to alleviate work incentive problems. A potential solution would be

to simply reduce replacement rates in the benefit system. However, since this solution would have obvious negative effects on income distribution, major reductions in the replacement rates have been ruled out as politically unacceptable in many countries. As an alternative, in-work benefits have been

als are observed over a period of three years. It is thus possible to test whether low-paid workers during this period seem to react to economic disincentives with respect to search effort, labor supply, retirement, other transitions out of the labor force, and geographical mobility.



introduced in some OECD countries. These may take the form of an earned income tax credit (EITC), which the United States, for instance, offers to low-paid workers. In-work benefits increase the incentives to search for a job because they raise the net income when employed relative to being non-employed. But unlike reductions in the replacement rates, in-work benefits do not change the absolute level of disposable income for the unemployed.

The study presents empirical evidence on the magnitude and the importance of disincentives for low-paid workers in Denmark. The database used allows the construction of very precise individual budget constraints, including information on fixed costs of work. These findings can be combined with extensive information on labor supply and individual attitudes towards work. Individu-

Tax and benefit schemes in Denmark

Denmark has no formal in-work benefit system. But since Denmark is one of the OECD countries with the strongest labor supply disincentives for low-paid workers, there has been a lot of discussion on these issues. These disincentives stem from fairly high gross replacement rates (more than half of employed workers in Denmark had effective replacement rates between 81 and 100 percent), high taxes on low incomes, and high fixed costs of work.

The benefit system in Denmark consists of unemployment insurance (UI) benefits and welfare payments. Unemployment benefits amount to 90 percent of previous individual earnings up to a maximum considerably below the average annual earnings for an unskilled worker. Membership of an UI fund is voluntary, but since UI funds are

highly subsidized by the state, there is a very high coverage of UI for low-skilled workers with a high risk of unemployment. On average, 80 percent of the Danish labor force participate in UI funds. In order to be entitled to UI benefits, the unemployed must have been employed for one year during the last 30 months. The maximum duration of UI was five years in 1996 (now: four years), but after one year (until 1999:

An analysis of the transitions in and out of the unemployment trap state between 1993 and 1996 yields the following figures: By 1996, 45 percent of the men and 40 percent of the women who were in an unemployment trap in 1993 had escaped the trap, while 19 percent of the men and 20 percent of the women were again observed in an unemployment trap in 1996. About 40 percent of the individuals

incentives are more important, while female unemployment risk is higher for those who focus more on non-economic incentives.

The study also found that large groups in the Danish labor market are experiencing considerable problems with respect to the economic incentives to work instead of living on unemployment benefits. Looking at the aggregate figures for the net compensation rates presented above, the incentive problems seem to have increased between 1993 and 1996. The analysis essentially supports the hypothesis that the cyclical upturn and/or labor market reforms which have tightened availability rules may have pushed or pulled individuals with low work incentives into jobs. This effect seems to be much stronger for women.

Search and mobility models

The estimations of search and mobility models show that economic incentives may have positive effects on on-the-job search. But the effect is highly correlated with a negative effect from tenure, and the positive incentive effect may reflect that individuals with high tenure tend to have lower compensation rates. A significant incentive effect on the probability of job search of unemployed individuals cannot be found. But conditional on active job search, those individuals with the highest incentives to find a job also search most intensively in terms of time and money spent on job search and the number of contacts with potential employers. The net compensation rate is used also in attempts to explain two flexibility indicators: the maximum acceptable commuting time and the willingness to relocate in order to get a job. The only significant impact that could be observed was on the maximum acceptable commuting time.

Economic incentives affect labor market behavior

The net compensation rate has a significantly positive coefficient in the estimation of the probability of being unemployed and receiving UI benefits during both 1993 and 1996 and for both men and women. With respect to the risk of being unemployed, the incentive effects of the net compensation rate seem to be larger for women than for men. Finally, a significant impact for women from the compensation rate on the propensity to leave the labor force using a voluntary exit route is found. The results indicate that economic incentives do indeed affect labor market behavior, notwithstanding the fact that many Danish workers are employed even though they experience negative economic work incentives. The main conclusion is that the purely economic variables have the strongest influence on the risk of being in an unemployment trap.

Transitions of employed/unemployed in and out of unemployment traps, Denmark 1993 – 1996

1993:	Men, 1996 in percent				Women, 1996 in percent			
	Not in trap	In trap	Not observed	Total	Not in trap	In trap	Not observed	Total
Not in trap	70,7	2,8	26,5	100,0	65,0	6,9	28,1	100,0
In trap	44,8	17,4	37,8	100,0	39,2	19,2	41,6	100,0
All	69,3	3,6	27,1	100,0	62,6	8,1	29,3	100,0

Source: IZA DP No. 274, p. 13



two years) the unemployed will get a job offer which they have to accept in order to remain eligible for UI payments in the future.

The conditions for receiving UI as well as welfare benefits is that the person is not only available for employment but also actively involved in a job search. In an international setting, the current UI benefit rules in Denmark are characterized as relatively tight.

Unemployment traps in Denmark

The share of workers in the labor force (employed or unemployed) who were in an unemployment trap are shown in Table 1. This situation is defined as having a net compensation rate > 1 , which means that the net disposable income from UI benefits is higher than from a full-time job at the actual wage rate (for employed individuals) or the expected wage rate (for unemployed individuals).

In 1993, 5.5 percent of male workers and 9.2 percent of female workers met this condition. In 1996, these figures had increased to 6.2 percent and 13.0 percent, respectively. During the same period, the number of employed workers with a net compensation rate larger than one increased from 7.0 to 9.5 percent, while the same figures for unemployed workers were 9.1 and 10.9 percent, respectively.

in an unemployment trap in 1993 did not have an observed value for a net compensation rate in 1996, i.e. they had left the labor force. A large number in this group had entered into a public-sector income support scheme different from UI benefits.

Attitudes towards work versus economic incentives

The political debate on "making work pay" usually concentrates on the transitions between unemployment and employment. There is, however, also the possibility that people tend to leave the labor force because other income compensation programs offer high net compensation rates. In the Danish context in the 1990s, this could be a leave scheme implying a temporary exit from the labor force. Alternatively, it could be a non-reversible exit to early retirement or to a status outside the labor force without any income, i.e. financial support from the family. In the latter case, the decision is motivated by the low wage potential rather than an income entitlement outside the labor market.

Purely economic incentives have the largest impact on the risk of creating unemployment traps, with attitude measures playing a minor – although non-trivial – role. Long-run economic incentives have the expected impact on search intensity and labor market flexibility. Male unemployment risk tends to be lower when long-run economic

Re-Employment Dynamics of Disabled Workers

In times of high unemployment in many developed economies, programs for reintegration of workers into the labor market are of great relevance. The disability insurance program in the Netherlands is noteworthy in this context since about 13 percent of the Dutch labor force are enrolled in this program. An analysis of the re-employment dynamics in this particular group therefore yields interesting results. To this end, the underlying factors that determine the time between entering the program and accepting new employment must be identified. An important aspect of a new IZA study on this topic (for details see: *Hielke Buddelmeyer, Re-Employment Dynamics of Disabled Workers, IZA Discussion Paper No. 269*) is that it explicitly takes into account that different people will face different, often declining, benefit schedules over time. Secondly, the analysis also explicitly acknowledges that people use information about the future when making their decisions.

In an international setting, the Dutch experience shows significant differences compared to the United Kingdom, former West Germany, and Sweden. Since it is unlikely that health is dramatically better or worse in any of these countries, these differences must be due to institutional factors. Germany and Sweden, for instance, provide substantial funding for rehabilitation measures to keep disabled workers in the labor force, whereas the Netherlands spends almost all their money on transfer benefits. The eligibility criteria and replacement rates for disability also differ substantially per country. The figures below should be sufficient to underscore the uniqueness of the Dutch case:

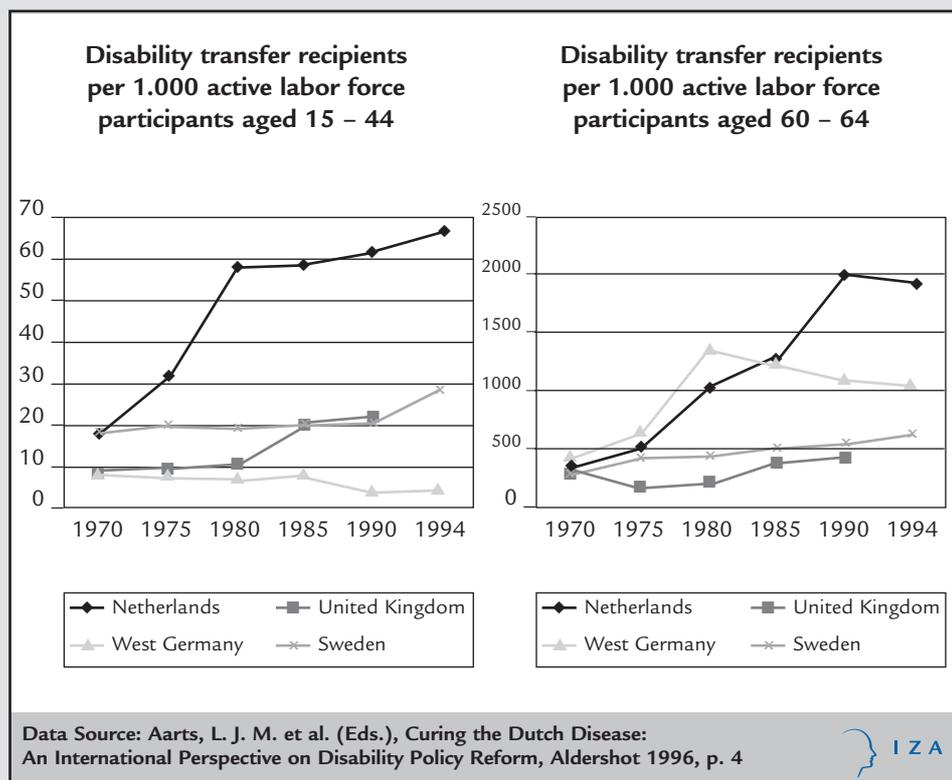
As mentioned above, the disability program plays an important role in the Netherlands simply because of the number of people enrolled – about one in eight workers. This figure alone is meaningless without the following explanations. First, disability is defined purely as a loss in earning capacity and does not correspond one-to-one with the meaning of the word "disabled" in its common usage. Secondly, the measure of disability is a continuous one, expressed as a percentage, and not an all-or-nothing condition. Thirdly, the reason for the loss in earning capacity is irrelevant and does not have to be job related. Finally, and perhaps most importantly, it is possible to work and be enrolled in the disability program at the same time.

The data was collected by interviewing people a) one month before possible entry to the program, b) six months after entering and, c) two and a half years after entering the program. Those who returned to work were predominantly (younger) men with a relatively high level of last earned wages and more likely to be higher educated. Perhaps not surprisingly, those who returned to work also reported to have a better overall health. Those people who were still in the disability program and did not return to work within the two and a half years after entering the program were generally older, had relatively low last earned wages, were generally less educated and reported relatively poor overall health. Approximately

one third of the people entering the program returned to work at some point during the time span of the data (Nov. 1991 – May 1994).

The model that tries to explain the observed patterns is based on individuals who in each period (month), with some probability, receive a job offer at a certain wage. If someone does not receive an offer, they have no choice but to continue searching. If someone does receive an offer, they have to decide whether to accept the job or whether to decline the job and continue searching. Estimation of this model shows that overall health status does not play a significant role in the wage offer, but it does matter for the probability of obtaining an offer. Over time, as can be expected, the probability of receiving an offer declines sharply. Besides health status and time, younger people are more likely to receive an offer. The same applies to those who are better educated and have more work experience. The key factors determining the wage offer are work experience, education, and gender. Better educated and more experienced workers, are offered higher wages. Women are offered lower wages.

The advantage of the approach taken in this study is that it allows an analysis of what would happen if changes were made to the disability program. It is shown that eliminating the disability program by transferring everyone to the unemployment program results in fewer people returning to work. This is due to the fact that the disability program allows for a supplemental benefit on top of wage earnings, provided that these earnings are sufficiently low. The higher the level of disability, the more low paying jobs are desirable. When the disability program is abolished, the attractiveness of these low paying jobs is also eliminated. As can be expected, increasing the benefits will lead to fewer people returning to work. This time it is not caused by the loss of the wage subsidy for low paying jobs, but rather the result of an increase in the value of staying at home. On the other hand, reducing the benefits increases the number of people returning to work. The most interesting aspect is that the response to a reduction in benefits is much weaker compared with the response to an increase. In summary, reducing benefits as a measure to increase the incidence of people returning to work is not very effective since the probability of accepting a job is already very high. The opposite, increasing the benefits, will lead to a sharp drop in the number of people returning to work, as will an elimination of the program. Therefore, policies designed to increase the number of people returning to work should be aimed at increasing the probability of obtaining an offer, rather than focusing on an increase of the acceptance probability.



Successful IZA Workshop: “The International Mobility of Highly Skilled Workers”

In the wake of globalization, increasingly integrated output and financial markets, labor markets for highly skilled specialists and managers are poised to become more international as well. But actual labor mobility remains remarkably low. A recent IZA workshop, organized by IZA Program Director *Rainer Winkelmann*, brought together 20 researchers from nine different countries to analyze high skilled labor mobility, identify its determinants and discuss appropriate policy responses as well as directions for further research.

In the opening paper, *Don DeVoretz* (Simon Fraser University) examined the determinants of high skilled migration from Canada to the United States. It is estimated that about 8 percent of all university graduates leave every year. Canadian graduates have a lot to gain by moving to the US. The return to a university degree for Canadian graduates in Canada is only 11 percent, compared to 43 percent if they move to the US. This is because education in Canada is highly subsidized, and emigrants avoid the deferred financing through high income taxes. Does this mean that a highly subsidized education system, combined with free movements across the border, is a bad idea? Not necessarily so, argued a second paper by *Silke Uebelmesser* (University of Munich). She showed that a more open country can actually experience a skill gain because domestic workers actually acquire more human capital in a world where migration is an option than in a world without migration.

Differences in labor income are obviously not the only factors influencing the decision to migrate. *Tim Krieger* (University of Göttingen) presented results indicating that inter-

national differences in the provisions for public pensions can lead to substantial gains from migration as well. For example, a 20-year-old single moving from the Netherlands to Germany can gain more than 40,000 present-value dollars through reduced expected net contributions to the pension system. *Philippe Marey* (ROA Maastricht) provided forecasts for labor market imbalances within Europe under different scenarios until 2002. An excess supply of graduates in science subjects in southern EU member states could, with the necessary degree of mobility, easily compensate for a shortfall in countries like Germany. *Barry McCormick* (University of Southampton) argued that skilled workers from less developed countries might use temporary migration as a means to finance entrepreneurial activities upon return.

Other papers by *Lars Nerdrum* (NIFU), *Claudia Villosia* (R&D Ricerche e Progetti), *Scott Fuess* (University of Nebraska) and *Mark Regets* (National Science Foundation) dealt with the situation of highly skilled migrants in Norway, Italy, Japan and the US, respectively. Whether people are actually able to move and take advantage of these opportunities is, of course, another question. *Gerald Willmann* (University of Kiel) developed and tested a political economy model that shows how, and under what circumstances, interest groups will successfully lobby to erect barriers to factor mobility.

Finally, four presentations were devoted to the results of a project financed by the German Ministry of Education and Research (BMBF) on the “International Mobility of Highly Qualified Workers”. First, *Ulrich Teichler* (University of Kassel) summarized results on post-graduation mobility from the

CHEERS project (Careers after Higher Education: A European Research Survey), a dataset with more than 36,000 observations from 11 European countries and Japan. In this dataset, a sample of the 1994 and 1995 graduation cohorts was interviewed in 1999. Overall, 2.9 percent of graduates were employed abroad at the time of the survey, confirming that international mobility is low. Mobility rates for Germany are even lower. Given the fact that Germany is relatively often chosen as a destination, Germany experiences a brain gain rather than a brain drain.

Rainer Winkelmann, *Melanie Ward* and *Lilo Locher* (all IZA) presented some first findings from the IZA International Employer Survey that was partially financed by the BMBF project. As part of the survey, 850 firms were interviewed in Germany, France, the UK and the Netherlands in order to obtain information on the determinants of their demand, their human resources strategies, and their experiences with recruiting foreign graduates. Again, mobility is observed to be low. Only 38 percent of the surveyed Germany firms employ any foreign highly skilled workers. Among those, the average share of foreign employees with a university degree among all employees with a degree is only 9 percent. The main motive for recruiting internationally is the demand for international competence (knowing foreign markets and languages). Firms with international operations or ownership are much more likely to recruit internationally than others. Moreover, the survey shows that most firms feel restricted by institutional barriers for recruiting non-EU nationals: 71 percent of German companies would hire more non-EU highly skilled nationals if the immigration rules were simplified.

IZA Steps Up Policy Advice – New Program Director for Labor Market Policy as of July 1, 2001: Hilmar Schneider

In order to intensify its activities in the field of labor market policy advice, IZA is adding a new area entitled “Labor Market Policy” to the institute’s research program. Director of this program area will be *Hilmar Schneider*. Since 1994, Dr. Hilmar Schneider has been head of the Labor Market Department at the Halle Institute for Economic Research (IWH) and lecturer for labor market policy at Martin Luther University, Halle-Wittenberg. At IWH he has been in charge of various high-profile research projects and studies in the field of labor market policy. His most important publications

include studies on the determinants of unemployment duration, labor market prospects and the efficiency of labor market policy in eastern Germany, as well as perspectives on the welfare state in Europe.

Hilmar Schneider received his Ph.D. from the University of Frankfurt (Johann Wolfgang Goethe-Universität) in 1987. He held a position as visiting scholar at the World Economy Laboratory of the Massachusetts Institute of Technology (MIT) in 1997. Apart from labor market policy, his research also focuses on questions of social

security, wage policy, and demography. In his new position as IZA Program Director, Hilmar Schneider will be able to draw on a profound knowledge of methodology and on many years of experience. IZA Director Klaus F. Zimmermann: “Hilmar Schneider will play an important role in improving IZA’s profile as a major supplier of scientifically well-founded, independent policy advice. Now, more than ever, IZA will use its competence to shape successful labor market policies.”

Renowned Economists to Meet at IZA Conference: “Pension Reform and Labor Markets” – Berlin – May 19-21, 2001

The financial unsustainability of many European pensions systems have put the European welfare state under increasing strain. As a result, many of the traditional functions of the welfare state – social insurance, redistribution from rich to poor, life cycle transfers, and the provision of social services such as health and education – have received greater scrutiny, implicitly or explicitly.

Many European countries find themselves at a crossroads. Budgetary shortages from existing pension arrangements are putting welfare provision in diverse areas under great pressure, while economic and social changes – such as skill-based technological change, globalization, educational under-achievement – are continuing to swell the demand for welfare services.

One reason why pension reform is so important for the future of the welfare state is that pension systems have a profound influence on people's incentives to work. Thus there is a strong case to be made that pension reform and labor market policy need to be formulated in conjunction with one another. In the current European policy systems, the combination of unfunded pension benefits, unemployment benefits, and disability benefits reduce the incentives to work and to participate in the labor force. It thereby reduces the tax base and social security contributions from which these benefits are funded. This development poses a severe fiscal threat to the sustainability of the current pension and labor market support systems. This problem is exacerbated by aging populations, the weakening of family ties, increasing interruptions of working spans, and the spread of part-time and temporary work.

Policy makers have recognized that pension reforms, designed to address the problems above, may be expected to influence labor market incentives. These incentives, in turn, not only affect employment, unemployment, and labor market participation – they also influence the effectiveness of pension reform. Although this interplay between pension reform and labor market activity is extremely important for policy purposes, it has received relatively meager attention in economic analysis thus far. The aim of this conference is to help fill this important gap.

In particular, the conference will investigate the effect of pension plans on retirement decisions, the influence of pension systems on labor supply, the interaction between pensions systems and disability benefits, the effect of pensions and pension portability on job mobility, the joint retirement decisions of spouses, the effect of pension funds on corporate governance,

the influence of pensions on the distribution of income, and the political pitfalls of pension reform.

The conference will end with an International Pensions Reform Forum, chaired by IZA director *Klaus F. Zimmermann*, and topic-focused encounters. World-renowned economists and policy makers, such as *Ken*

Apfel (former US Social Security Commissioner), *Joseph Stiglitz* (former chairman of the Council of Economic Advisors, former Chief Economist of the World Bank, and Stanford professor), *Friedrich Breyer* (professor of public economics at University of Konstanz, and DIW Berlin) and *David Wise* (Harvard University) will discuss policy options.

IZA Conference Pension Reform and Labor Markets

May 19.-21., 2001, Berlin

Program Chair and Organization:

Dennis Snower / Michael Orszag (Birkbeck College, London and IZA)

Saturday, May 19, 2001

Welcome from the Organizers

Dennis Snower (Birkbeck College, London and IZA)

Michael Orszag (Birkbeck College, London and IZA)

First Session: Labor Supply and Social Security

Richard Johnson (Federal Reserve Bank of Kansas City)
[The Effect of Old-Age Insurance on Retirement: Evidence from Historical Cross-Country Data](#)

Axel Börsch-Supan (University of Mannheim)
[Incentive Effects of Social Security under an Uncertain Disability Option](#)

Salvador Valdes-Prieto (Catholic University of Chile)
[Links Between Participation Decisions and Pension Funding](#)

Second Session: Private Pensions

Richard Hinz (US Department of Labor)

[Lessons from US 401\(k\) Experience](#)

Carl Emmerson (IFS)

Richard Disney (University of Nottingham)

[Job Mobility and Personal Pensions](#)

Vincenzo Andrietti (University Carlos III de Madrid)
[Occupational Pensions and Interfirm Job Mobility in the European Union: Evidence from the ECHP Survey](#)

Third Session: New Ideas in Early Retirement

Trygvi Herbertsson (University of Iceland)

[The Costs of Early Retirement](#)

Steinar Strom (University of Oslo)

[Retirement in Non-Cooperative and Cooperative Families](#)

Vincenzo Galasso (University of Bocconi)
[Early Retirement](#)

Sunday, May 20, 2001

First Session:

Pensions, Savings and Income Distribution

Margherita Borella (CeRP, University of Turin)
[Social Security Systems and the Distribution of Income: an Application to the Italian Case](#)

Eytan Sheshinski (Hebrew University, Jerusalem)
[Bounded Rationality and Retirement](#)

Second Session: Pensions and Incentives

Richard Ippolito (George Mason University)
[Pension and Incentives](#)

Edward Whitehouse (Axia Economics)

Richard Disney (University of Nottingham)
[Pension Plans and Retirement Decisions](#)

Michael Orszag

(Birkbeck College, London and IZA)

Dennis Snower

(Birkbeck College, London and IZA)

Peter Orszag (Sebago Associates)

Joseph Stiglitz (Stanford University)

[Pension Systems and Labor Market Incentives](#)

Third Session: Political Economy

Ann Robinson (University of Bournemouth, formerly director general of National Association of Pension Funds)

[Corporate Governance and Pension Funds](#)

Sven Schreiber (Free University of Berlin)

[Pensions and the Strategic Prevention of Unemployment](#)

Franco Modigliani (Massachusetts Institute of Technology)

Pedro Sainz de Baranda (Massachusetts Institute of Technology)

Marie-Louisa Ceprini (Massachusetts Institute of Technology)

[Opportunities for Social Security Reform in Italy, Spain and the U.S.](#)

Monday, May 21, 2001

First Session: Early Retirement

David Wise (Harvard University)

[Microeconomics of early Retirement - an Overview](#)

Costas Meghir (University College London and IZA)

Sarah Smith (Financial Services Authority)

Richard Blundell (University College London and IZA)

[Pension Incentives and the Pattern of Retirement in the UK](#)

Reinhold Schnabel (University of Essen)

[Micro Modeling of Retirement Decisions in Germany](#)

Special Event

International Pensions Reform Forum

Chair: *Klaus F. Zimmermann* (IZA, DIW Berlin, Bonn University)

Kenneth Apfel (University of Texas, former US Social Security Commissioner)

Joseph Stiglitz (Stanford University and Sebago Associates, Inc.)

Friedrich Breyer (University of Konstanz, and DIW Berlin)

David Wise (Harvard University)

SHORT REPORTS

+++ IZA/EERC Workshop in Kiev, Ukraine: "Labor Market Adjustment in Russia and Ukraine" – April 9-10, 2001 +++

Jointly with the Economics Education and Research Consortium (EERC), IZA hosted a workshop entitled "Labor Market Adjustment in Russia and Ukraine" in Kiev. Organized by IZA Program Director *Hartmut Lehmann* (Heriot-Watt University, Edinburgh), the workshop discussed recent labor market developments in Russia and Ukraine, including such aspects as gross job flows, wage determination, earnings inequality, pensions systems, the informal sector, human capital, and the evaluation of active labor market policies. An additional closed session was concerned with the "Ukrainian Longitudinal Monitoring Survey". More information at www.iza.org.



+++ European Summer Symposium in Labour Economics (ESSLE) in Buch/Ammersee, Germany – April 24-28, 2001 +++

The third European Summer Symposium in Labour Economics (ESSLE) took place in Buch at Lake Ammersee (April 24-28, 2001). Leading international experts in the field of labor economics and young economists invited by IZA and CEPR discussed current research results and perspectives of future cooperation. The topics of this year's symposium covered such areas as layoff protection, unemployment compensation, organizational changes and wages, European labor markets and product integration, and job and wage mobility. A detailed program is available at www.iza.org. The next edition of IZA Compact will give a special report on ESSLE.



+++ IZA Workshop in Bonn: "Improving Labor Market Policies by the Evaluation of their Impact" – June 1, 2001 +++

Many European countries spend huge sums on labor market policies and programs, but these often lack a scientific evaluation. Organized by IZA Program Director *Christoph M. Schmidt* (University of Heidelberg) and *Astrid Kunze* (IZA), is designed to give researchers an opportunity to discuss methodological concepts, current findings, and future strategies in this relatively new field. More information at www.iza.org.



+++ 15th Conference of the European Society for Population Economics (ESPE) in Athens, Greece – June 14-16, 2001 +++

Economists from all over the world will

come together in Athens at the 15th Conference of the European Society for Population Economics (ESPE), June 14-16, 2001. The conference meets for the exchange of research in allied fields of labor economics, household economics, public economics, demography, statistics, and economic history. Further information is available at www.aueb.gr/espe2001/ and www.iza.org.



+++ Web Business Award Nomination for IZA +++

IZA has been nominated for the Web Business Award in March this year. With this award Globalbizshows.com honors companies and organizations for their efforts in raising the awareness of the online community in the field of economics. Along with the World Bank, the World Economic Forum, and other institutions, IZA was nominated because it "stood out from the rest of its field as having made major contributions online."



+++ Bonn Graduate School of Economics +++

The Bonn Graduate School of Economics offers a full set of courses for Ph.D.-students on microeconomic and macroeconomic theory and policy, as well as applied econometrics. These courses are offered by members of the Department of Economics of the University of Bonn and by invited teachers. Courses are taught in English. The school recommends, however, that students acquire some knowledge of German while present.

Students in their second year of the Bonn Graduate School of Economics may continue their studies in Bonn or spend a year abroad at one of the EDP institutions in Barcelona, London, Louvain-la-Neuve, Paris or Tel Aviv (EDP=European Doctoral Program in Quantitative Economics). In Bonn, they attend the weekly workshop of the Graduate School and the weekly seminar, organized jointly with IZA and the Center for European Studies (ZEI). In this internationally renowned seminar, invited speakers from inside and outside the University present their current research.

Highly qualified students with a Masters Degree in economics or related fields, such as mathematics, statistics, business administration, accounting and finance, are encouraged to submit their application to Bonn Graduate School of Economics, Prof. Urs Schweizer, Department of Economics, Adenauerallee 24, D-53113 Bonn, Ger-

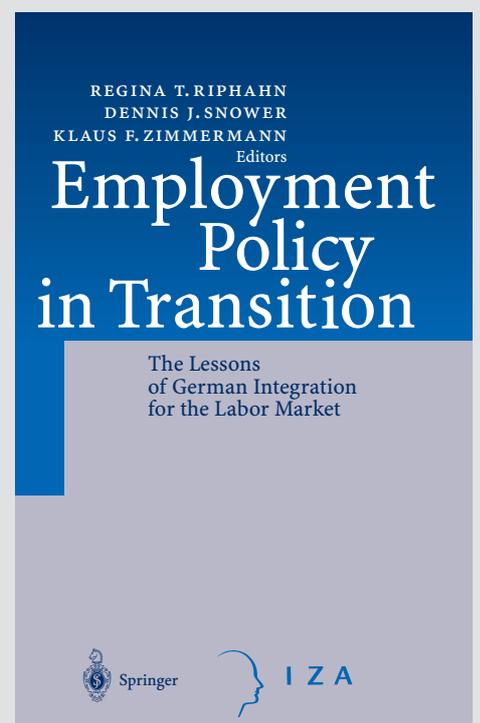
many. The application must include the application form (downloadable from <http://www.bgse.uni-bonn.de>, which also contains more information on the Graduate School), a short curriculum vitae, academic transcripts and two confidential letters of recommendation from academic teachers. Applicants who have taken the graduate record examination (GRE) should include a copy of their test scores with their application. A limited number of grants to cover living expenses are available upon request. Applications for entry into the Graduate School in Fall 2001 should be received by May 15th, 2001.



+++ Book Recommendation: Employment Policy in Transition +++

A recently published book on the lessons of German integration for the labor market examines different stages of the labor market developments after German unification. The internationally renowned authors of this volume offer valuable insights into ten years of market economy in former East Germany. This book is highly recommended reading for anyone interested in labor markets in transition and the German experience in particular.

R. T. Riphahn/D. J. Snower/K. F. Zimmermann, Employment Policy in Transition: The Lessons of German Integration for the Labour Market, Heidelberg 2001, ISBN 3-540-41166-6.



NEUE IZA DISCUSSION PAPERS

A complete list of IZA Discussion Papers is available on our homepage at www.iza.org
Most papers are downloadable.

- 238 R. Euwals, A. Börsch-Supan, A. Eymann**
The Saving Behaviour of Two Person Households: Evidence from Dutch Panel Data
- 237 S. Klasen, I. Woolard**
Surviving Unemployment without State Support: Unemployment and Household Formation in South Africa
- 236 R. Hujer, M. Caliendo**
Evaluation of Active Labour Market Policy: Methodological Concepts and Empirical Estimates
- 235 W. Schnedler**
Who gets the Reward? An Empirical Exploration of Bonus Pay and Task Characteristics
- 234 R. Rotte, M. Steininger**
Sozioökonomische Determinanten extremistischer Wahlerfolge in Deutschland: Das Beispiel der Europawahlen 1994 und 1999
- 233 C. Dustmann, C. M. Schmidt**
The Wage Performance of Immigrant Women: Full-Time Jobs, Part-Time Jobs, and the Role of Selection
- 232 E. Bardasi, M. Francesconi**
The Effect of Non-Standard Employment on Mental Health in Britain
- 231 G. Saint-Paul**
The Economics of Human Cloning
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From December 2000 until March 2001 a number of renowned economists stayed at IZA to discuss issues of labor market research and policy:

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(Northwestern University, Evanston, Illinois)

Badi Baltagi
(Texas A&M University)

Erling Barth
(Institute for Social Research, Norway)

Thomas Beissinger
(University of Regensburg, Germany)

Stefan Bender
(IAB Nürnberg, Germany)

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(University of Bergen, Norway)

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(Swiss Coordination Centre for Research in Education, Switzerland)

O P I N I O N

Free Movement of Labor after EU Enlargement



Many Europeans apparently fear that the planned enlargement of the EU would entail a strong increase in immigration from the new member states to Western Europe – and Germany in particular. The argument goes that the consequences for some European labor markets would be dramatic. This is the main reason behind the ongoing debate about installing an interim period of 5-7 years until the free movement of labor would take effect. The proponents of this approach refer to similar rules that applied to Spain and Portugal when those two countries joined the EU. But would the same rules also make sense in the case of EU eastward enlargement?

Various studies – conducted by IZA, the German Institute for Economic Research (DIW Berlin), the ifo Institute in Munich and others – have proven these fears to be clearly exaggerated. All of these studies basically arrive at the same conclusion: Immigration from the new member states will not exceed a moderate level, and most of it will only be temporary. According to IZA analyses, gross immigration to Germany will average about 90,000-140,000 individuals annually during the first 15 years following EU eastward enlargement. For the entire EU, IZA estimates immigration during the same period at 2-3 million individu-

als – equivalent to 2-3 percent of the population of the ten new member states. Due to the large scope of return migration, however, net migration can be expected to be much lower in the long run. And only a fraction of those who will cross the borders to Western Europe are actually going to seek employment.

Other studies yield somewhat higher estimates: DIW Berlin, for instance, suggests that immediate and unrestricted freedom of movement will bring about an average annual net migration to Germany of 144,000 individuals during the first decade after EU enlargement, starting with an initial net inflow of 220,000 people per year. For the second decade, the institute forecasts a steep decline in immigration to no more than 54,000 net immigrants per year. Like the IZA analysis, the DIW study gives no reason to worry. The ifo Institute estimates that the net migration to Germany will amount to an average of 250,000-300,000 individuals during the initial years, but suggests that net immigration will not decline as substantially in the second decade as predicted by DIW. Hence, net immigration would be somewhat larger in the long run than in the IZA and DIW studies.

In light of these findings, public fears are clearly unjustified, especially since future migrants from the new member states will have much higher qualification levels than those who came to Germany during previous migration waves. Make no mistake: Germany and Austria will certainly absorb the largest share of immigrants. This is due to the well-established ethnic networks in these countries. It would nonetheless be inappropriate to put the freedom of movement on hold for some time. An interim period of 5-7 years would mean that the Western labor markets would not open up until the end of this decade. Yet, demographic trends unequivocally show that the demand for immigrant labor in Germany will be exceptionally strong over the next five years. After that, it will take at least until 2015 for the demand to regain a comparably high level.

The proposed interim period, however, would trigger additional migration from Eastern Europe at a time when demographically based

immigration needs in Germany will be virtually non-existent for a while. In contrast, if the German labor market were to open up immediately after EU enlargement, demographically based needs would be at its peak. By then, the demographic shortage will amount to 500,000 people. The expected influx in the wake of EU enlargement would therefore not just be easily manageable, but even highly desirable.

On a different note, EU enlargement will, of course, also allow Western Europeans to tap new markets in the east. This will encourage the creation of new agglomerates and binational centers with a high growth potential, particularly in the eastern part of Germany. Immigrants come with language skills and cultural capital – both are prerequisites for successful entrepreneurial activities in the new markets.

Even today, most restrictions on the movement of goods, services, and capital have already been lifted. If individuals are not allowed to migrate from east to west, the production – especially in the labor-intensive sectors – will be moved from west to east. This would have a permanent negative impact on the German labor market. Higher unemployment would be the result, with the interim period being the major cause.

Keeping the borders officially closed to workers will not keep people from illegally migrating to the sectors dominated by low-skilled labor. After all, they would enjoy guaranteed amnesty at the end of the interim period. The consequence for Germany would be rising unemployment in the low-wage sector.

A sound strategy must therefore include two key elements. First, we should open up our labor markets immediately after EU enlargement; and second, we should make a targeted effort at recruiting highly qualified workers from Eastern Europe in order not to lose them to the other regions of the world that compete with us for the most talented minds.

K. F. Zimmermann



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the Study
of Labor

IMPRESSUM

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 Graphics/Photographs: IZA
 Layout/Printing: Verlag Erik Dynowski,
 Cologne, Germany