



### Happiness Research in the Spotlight IZA Prize in Labor Economics Awarded to Richard Easterlin

Thanks in large part to the pioneering work of *Richard A. Easterlin* (University of Southern California), research on the foundations of happiness has become an important and growing subdiscipline of economics. By awarding Richard Easterlin with the 2009 IZA Prize in Labor Economics, IZA recognizes his outstanding contributions to the analysis of the interactions between labor market participation, wealth and subjective well-being, as well as the relationship between demographic developments and economic outcomes. In both fields, his work formed the cornerstones for broadening the scope of traditional economic analysis and thus contributed to advancing our understanding of behavior in a wide variety of economic settings such as education, labor supply decisions and the economics of the family. Easterlin's work is influential not only by historical standards, but it has also shaped current political debates about alternative welfare indicators.

The official IZA Prize Ceremony took place in Washington, D.C., on October 22, 2009.

It was accompanied by a two-day scientific conference on the "economics of happiness," which brought together many of the internationally leading researchers in the field. The event was preceded by a policy forum, at which a number of renowned experts from science and policymaking discussed the consequences of the global financial crisis, particularly for the developing countries, and the role of national governments in dealing with the effects of the crisis.

At a reception held during the event, the most recent volumes forthcoming in the IZA Prize Book Series, soon to be published with Oxford University Press, were presented as preprint versions. All IZA Prize laureates contribute to this series. In addition to Richard Easterlin's book "Happiness, Growth, and the Life Cycle," IZA will publish books by Orley C. Ashenfelter, Edward P. Lazear, Dale T. Mortensen/Christopher A. Pissarides, David Card/Alan B. Krueger, Richard B. Freeman and Richard Layard/Stephen Nickell. The first book of the series about the lifetime achievement of Jacob Mincer (winner of the



IZA Prize Laureate Richard A. Easterlin with IZA Director Klaus F. Zimmermann

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2002 IZA Prize) recently received the “Best Monograph Award” from the European Society for the History of Economic Thought.

**“Easterlin Paradox”:**  
Economic growth does not necessarily increase life satisfaction

Easterlin’s research shows empirically that a rising level of material wealth does not necessarily imply higher life satisfaction. It is true that wealthier members of a society on average show higher well-being. But once a level of wealth is reached that satisfies basic needs, individual and societal well-being no longer increases with further economic growth.

Social comparisons and changes in expected living standard strongly influence individual well-being. When an individual has a high income but earns less than the social comparison groups, this directly affects subjective well-being. Also, as people tend to raise their demands with increasing income, an increase in wealth does not necessarily make them happier. Easterlin demonstrated that people in wealthy nations show no higher life satisfaction than people in poorer nations once the level of income is high enough to provide for food, shelter and other fundamental needs. This apparently contradictory finding came to be known as the “Easterlin Paradox.” The mechanisms identified by Easterlin are highly relevant for many behavioral aspects of labor economics, such as job search behavior or female labor force participation. The Easterlin Paradox continues to fascinate scientists of various research disciplines. The “World Data Base of Happiness,” which collects scientific work on well-being, lists more than 10,000 research papers in such diverse fields as psychology, medicine, sociology and economics.

These findings have also become important for policymaking in the recent past. For example, the commission to measure welfare and social progress in France, which was installed by president Sarkozy, has been inspired by Easterlin’s work in many ways.



David G. Blanchflower

**“Easterlin Hypothesis”:**  
Educational and labor market outcomes vary with birth cohort size

Easterlin’s research interests also include the relationship between demographic development and economics variables. His central idea – the so-called “Easterlin Hypothesis” – postulates that the economic and social fortunes of a cohort tend to vary inversely with its relative size. Easterlin attributes this relationship to several crowding mechanisms which operate in the family, education system and labor market. First, a larger birth cohort is likely to entail a larger number of siblings, which in turn can lead to a dilution of parental time and family resources per child. On average, a larger cohort is thus likely to perform worse at school. Second, there can be additional crowding effects caused by institutional factors of the education system: Since the human and physical capital stock in education tends to be relatively inflexible, resources per student are lower in larger birth cohorts, thereby lowering the average quality of schooling obtained by members of large cohorts. Both mechanisms contribute to lower economic success of large birth cohorts. Finally, Easterlin argues that the entry of a large cohort of young and inexperienced workers into the labor market tends to be accompanied with lower relative wages and higher unemployment rates. These important findings of Easterlin’s research have influenced economic science and policymaking to this day.

“Richard Easterlin’s lifetime achievement is highly impressive. The economic analysis of well-being would not have been possible without his contributions. His work is also politically important because it shows that individuals do not only seek to maximize their wealth in order to satisfy their well-being and be ‘happier’. The quality of life can also be measured in terms of social fairness, good infrastructure, and a welfare state which encourages the strong and supports the weak,” said IZA Director *Klaus F. Zimmermann*. “Against the background of the current economic crisis, Easterlin’s findings are more significant today than ever for social and economic policies worldwide.”

**Policy Forum: “The Global Economic Crisis and the Labor Markets”**

Before the official prize ceremony, the policy forum on the effects of the financial crisis started with a keynote address by IZA Program Director *David G. Blanchflower* (Dartmouth College). He sparked a lively debate on the consequences of the crisis for developing countries. The panelists were

*Jan Svejnar* (University of Michigan), *Tilman Brück* (DIW Berlin), *Carol Graham* (Brookings Institution), *Theresa K. Osborne* (Millennium Challenge Corporation) and *Sonia Plaza* (World Bank). It was emphasized that the efforts put into international development cooperation must be strengthened in order not to jeopardize the achievements made in the recent past.

*Rebecca M. Blank* (Under Secretary for Economic Affairs, U.S. Department of Commerce) opened the second part of the discussion with a report on the difficulties and restrictions faced by policymakers, in particular the U.S. government, in dealing with the crisis. She pointed out that the scope for national governments is limited, but that the available options must be used wisely and efficiently even as the risk of failure increases.

She agreed with Blanchflower, *Alan B. Krueger* (Assistant Secretary for Economic Policy and Chief Economist of the U.S. Treasury; 2006 IZA Prize laureate), *Lord Richard Layard* (London School of Economics, 2008 IZA Prize laureate) and *Andrew J. Oswald* (University of Warwick) that a definite end to the worldwide recession is not yet in sight. According to the panelists, governments around the world must continue to implement active fiscal and economic policy measures to a sensible extent.

**Scientific conference in honor of Richard Easterlin**

Organized by IZA Research Director *Marco Callendo*, the conference in honor of the IZA Prize winner brought together some of the world’s leading happiness researchers. The event provided an overview of the current state of research and outlined new developments and research questions that will be relevant for this scientific discipline in the future.

Easterlin himself presented new evidence on well-being in Latin American countries, confirming that well-being and economic growth show a positive association in the



Rebecca M. Blank

## Award Statement of the IZA Prize Committee

The IZA Prize in Labor Economics 2009 is awarded to Richard A. Easterlin (University of Southern California). In various seminal contributions, Easterlin has demonstrated the importance of material aspirations and relative economic status for human behavior. His work has laid the foundations for enlarging the scope of traditional economic analysis and has increased our understanding of behavior in several important domains, such as fertility choices, labor market behavior, or the determinants of individual well-being.

In two path breaking books – *Population, Labor Force, and Long Swings in Economic Growth* (1968), *Birth and Fortune* (1980) – and several influential papers, Richard Easterlin laid the ground for a novel view on the channels through which economic forces affect demographic magnitudes and are, in turn, affected by them. His central idea, the so-called “Easterlin Hypothesis” or cohort size hypothesis, posits that the economic and social fortunes of a cohort tend to vary inversely with its relative size.

According to Easterlin, this effect is caused by material aspirations a generation forms during adolescence, taking the economic outcomes of their parents as a benchmark of comparison. Members of a large birth cohort who grow up during a time of economic prosperity form high income aspirations for themselves. Compared to their expectations, such a cohort faces relatively bad prospects since crowding mechanisms in the family, the education system, and the labor market contribute to relatively lower economic success of the cohort: a larger birth cohort is likely to entail a higher number of siblings per family which in turn can lead to a dilution of parental time and family resources per child. Since the human and physical capital stock in the education system tends to be relatively inflexible, resources per student are also lower in larger birth cohorts. Both mechanisms contribute to a decrease in the quality of education for the cohort. Finally, the entry of a large cohort of young and inexperienced workers into the labor market tends to be accompanied with lower relative wages and higher unemployment rates. As a consequence, the cohort feels deprived compared to its aspiration level. In order to keep up with its aspirations, such a cohort is likely to exhibit lower birth rates than expected, breeding a smaller succeeding cohort with relatively low material aspirations. Richard Easterlin’s findings have spurred the interest in the economic analysis of fertility and family decision-making. By integrating insights from demography, psychology, and sociology, the cohort size effect contributed to understanding phenomena such as long-term swings in fertility, but also swings in labor and goods market conditions.

Richard Easterlin also made pioneering contributions to the analysis of individual well-being. In his 1974 article “Does Economic Growth Improve the Human Lot?” he discovered what is now known as the “Easterlin Paradox”: in cross-sectional analyses of subjective well-being within countries, people with higher income on average report higher levels of happiness. However, the relationship between income and subjective well-being does not hold in time-series analyses, where it is usually found that countries which experience economic growth do not necessarily become “happier”. Moreover, comparing well-being measures across countries, happiness does not vary much with national income once material wealth is sufficient to meet basic fundamental needs with respect to clothing, nutrition, or housing.

Again, Easterlin suggested that relative income concerns and aspiration processes are at the heart of this puzzling finding. Once basic needs are fulfilled, an increase in absolute income does not raise well-being any more if it is not accompanied by an improvement of relative position within the society. At the same time, an increase

in income tends to induce an adaptation of income and consumption aspirations. Easterlin’s research on happiness has inspired many economists and other social scientists to systematically analyze the relationship between subjective well-being and socioeconomic characteristics such as marital status, health, employment status, or political institutions. The relevance of relative income concerns and material aspirations for economic behavior are now widely acknowledged. For instance they have contributed to a better understanding of female labor supply decisions and job search by the unemployed. Some of the most important theories that have recently been developed by “behavioral” economists, e.g., the theories on reference-dependent utility or inequity aversion, share the spirit of Easterlin’s earlier work. Anticipating the potential of using psychological concepts for analyzing economic decision-making, Easterlin can thus be considered a pioneer of the ongoing integration of psychological motives into economic models of human behavior.

Easterlin’s work has also shaped the political debate on how to measure societal development. Recently, several governments around the globe have launched initiatives to integrate insights from research on subjective well-being for assessing social prosperity instead of focusing only on a narrowly defined concept of national income. On a methodological dimension, Easterlin’s careful use of survey techniques has increased economists’ confidence in subjective measures as reliable tools for analyzing human preferences and decision-making. The recent developments in scholarly research – not least the more than 10,000 research papers enlisted in the “World Database of Happiness” – show that Easterlin’s vision of regarding subjective and objective measures as complementary is increasingly coming true.

Apart from being one of the founding fathers of two important and growing fields of economic research, Richard Easterlin continues to be an extremely productive scholar himself. Over the last 50 years, he has published an impressive amount of articles in outlets such as *American Economic Review*, *Quarterly Journal of Economics*, *Economic Journal*, *Proceedings of the National Academy of Sciences*, *Journal of Economic Behavior and Organization*, or *Journal of Economic History*.

Richard Easterlin earned his Ph.D. in 1953 from the University of Pennsylvania and is currently professor of economics at the University of Southern California. He is Member of the National Academy of Sciences, a Distinguished Fellow of the American Economic Association, a Fellow of the American Academy of Arts and Sciences and the Econometric Society, and a former Guggenheim Fellow. Easterlin is past President of the Population Association of America and the Economic History Association. He served on the editorial board of journals such as *American Economic Review*, *Journal of Economic Literature*, *Journal of Economic History*, *Journal of Population Economics*, and *Journal of Economic Behavior and Organization*.

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Lord Richard Layard

short run, but not in the long run. He suggested that this might be due to income aspirations and the psychological phenomenon of loss aversion, which states that monetary gains increase utility less strongly than equally sized losses reduce it.

Loss aversion and income aspiration processes do not only influence the well-being of individuals, but they can also have important effects on labor market behavior. This was the conclusion drawn by *Andrew Clark* (Paris School of Economics), who showed that decreases in wages due to salary fluctuations increase workers' likelihood to quit their current job. In a similar vein, *Alois Stutzer* (University of Basel) pointed out that fluctuations and economic shocks seem to be generally detrimental to individual well-being. This is particularly true for people who are more likely to be affected by shocks, for instance because they have weaker social security coverage. Therefore, such institutions seem to have additional, usually neglected benefits for a society since they help to reduce the anticipatory feelings of economic insecurity.

Carol Graham took a closer look at the human ability to adapt to novel circumstances and the tendency to follow social norms. According to Graham, this ability is likely to be a positive trait on the individual level because, for instance, individuals can adapt to worsening health conditions. At the same time, she warned that adaptation can be problematic at the collective level since it makes it difficult to overcome inferior social norms, which potentially explains why societies can get stuck in bad economic and social equilibria.

A second recurrent theme during the conference was the influence of social comparison and relative income concerns on subjective well-being. Easterlin's early work had already suggested that relative income concerns could be one of the main factors

for the happiness-income paradox. Once basic needs are fulfilled, an increase in absolute income does not raise well-being further if it is not accompanied by an improvement of one's relative position in the society. Consequently, for a given level of absolute income, greater income inequality within a society should decrease well-being. *Rainer Winkelmann* (University of Zurich) confirmed that this is indeed the case for middle-class households in Switzerland. *Ada Ferrer-i-Carbonell* (IAE Barcelona) discussed the connection between individuals' aversion against income inequality and their attitudes towards risk, showing that risk attitudes at least partly determine the effect of inequality on life satisfaction. Using data from the German Socio-Economic Panel (GSOEP), Ferrer-i-Carbonell found that the most risk-averse individuals experience the greatest drops in life satisfaction through higher income inequality. *Claudia Senik* (University Paris-Sorbonne) emphasized that differences in happiness per se can have important consequences on human behavior: If married couples report strong differences in well-being, the likelihood of divorce increases.

*Robert Frank* (Cornell University) showed that social comparisons not only affect individual well-being, but they can also have important effects on job satisfaction, workers' labor supply and job selection, and the demand for consumption goods. Therefore, data on individual well-being is not only of academic interest but can also inform policymakers, for instance in estimating the trade-off between unemployment and inflation, as was pointed out by *Rafael Di Tella* (Harvard Business School).

Taking stock of the developments over the last 30 years, the participating scholars agreed that knowledge on the determinants and consequences of individual well-being has rapidly increased since Easterlin's



Andrew J. Oswald

ground-breaking early work, but that there is still scope for fruitful future research. *Justin Wolfers* (Wharton School) pointed out that more high-quality data is needed to arrive at a conclusive answer on the relationship between happiness and income inequality. Another recent development which underlines the interdisciplinary nature of happiness research is the connection of subjective well-being data with measures of physical well-being and other biomarkers. Along this avenue, David Blanchflower studied well-being data and measures of heart rate and blood pressure, *Mary C. Daly* (Federal Reserve Bank of San Francisco) analyzed the connection between subjective well-being and individuals' tendency to commit suicide, and *Erzo F.P. Luttmer* (Harvard University) discussed the relationship between health shocks and well-being and their impact on the design of health insurance systems.

An approach to complement and confirm subjective measures of well-being with objective data was suggested by Andrew Oswald. Using a sample of 1.3 million U.S. citizens, he analyzed the distribution of subjective well-being across U.S. states compared to an objective measure of quality-of-life that takes into account variables such as social or local amenities, weather, crime rates, etc. Oswald's analyses reveal a strong correlation between the objective and subjective measure of well-being, which convincingly shows that subjective data on life satisfaction or happiness are meaningful measures of individuals' well-being. It is therefore not surprising that more and more governments try to build new indicators of social prosperity which go beyond GDP figures and take into account the findings of happiness research.

It was Richard Easterlin's great work that initiated this trend and still contributes to the progress of this increasingly important field.



Richard Easterlin signing a copy of his IZA Prize Series volume

# German Plans for Tax Reform and Basic Income: Risks and Side Effects

In the first weeks of the new German government, the planned tax cuts are a hot topic of public debate. The ruling coalition of Christian Democrats (CDU/CSU) and Free Democrats (FDP) has promised to introduce a progressive income tax schedule with tax brackets “possibly by January 2011,” with the number and size of the brackets still to be determined. Although the wording remains vague, the promise that taxes would be substantially reduced in the process has triggered a heated debate, which mainly centers on the question how an income tax reform of this magnitude could be financed.

The findings of a recent IZA simulation study seem to support the opponents of the reform. Assuming the introduction of a three-bracket tax schedule, as proposed in the FDP’s campaign manifesto, with a reduced tax rate of 10% for an annual income of less than 20,000 euros per year, 25% for 20,000 to 50,000 euros, and 35% for incomes above 50,000 euros, the resulting fiscal costs of the reform would be at least 50 billion euros per year. This would be more than twice the amount that the coalition had announced in tax cuts.

The proposed reform would provide incentives for labor supply that could lead to the creation of up to 600,000 new full-time jobs. But the potential gains from newly created jobs exceed the fiscal costs of the reform by far. In fact, under this scheme each new job would cost the government about 86,000 euros. The reform is particularly expensive because it is not financed by income redistribution. Since all income groups are meant to benefit from the reform, the government will have to pick up the bill in the end. Furthermore, high-income groups, who carry the lion’s share of the tax burden, would benefit disproportionately from the FDP proposal. While this may seem reasonable in view of the steep progressiveness of the German tax system, it certainly does not help to finance such a reform.

The IZA simulation also shows that the negative fiscal effects of the reform will be aggravated by the simultaneous introduction of an unconditional basic income scheme as proposed by the FDP during the election campaign. The proposal sought to merge all tax-funded transfers – including

## Labor Supply Effects and Fiscal Cost

Reform	Tax	Tax+BI
<b>Labor supply effects (newly created full-time equivalent jobs)</b>		
Single males	117,000	131,000
Single females	81,000	101,000
Single parents	18,000	24,000
Couples	387,000	-75,000
Total	<b>603,000</b>	<b>181,000</b>
<b>Employment effects (number of new jobs taken up)</b>		
Single males	70,000	80,000
Single females	52,000	88,000
Single parents	9,000	33,000
Couples	80,000	5,000
Total	<b>211,000</b>	<b>206,000</b>
<b>Fiscal costs (in billion euros)</b>		
Total	-51.83	-86.58
<b>Cost per full-time equivalent (in euros)</b>		
Total	85,950	478,320

Source: Own calculations with IZAΨMOD.

unemployment assistance, welfare, child and housing allowances – into one single transfer payment. According to the FDP, the average basic income would amount to 662 euros for childless singles. In addition, the FDP wants to provide better incentives for transfer recipients to take up employment by raising the amount of additional labor income that can be earned without reducing the benefit entitlement.

The simulation reveals that the basic income scheme is essentially a form of in-work benefit to promote employment among low-wage workers. In sum, the labor supply effect is only slightly positive (at about 180,000 full-time equivalents) since two-person households will tend to reduce their labor supply. This is mainly because the basic income scheme alone would of-

fer few employment incentives for secondary wage earners. Instead, it would make a reduction of working hours more attractive due to the tax relief and the generous treatment of additional labor income for transfer recipients. These disincentives explain the immense costs of 86 billion euros if the tax reform were to be accompanied by the introduction of the basic income scheme.

The planned reforms fail to tackle a key problem of the German labor market, which is that the current tax-benefit system does not set the right incentives to work. This problem could be solved effectively by implementing the workfare principle of reciprocity. Transfer recipients who are fit to work should only receive the full amount of benefits if they give something back that is roughly equivalent to full-time employment. This obligation to reciprocate would be an efficient mean to raise the employment incentives in the low-wage sector without lowering the level of the basic livelihood guarantee. In a second step, the social security system should be relieved of income redistribution other non-insurance tasks. This sort of benefits should be entirely tax-financed. Such a reform would have a much more substantial impact on employment and growth than the currently discussed reform proposals, which would mainly result in a tax relief for top-income earners.

The simulation study was published in German language in the “IZA Standpunkte” series, which is downloadable free of charge from the IZA website.

Dirk Neumann  
Andreas Peichl  
Hilmar Schneider  
Sebastian Siegl

Die Steuerreformpläne der  
neuen Bundesregierung  
und das Bürgergeld:

IZA Standpunkte Nr. 21, November 2009

<http://ftp.iza.org/sp21.pdf>



## IZA Young Labor Economist Award for Alexandre Mas

The 2009 IZA Young Labor Economist Award was awarded to *Alexandre Mas* (Princeton University and Chief Economist of the U.S. Department of Labor) for his outstanding paper on “Labour Unrest and the Quality of Production: Evidence from the Construction Equipment Resale Market”, (Review of Economic Studies, 2008).

IZA Research Director *Marco Caliendo* presented the award to Mas during an IZA reception held at the Allied Social Science Associations annual meetings in Atlanta on January 4, 2010. The award reflects IZA’s strong ambition to support young and aspiring academics.



Marco Caliendo, Alexandre Mas

# Labor Market and Employment in Germany, 2000-2009

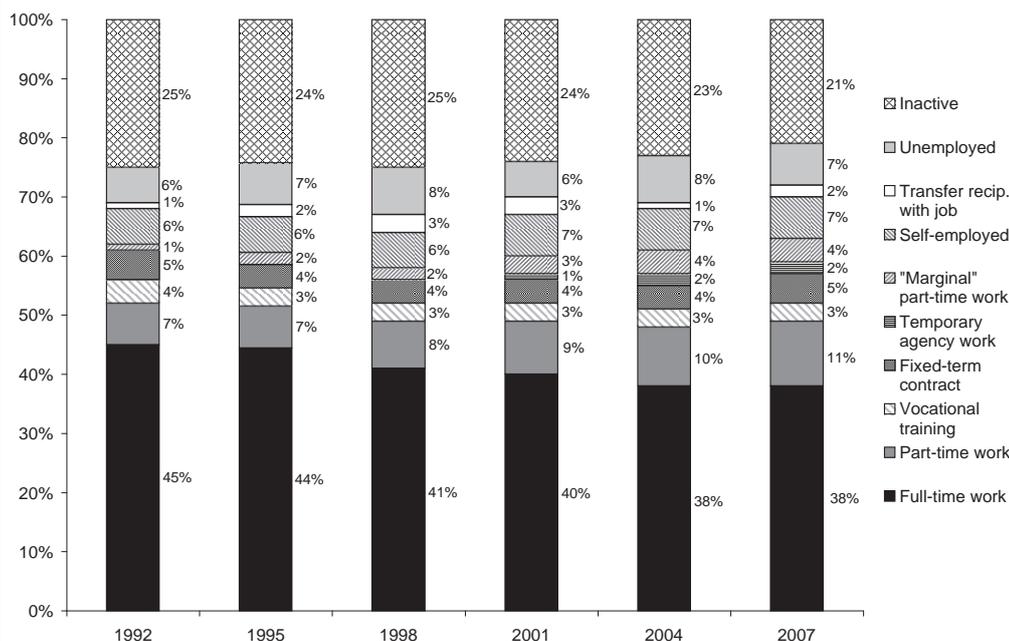
## Higher Employment with Increasing Differentiation

The recent labor market and social policy reforms have substantially altered the regulatory framework of the German labor market. This is particularly true for the activation of transfer recipients and the expansion of more flexible employment re-

and 2008, considerably more jobs were created than during previous economic upswings. The current employment structure, however, is also characterized by increasing heterogeneity, which is reflected by the notable rise in atypical and low-paid jobs. To

The trend towards higher flexibility has increased the absorptive capacity of the labor market, but it has also led to higher job insecurity and lower wages for parts of the working population.

Employment and inactivity in Germany, 1992-2007



Source: SOEP, own calculations (IZA Research Report No. 22).

relationships. At the same time, the scope of collective bargaining and the structure of industries and jobs have undergone major changes. While atypical employment relationships have become more commonplace, permanent full-time jobs have also been subject to more variable working-time arrangements and payment schemes.

some extent, this is a consequence of the changes in the regulatory framework and the collective bargaining system, as well as the structural shifts between industries.

employment or increase in unemployment. This is due in part to a continuing expansion of the service sector and the wide use of short-time work (*Kurzarbeit*) and flexible

Much of the employment deficit observed in the 1990s has now been overcome. In fact, labor market participation in Germany reached a historic peak in 2008. At the same time, inactivity among the working population was at an all-time low. Substantial progress was made in the labor market integration of women and older workers. From a structural perspective, the private services sector has shown a particularly dynamic development. On the down side, the employment prospects for young labor market entrants have deteriorated.

### Crisis-resistant labor market

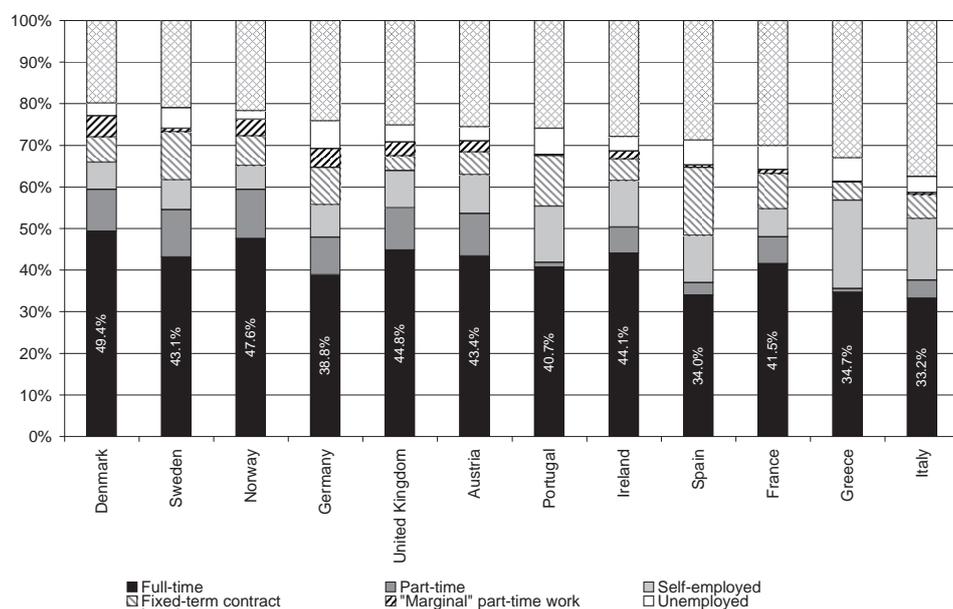
Despite its strong dependence on exports, the German labor market has been much less affected by the recent global economic crisis than other European labor markets. So far, there has not been any notable decrease in

As a first step towards a comprehensive analysis of the labor market situation in Germany, IZA has published a research report in cooperation with the Bertelsmann Foundation that sheds light on the key trends in employment (*„Arbeitsmarkt und Beschäftigung in Deutschland 2000-2009: Beschäftigungserfolge bei steigender Differenzierung“*, November 2009).

### Heterogeneous employment structure

The authors of the study, *Werner Eichhorst, Paul Marx* (both IZA) and *Eric Thode* (Bertelsmann Foundation and IZA Policy Fellow), found that in recent years, particularly between 2006

Structure of the working-age population across countries by employment status, 2007



Source: European Labour Force Survey, own calculations (IZA Research Report No. 22).

working-time accounts in manufacturing. These instruments (still) act as employment stabilizers, particularly in the export industries. They can help overcome a temporary crisis without a tremendous increase in unemployment –provided that the economy will recover in the near future. However, it is too early to conclude that the German labor market has become generally crisis-resistant. By the same token, it is still difficult to draw conclusive international comparisons. According to the latest forecasts, the German labor market may run into troubled waters during winter 2009/2010 and the following months. However, given that the most recent economic data suggest relative stability, the medium-term labor market trend is unlikely to be significantly negative.

**Structural problems persist**

Despite the improvements in the areas of labor market integration and employment,

Germany has not yet entirely overcome its structural deficits. Some of the fundamental problems that were glossed over by the last upswing until 2008 will resurface again during this crisis:

- high and persistent long-term unemployment and the related problem of dequalification, which impedes the efficient labor market integration of low-skilled workers and transfer recipients,
- the division of the labor market into “standard” employment relationships and more flexible jobs with poor career prospects,
- the insufficient (by international standards) labor market integration of women and mothers, who often find it difficult or not worthwhile to combine family and work due to an inadequate supply of childcare services, or fiscal disincentives to work,
- the growing difficulties for young people to enter the labor market and start a professional career.

A comprehensive assessment of the German labor market in international comparison, including further studies to be completed over the next months, will be published as a book in spring 2010.

Werner Eichhorst  
Paul Marx  
Eric Thode

**Arbeitsmarkt und Beschäftigung in Deutschland 2000-2009**

Beschäftigungserfolge bei steigender Differenzierung

IZA Research Report No. 22  
November 2009

[www.iza.org/files/report22.pdf](http://www.iza.org/files/report22.pdf)



## New Research in Labor Economics Volume on Ethnicity and Labor Market Outcomes

How immigrants and their descendants fare in the host society and in particular in the labor market is a very important question. While differences among ethnicities have been found to be marked and persistent within many host countries, and while the labor market consequences of diversity have been recognized, they have not been sufficiently examined. Edited by IZA migration experts *Amelie F. Constant*, *Konstantinos Tatsiramos* and *Klaus F. Zimmermann*, a recent volume of Research in Labor Economics contains fresh knowledge to help better understand the complex relationship between ethnic or minority groups, the role of ethnic identity and their disparate economic performance. Focusing on topics such as citizenship, interethnic marriages, and immigrant entrepreneurship, the book brings the role of ethnic identity in the forefront of scientific and political discussion and pro-

vides a link among these themes, anticipating new trends and directions in this area.

The Research in Labor Economics series presents important new research in labor economics related particularly to worker well-being covering themes such as work and worker welfare, earnings distribution, skills, training, public policy, discrimination and migration. All academics and researchers in the field of labor economics are invited to submit their work for consideration in the series. Proposals for special issues (e.g. from workshops or sessions of international conferences) and symposia are also considered.

For general information on RLE guidelines and online submission go to:  
▶ [www.iza.org/rle](http://www.iza.org/rle)

Amelie F. Constant  
Konstantinos Tatsiramos  
Klaus F. Zimmermann  
(Eds.)

**Ethnicity and Labor Market Outcomes**

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## An Extraordinary Scholar: In Memoriam of IZA Research Fellow Katherine Terrell

It is with the most profound sadness that we learned of the unexpected passing of IZA Research Fellow *Katherine Terrell* on December 29, 2009. She was an extraordinary scholar and a role model to many.

Katherine Terrell was a Professor of Business Economics and Public Policy at the Stephen M. Ross School of Business, and a Professor of Public Policy Analysis at the Gerald R. Ford School of Public Policy at the University of Michigan. She published widely in the areas of economic develop-

ment and labor economics. Her research evaluated the impact of government policies and the effect of globalization on wages, employment, income inequality and firm performance in emerging market economies. She also served as a consultant to various international organizations such as the World Bank, the OECD and the EBRD.

Kathy was an IZA Research Fellow for over ten years and has made immense contributions to the network. She published 19 IZA Discussion Papers and participated in



**Katherine Terrell †**

numerous IZA workshops and conferences (see e.g. ▶ pages 13/14 of this IZA Compact issue).

Those who knew her will always remember her warm personality and outstanding professional qualities.

## China in the Fast Lane? Great Opportunities for Economic and Scientific Cooperation

IZA has been in close touch with Chinese research institutions and labor economists for many years. This relationship is reflected, for example, by the honorary professorship for IZA Director *Klaus F. Zimmermann* at Renmin University of China. "China has a dynamically growing market for scientific research, which will soon have caught up to Europe and the United States. IZA accompanies the development of a first-class community of labor economists in China. At the same time we benefit substantially from the networking opportunities that arise in the process," said Zimmermann. Moreover, the impressive growth of the Chinese economy and its impact on labor market structures provide a fascinating field of study, on which IZA devotes much research effort. To strengthen the ties with its Chinese partners, an IZA delegation spent several weeks in China during fall 2009.

### "Will the next recovery be green?" Forum at German Embassy, Beijing

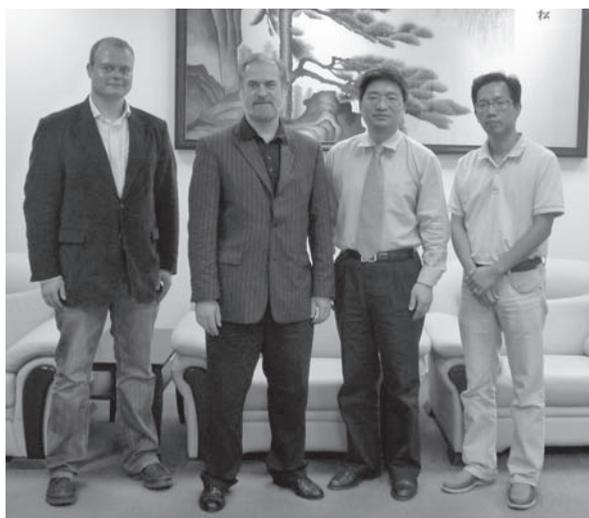
On September 14, the German Embassy in Beijing played host to a panel on the topic "Global Green Recovery." IZA Director Klaus F. Zimmermann outlined in a presentation how a potential "green economic recovery" can develop from the current economic and financial crisis. However, these opportunities have largely been neglected and the crisis has not been exploited. The public funds distributed in the form of economic stimulus packages were not devoted to any meaningful climate protection measures, such as investment in infrastructure to integrate electricity from renewable energy resources into the national grid. Zimmermann therefore pointed out that stimulus packages should be phased out with the economic recovery and replaced by new investment in effective climate protection measures.

The second speaker to address the well-attended audience was *Ottmar Edenhofer* from the Technical University Berlin and the Potsdam Institute for Climate Impact Research (PIK). The central idea is that a well-functioning market for carbon trad-



IZA Director Zimmermann exchanges ideas with Chinese experts

ing is necessary, which in turn would allow renewable energy to be competitive as well. The open forum was led by a reporter from the *Frankfurter Rundschau*, *Bernhard Bartsch*, and particular focus was given to the Chinese perspective. As the largest emitter of carbon dioxide worldwide, China plays a prominent role in the current debate on the question of historical responsibility and emission rights. *Han Wenxiu*, Director General of the Office of the Leading Group on Financial and Economic Affairs of the National Development and Reform Council, made clear that although China requires a technology transfer, it would also participate in carbon trading.



IZA visits the Shanghai University of Finance & Economics

### China Institute of Industrial Relations: Strengthening established cooperation

IZA has long-standing ties with the China Institute of Industrial Relations (CIIR), which is affiliated with the All-China Federation of Trade Unions. Therefore, the main focus of the conference between the IZA and CIIR delegations was how to

enhance the current collaboration. In addition, the situation of both countries against the backdrop of the financial crisis was discussed at length. Although there are many astonishing parallels between the two countries, a crucial difference also became apparent: While Germany's monetary and fiscal policy efforts to stabilize the economy are debt-financed, China can draw on a surplus accumulated in the previous years.

### Analyzing internal migration flows: IZA and CCER researchers meet

The topic of migration flows in China was central to the exchange of ideas between the IZA delegation and *Zhao Yaohui* and *Lei Xiaoyan*, two professors from the China Center for Economic Research (CCER). Interesting developments have become apparent in this field, especially in the wake of the financial crisis. Initially, migrant workers had been returning back to rural areas; however, there has since been a reverse trend and migrant workers are returning to metropolitan areas. This development was also discussed with regard to the government's instruments to regulate the migration flows.

### Beijing Normal University (BNU): Presentation of recent IZA book

IZA also maintains close ties with Beijing Normal University. Alongside strengthening this bond, the main focus of the visit was a presentation by IZA Director Klaus F. Zimmermann on his recently published book "EU Labor Markets after Post-Enlargement Migration." At the well-attended presentation, the Chinese representatives showed great interest in the consequences of the EU enlargement for migration flows within Europe. With certain restrictions, the research findings could also be applied to population migration within China. In the subsequent talks with high-ranking representatives of the university, various possibilities and prospects for future collaboration were discussed.

**Tsinghua University:  
Future avenues of  
cooperation**

The IZA delegation also paid a visit to Tsinghua University, Beijing, and met with members of the economics faculty. After a short introduction, various potential areas of cooperation were explored. The economic development of China and Germany in times of the economic crisis was discussed, as well as the circumstances of Chinese migrant workers.



**Participants of the CIER/IZA Workshop**

**Data infrastructure  
in China: Visit to  
National Bureau of Statistics**

The talk between the IZA delegation and two high-ranking representatives of the National Bureau of Statistics of China dealt with the current data infrastructure situation in China and future prospects for labor market research. At the center of attention was an existing dataset which in many respects seems comparable with the German SOEP administered by DIW Berlin. The Chinese representatives also outlined requirements and conditions for data access.

**1st Annual CIER/IZA Workshop  
at Renmin University of China**

At Renmin University of China, the first joint workshop with IZA took place September 18-19, 2009. After a welcome address by the Director of the China Institute for Employment Research (CIER), *Xiangquan Zeng*, and IZA Director Klaus F. Zimmermann, the labor market developments in China and Germany were discussed in a policy-oriented session of the workshop. A high-ranking official from the Chinese Ministry for Human Resources and Social Security, *Faming Yu*, enriched the discussion by presenting the viewpoint of the Chinese government. Over the course of the conference, labor market researchers from various universities in Beijing and IZA network members presented their latest research results. Among the presenters were IZA Program Director *Hartmut Lehmann*

(University of Bologna) and *Amelie F. Constant* (DIW DC and George Washington University), who serves as Deputy Program Director for Migration at IZA. The presentations included initial results based on an IZA database covering migration flows within China. The future potential of this database for empirical economic research soon became apparent – with implications not restricted to China.

**IZA visits the Shanghai University of  
Finance and Economics (SUFE)**

The IZA delegation spent two days in the financial capital of China at the Shanghai School of Finance and Economics, the most distinguished university in the city, and its associated School of Economics. IZA Director had once again invited to present the latest research results on intra-EU mi-



**Zimmermann meets with Nobel laureate Robert Mundell**

gration. Discussions with high-ranking university representatives also focused on future possibilities of close collaboration.

**Extended cooperation  
between IZA and  
Xiamen University**

In Xiamen, Zimmermann's presentation of his book on migration in Europe following EU enlargement again attracted great interest. The IZA Director addressed a large audience in the university's seminar room which is regularly used for a direct broadcast of the weekly IZA seminar. From the numerous questions posed by the audience it again became apparent that some results can also be applied to migration flows within China.

A strong emphasis in Xiamen is on empirical labor market research. This focus will be further expanded in the future, with a great potential for enhanced cooperation with IZA.

**Labor research made in Germany:  
Chinese University of Hong Kong**

At the Chinese University of Hong Kong, the last stop of the IZA visit to China, Klaus F. Zimmermann illustrated developments in the German labor market, where the focus in recent years has been on reforms. The audience showed particular interest in the structure of German labor market policy, as well as in the consequences of the financial crisis and the measures to combat the effects.

The IZA delegation also met with *Robert A. Mundell*, winner of the 1999 Economics Nobel Prize, who visited the university at the same time. This was an ideal chance to exchange ideas and views on the causes and consequences of the financial crisis. The Nobel laureate remained skeptical about the creation of a new global financial order. IZA Director Zimmermann used the opportunity to present the Canadian economist with a copy of "EU Labor Markets after Post-Enlargement Migration" fresh off the press.

Zimmermann showed himself very satisfied with the outcome of the China visit: "China not only provides vast opportunities for empirical labor market research, but also high-quality partner institutions with which IZA will collaborate more intensively in the future."

# Genes, Brains, and the Labor Market

## IZA/Volkswagen Foundation Workshop on Neuroeconomics

How can we explain the strong correlation between parents' and children's labor market outcomes? To what extent is the correlation driven by the social environment and genetic factors? Can we use molecular genetic methods and neuroscientific approaches to explain individual differences in perceived risk attitudes, trusting behavior, and social preferences? These were the main questions discussed during the IZA/Volkswagen Foundation workshop on "Genes, Brains, and the Labor Market," held at IZA in Bonn on November 6-7, 2009.

Neuroeconomics is a new field of research which combines economic experiments with computer tomography and molecular genetic analyses. This interdisciplinary approach has great potential in helping to explain human behavior and therefore its significance is growing rapidly.

One theme of the conference was the neuronal foundation of social norm compliance. By measuring the brain activity of subjects while they participate in economic decision-making experiments, researchers try to enhance our knowledge on when and why many people are willing to comply with social norms although this entails financial costs for them. *Peter Kirsch* (Central Institute of Mental Health Mannheim and University of Heidelberg) presented results from a study which indicates that there is a relationship between the tendency to follow a social preference and activation in certain brain regions, showing that brain activity is correlated with the decision to punish other participants for violating fairness norms. *Arno Riedl* (University of Maastricht) showed that positive and negative divergence from expected behavior of other persons result in brain reactions of different intensity. This helps to explain why punishment of unfair behavior is often much stronger than rewards for fair behavior.

The second part of the workshop focused on the molecular genetic foundations of

human behavior. *Jonathan Beauchamp* (Harvard University) and *Dan Benjamin* (Cornell University) reported results from comprehensive studies that investigate the genetic factors of educational outcomes. Other researchers dealt with the "oxytocin receptor gene" and its influence on decision-making in interactive situations. There is mounting evidence that oxytocin, a peptide hormone which is best known for its influence on social bonding between mothers and their children, can also influence decisions in economic environments. Combining modern methods of molecular genetics and

In another study with an application to real life, *David Cesarini* (MIT) provided evidence that risk behavior and retirement saving decisions are partly driven by biological factors. Based on the behavior of fraternal twins, he showed that higher genetic similarity is associated with lower divergence in risk behavior and corresponding investment decisions. *Steven Lehrer* (Queens University) investigated how genetic predisposition and individual impulsiveness influence addictive behavior of Canadian adolescents. His results suggest that the degree of impulsiveness in childhood years

has a strong impact on whether or not the individual will become addicted to nicotine during adolescence. This example illustrates the complexity of the interactions between genetic predisposition, individual preferences and social environment.

Although not all of the presented studies have such immediate implications for daily life, it is likely that neuroeconomic research will gain influence in traditional economic science. This is particularly true for research in personnel and labor

economics. *Armin Falk* summarized the objective of neuroeconomics: "We are developing a novel view on the determinants of human behavior." The IZA workshop served as a forum to present a broad array of pioneering work in this new area of research, which not only seeks to explore the empirical foundations of differences in human behavior, but also contributes to the design of institutional frameworks that take the characteristics of human preferences and behavior into account.

The workshop was organized by *Armin Falk* and IZA Research Associate *Steffen Altmann* in cooperation with *Paul Heidhues* and *Martin Reuter* from the University of Bonn. A list of presented papers is available online:

► [www.iza.org/link/genes-brains](http://www.iza.org/link/genes-brains)



economic experiments makes it possible to identify those variations in the oxytocin receptor gene that are essential for behavioral differences. *Martin Reuter* (University of Bonn) showed that a subgroup of subjects with a certain gene variation exhibit about 50% higher levels of trust in exchanges with an anonymous counterpart. Moreover, *Salomon Israel* (Hebrew University) gave an idea how variations in genes affect cooperation and generosity of subjects. The importance of these results for efficient cooperation in the workplace was demonstrated by *Armin Falk* (University of Bonn and IZA Program Director). Using various behavioral experiments in combination with computer tomography, he studied how employees react to perceived mistrust: Participants who have a feeling of mistrust, e.g. because their superior exerts tighter control, are less productive than those who feel trusted by their superiors.

# The Economic Crisis and the Labor Market

## Second IZA Employment Seminar in Brussels

After the successful first edition in fall 2008, a second IZA Employment Seminar was held in Brussels on November 12 and 13, 2009. Organized by IZA Deputy Director of Labor Policy *Werner Eichhorst*, and IZA Director *Klaus F. Zimmermann*, the event brought together about 50 academic and policy-oriented experts from EU member states, Brussels-based think tanks, the European Commission, the European Central Bank and other international organizations such as the OECD and the ILO. Many of the participants are also members of the international IZA Policy Fellow network.

The purpose of the Employment Seminar series is to stimulate the discussion between current labor market research and policy making both at the national and the EU level. While the previous discussion had centered around the rise in inequality associated with the growth in employment experienced in the European countries, this year's seminar focused on understanding and explaining the cross-country divergence in labor market performance and policy choices in response to the global economic crisis.

Almost all European countries lost jobs since mid-2008, but the extent of unemployment increases is far from identical. Neither is there a simple relationship with the development of GDP. Hence, there is a strong need to study the major intervening factors. Among these factors are the sectoral distribution of employment, the scope and structure of fiscal stimulus packages, automatic stabilizers and labor market institutions such as working time and wage flexibility, dismissal protection, the regulation of fixed-term contracts or active labor market policies.

The first part of the seminar was devoted to comparative studies tracing the development of national labor markets during the period of the crisis so far. A general overview on the interaction between the economic shock, fiscal stimuli, labor market institutions and crisis-related policies was given by *Werner Eichhorst* and *Steven Tobin* (International Institute for Labour Studies at the ILO) while *Alfonso Arpaia* (European Commission, Directorate-General for Economic and Financial Affairs) presented recent work on the development of EU member states' labor markets. *David Bell*

(University of Stirling) showed the peculiar situation in the United Kingdom, Ireland and the United States. *Pierre Cahuc* (Ecole Polytechnique and IZA Program Director) compared France and Spain with a particular reference to the role of dismissal protection and fixed-term contracts. *Tito Boeri* (Bocconi University) addressed the relation between working time flexibility and external flexibility in the Italian case.

The second part of the seminar continued with country studies presented by national experts. *Mihails Hazans* (University of Latvia) and *Béla Galgóczi* (European Trade Union Institute) shed light on the particularly severe situation in the Baltic states and Hungary, but also in other new EU member states, which is due to strict fiscal constraints, whereas *Per Kongshøj Madsen* (University of Aalborg and IZA) pointed out that the Danish flexicurity system still operated under "business as usual" conditions. This compared with the relative stability of labor markets in Germany, Portugal and Italy, as *Eric Thode* (Bertelsmann Foundation, Gütersloh), *Francisco Madelino*

(Innovation & Skills, London), *Bruno Coquet* (President of the EU Employment Committee), *Andrew Watt* (European Trade Union Institutes) and *Thérèse de Liedekerke* (Business Europe) addressed the issue of how to design viable structural reform policies going beyond the short-term actions currently observed in most countries.

While many speakers acknowledged the cushioning effect of working time flexibility and publicly subsidized short-time work modeled after the German 'Kurzarbeit' scheme, they also highlighted the perceivable limitations of policies aimed at safeguarding existing jobs, in particular in firms and sectors that will undergo major structural changes in the foreseeable future. Export-oriented manufacturing is under the most pressure as recent job losses already show. The participants of the seminar also drew particular attention to the unequal distribution of risks across different groups of the working-age population. In many European countries it is the young, the low-skilled and workers holding non-standard jobs who have to bear a disproportionate risk of unemployment. National governments have addressed this issue to some degree by extending unemployment protection to non-insured vulnerable groups and by intensifying active labor market policies, most importantly activation, publicly funded training and employer subsidies to maintain or hire workers.

But the need to intensify activation and training in order to facilitate mobility on the labor market goes far beyond what is currently done. As the crisis will

tend to accelerate structural change in the European economies, long-term inactivity and persistent unemployment can only be avoided if job creation is stimulated and training and mobility policies are put in place that help fill upcoming vacancies in dynamic sectors and firms. Given the fact that the crisis and the related developments in the labor market are a moving target, and that the relative success of countries in coping with the crisis may vary between the short and the medium run, it is of great importance to reexamine this issue in due course. IZA will be up to this task.



Bruno Coquet, Thérèse de Liedekerke, Werner Eichhorst, Andrew Watt

(Institute of Employment and Vocational Training, Lisbon) and *Paolo Sestito* (Bank of Italy, Rome). According to the country expert, much of this stability can be explained with working-time buffers applicable to the core labor force, but at the expense of a potential slowdown of structural change. Finally, *Anton Hemerijck* (VU University Amsterdam), *Bernhard Weber* (State Secretariat for Economic Affairs, Berne) and *Fredrik Jansson Dahlén* (Swedish Public Employment Service, Stockholm) discussed whether small corporatist countries such as the Netherlands, Switzerland and Sweden are characterized by clever crisis management.

Against this background, a panel consisting of *Bill Wells* (UK Department for Busi-

## Fifth IZA Conference on Labor Market Policy Evaluation High-Quality Research Presented at Georgetown University

The Fifth IZA Conference on Labor Market Policy Evaluation was held at Georgetown University in Washington, D.C., October 2-3, 2009. Co-organized by *Gerard van den Berg* (University of Mannheim and IZA), *Marco Caliendo* (IZA), *James Albrecht* and *Susan Vroman* (both Georgetown University and IZA), the event attracted evaluation experts both from Europe and the United States. The conference focused on methodological advancements in the evaluation literature but also included policy-relevant applied evaluation studies.

*Jeffrey Smith* (University of Michigan) started the conference with his presentation on regression discontinuity design. Using data from the “Kentucky Working Profiling and Reemployment Services,” he illustrates the performance of different non-experimental estimators in comparison to their experimental counterparts. He concludes that non-experimental estimators perform quite

well and reliably replicate the benchmark estimates. *Jose Galdo* (Carleton University) implemented a matching estimator that removes in a first step space and time (fixed) effects before matching on participants’ characteristics is applied. He also provides evidence on the performance of the new estimation procedure compared to experimental results using the same data as Smith. *Daniel Millimet* (Southern Methodist University) and *Salvador Navarro* (University of Wisconsin-Madison) contributed papers with a methodological focus. Navarro develops a model that deals with dynamic selection into treatment and provides some evidence for the existence of such selection and the influence on respective treatment effects. Millimet proposes two alternative estimators to overcome the problem of identification in the absence of an appropriate exclusion restriction. *Jeffrey Grogger* (University of Chicago) discusses the problem of missing information in state specific administrative data if individuals change states. He proposes a procedure which uses attrition information to construct bounds for the average treatment effects and demonstrates resulting implications for prospective social experiments.

The keynote lecture of this year’s conference was given by *Alberto Abadie* (Harvard University) on “A General Theory of Matching Estimation.” Using martingale representation for matching estimators, Abadie is able to derive the asymptotic distributions of matching estimators. This offers a new and innovative way to tackle the problem of inference and lays the groundwork for new estimators.

This is particularly interesting as it suggests that the government may regulate the degree of informalization of employment by adjusting the level of minimum wages. *Tanika Chakraborty* (DIW Berlin) presented some positive evidence of English training in school on subsequent wages using a natural experiment. For the case of Germany, *Arne Uhlenдорff* (University of Mannheim) reconsidered the stepping stone hypothesis of marginal employment within a multivariate duration model, and *Aderonke Osikominu* (University of Freiburg) compared short-term job-oriented training to long-term human-capital oriented training. Uhlenдорff finds no significant evidence for the stepping stone hypothesis, while Osikominu shows positive effects for short-term training, especially if it starts at the beginning of an unemployment spell.



*Francois Fontaine* (University of Strasbourg) explained empirically the unemployment insurance

Two presentations were devoted to search models. *Ronald Wolthoff* (University of Chicago) suggests an equilibrium search model with multilateral meetings between workers and firms to analyze the magnitude of probable search and recruitment frictions. He introduces endogeneity of the firms’ and workers’ decisions about the quantity of contracts. *Luca Flabbi* (Georgetown University) presented his work on the preferences for job flexibility among women and their impact on labor market outcomes. He uses a search model where jobs are characterized by wages and flexibility, which will be costly for firms and valued by workers. He concludes that women are fond of flexibility and that policies aimed at reducing the costs of job flexibilities may lead to a reduction in the gender wage gap.

Several researchers presented applied studies evaluating different labor market programs, which contribute substantially to the existing literature. For instance, *Katherine Terrell* † (University of Michigan) considered the consequences of introducing minimum wages in Brazil. She finds higher wages for male employees and an increase in the probability that a formal worker switches to informal or self-employment.

non take-up. He delivers various explanations and shows that a limited misperception of the eligibility rules contributed most. Marco Caliendo (IZA) presented a new way to examine ex-ante effects of labor market policies. Using the new *IZA Evaluation Data Set*, he links self-reported perceived participation expectations of newly unemployed individuals to their job-search behavior. He identifies negative ex-ante effects on the reservation wage and a positive effect on the search intensity. *Francis Vella* (Georgetown University) investigates the intergenerational transmission of education for a representative sample. Previous studies focused only on twins or adoptees due to identification issues. The main message was that the observed intergenerational correlation with respect to education captures both a causal parental effect and a transfer of unobserved ability.

The Fifth IZA Conference on Labor Market Policy Evaluation was a big success with high-quality papers representing a good mix of methodological advancements and policy-relevant applied studies. Next year’s annual conference, organized jointly with IFAU, will take place in Uppsala, Sweden, October 1-2, 2010.

# Political Economy of Labor Market Reform

## IZA Topic Week on the Situation in Transition and Emerging Economies

While research on the political constraints of economic reform has been a fertile field in economics and political science, the analysis of the interplay of general economic policies and labor market reform on the one hand, and political structures and labor market reform on the other, has been rather limited, especially within the context of transition and emerging economies. A project funded by the Volkswagen Foundation and located in IZA's research area "Labor Markets in Emerging and Transition Economies" tries to shed some light on the political economy of labor market reform in these countries.

One component of this project is the IZA topic week "The Political Economy of Labor Market Reform in Emerging and Transition Economies", co-sponsored by the Volkswagen Foundation and held in Bonn from October 7-10, 2009. The topic week had three overarching themes: (a) the links between privatization and labor market developments and human capital; (b) labor market institutions and labor market performance; and (c) informal employment. Two invited lectures were embedded in a workshop where researchers from all over the world presented studies on these three themes.

The first lecture was given by *Jan Svejnar* (University of Michigan) on "privatization, productivity and employment." It was based on the survey paper recently published in the *Journal of Economic Literature*. In his lecture, Svejnar highlighted those studies that provided evidence of the effects of privatization and ownership on labor productivity, employment, wages and wage arrears, discussing episodes from Central and Eastern Europe (CEE), the Commonwealth of Independent States (CIS) and, where possible, China. Regarding labor productivity, the presented evidence showed positive or insignificant effects of privatization in CEE and CIS and insignificance in China. The most surprising result from studies on employ-

ment is the better performance of private firms. Contrary to the prediction of many theoretical models and to the outcome in some developing countries, privatization in the CEE, CIS and China is not associated with a reduction in employment. On the other hand, an additional year of education provides the same return independent of ownership although private firms reward university education more than State-Owned Enterprises. The inspiring lecture set the stage for two studies that dealt directly with privatization.



The paper presented by *Álmos Telegdy* (Central European University) analyzed the motivations of politicians in selecting firms for privatization. The authors take advantage of a particular feature of the privatization process in Romania where some firms were barred from privatization. They use information about actual privatizations to simulate the effect of privatization on barred firms. Using several estimation techniques and a battery of robustness checks, they find that politicians expected privatization to increase employment in the group of privatized firms and to decrease it in the not-to-be-privatized group. The differences in efficiency and wages are much smaller. Thus, employment concerns played a key role in privatization decisions.

A paper co-authored by *Irina Denisova* (CEFIR, New Economic School, Moscow) examined the relation between individual market skills in different institutional environments and support for the revision of privatization using the Life in Transition dataset for 28 transition economies

in 2006. By interacting skills and institutions, the authors test whether democracy and good governance complement market-relevant skills or substitute them. The main findings are that with increasing levels of democracy and the quality of governance the difference in the levels of support for revising privatization between individuals with high and low market skills increases, thus suggesting that democracy and good governance complement market skills. In democratic and well governed countries, individuals with low market skills support revision of privatization

much more than individuals with high market skills. More generally, these results also hold for support for a market economy and imply that, depending on the quality of institutions, different constituencies may express different preferences for economic policy.

Preferences and perceptions of economic policies and political institutions are at the heart of

the paper presented by *Riccardo Rovelli* (University of Bologna), which explores how post-Communist transformations affected people's perceptions of both the economic and the political systems. For this purpose, the authors conduct an econometric analysis of about 60,000 interviews in 14 European, post-Communist countries between 1991 and 2004, focusing in particular on people's changing evaluations of the past and present and on their expectations for the future. The authors establish some important results using in the first instance a "macro-economic pseudo-panel", which uses as units of observation 75 country-year averages. They find that people, in the context of a growing economy, appreciate more extensive reforms, while they dislike "unbalanced" reforms. On the other hand, nostalgia for the past regime kicks in when deterioration in income distribution and more inflation appear together with an increasing rate of economic privatizations. Second, the presented estimates of a model based on individual data produce some new evidence on how a person's re-

action to the macroeconomic and to the reform variables may differ, according to the characteristics of the group to which he or she belongs. For instance, in most transition countries high income earners are those who demand more extensive reforms, while low income earners are among those who oppose them, and their nostalgia for the past is further increased when income inequality worsens. In all, these considerations point to the importance of well designed, comprehensive and inclusive reform packages on the road to a market economy.

The second invited lecture was given by *Werner Eichhorst* (IZA) on labor market institutions and indicators. For nearly twenty years there has been a growing awareness in OECD countries of the important effect of institutions on labor market performance. Eichhorst surveyed the seminal studies that link institutions to labor market performance, showing the increasing sophistication of the empirical methods employed as well as the limitations of aggregated data analysis. A second theme of the lecture was the work undertaken by the OECD and independent researchers that attempts to construct institutional indices that are consistent over time and across countries. While this work has been impressive, there are still many loose ends that require additional research efforts. In particular, further research should be devoted to a theoretical refinement of interactions between different labor market institutions and between institutions and the economic environment, thus providing strong theoretical predictions on which the empirical work can be based.

A paper presented by *Hartmut Lehmann* (University of Bologna and IZA Program Director) and *Alexander Muravyev* (IZA) offered a first comprehensive study of the relationship between labor market institutions and policies and labor market performance in the countries of Eastern Europe and Central Asia, transition economies that in the last two decades underwent radical changes with tremendous variation in key economic variables. Their analysis focuses on four indicators of labor market performance: employment to population ratio, unemployment rate, long-term unemployment rate, and youth unemployment rate. These outcomes are related to employment protection legislation, generosity of unemployment benefits, active labor market policies, taxation of labor, and unionization rates. The authors find a negative effect of stricter employment protection and a positive effect of active labor market policies on labor market outcomes. Unemployment ben-

efits and unionization are also correlated with labor market outcomes, albeit to a lesser extent, while there is no evidence of a negative effect of higher tax wedges on the performance of labor markets in transition countries.

*Jeffrey Nugent* (University of Southern California) presented a paper that constructed indexes of labor market rigidities (LAMRIG) over time for as much of the period 1960-2004 and for as many countries as possible. The authors attempt to replicate the analysis in the preceding literature, testing for the relative importance of legal origins, level of development and political factors in explaining the variations across the larger set of 145 countries for the period 1995-1999. The full panel data set is then used, first, to explain the levels of the LAMRIG indexes on the basis of these same factors, and subsequently to explain the determinants of changes in the LAMRIG indexes over time. The latter is done with a broader range of determinants, including also structural, institutional variables and political and economic crises of various sorts. Compared to previous studies the authors' results show that legal origins are less important but that inertia, level of development and other reforms are more important.

*Katherine Terrell* † (University of Michigan) analyzed the evolution of Ukraine's gender gaps throughout the wage distribution and assessed the relative importance of two explanations: changes in the composition of the labor market and changes in returns to productive characteristics, both of which can be affected by minimum wage legislation. The mean gender gap is large (about 40%) and unvarying from 1986 to 1997, but falls to 34% by 2003 (after four years of GDP growth), when it is still twice the mean gap for the advanced EU countries. The decline in Ukraine's mean gender gap is explained by a shrinking of the gap in the bottom half of the distribution but not in the top half. The decline in the gaps in the lower half of the distribution is explained by a massive decline in men's wages, driven entirely by a worsening of their returns (largely of those with lower education and working in agriculture). The rising minimum wage in 1997-2003 impacted women's wages more than men's and was an important factor in explaining why women's wages did not fall as much as men's wages.

Studies on the informal sector and informal employment also contributed to the topic week in a substantial fashion. For example, *Olivier Bargain* and *Prudence Kwenda* (both University College Dublin)

provided new evidence on the wage gap between informal and formal salary workers in South Africa, Brazil and Mexico. Using rich datasets that allow defining informality in a relatively comparable fashion across countries, the authors compute precise wage differentials by accounting for taxes paid in the formal sector. To account for unobserved heterogeneity, the authors use large (unbalanced) panels to estimate fixed effects models at the mean and at different points of the wage distribution. They find that workers' heterogeneity explains a large part of the (conditional) wage gap. The remaining informal sector wage penalty is significant in the lower part of the distribution but almost disappears at the top. Interestingly, this pattern is consistent across all three countries despite considerable labor market differences.

Using individual survey data from the Ukraine, a study presented by *Melanie Khamis* (IZA) explored links between the degree of willingness to take risks, time preferences and labor market status. In the Ukrainian dataset, questions regarding the willingness to take risks in general or to invest in an asset and also time preferences are posed, which were modeled after the German Socio-Economic Panel. The authors find that that the determination of the willingness to take risks exhibits similar patterns in the German and Ukrainian samples, validating the used risk measures over time and space. Linking these risk measures to the labor market, they find that workers who are willing to take more risks in general and in career matters have a higher propensity to engage in voluntary informal employment relationships or are in formal or informal self-employment. Time preferences, on the other hand, do not yield significant results with respect to informal or formal employment.

Another highlight of the topic week was the dinner speech by IZA Director *Klaus F. Zimmermann* on "The Political Constraints of Implementing Labor Market Reforms." Drawing on his extensive experience as a policy advisor, he provided interesting insights into the obstacles that economists have to overcome when trying to convince policy makers to adopt appropriate policies. The topic week was thus rounded off by a welcome dose of political realism.

The presented papers are downloadable from the online conference program:

► [www.iza.org/link/TransEconTW09](http://www.iza.org/link/TransEconTW09)

## New IZA Staff Members

*Anne Gielen* has been a member of IZA's affiliate and fellow network since July 2006. In September 2009, she joined the IZA staff as a Research Associate. She is also in charge of the IZA seminar and guest researcher program. Anne holds an M.Sc. (2003) and a Ph.D. (2008) in Economics from Tilburg University. Before coming to IZA, she worked as a post-doc researcher at the University of Maastricht. Her main research interests are labor mobility, happiness, and personnel economics.



Anne Gielen



Anna Myunghee Kim

*Anna Myunghee Kim* completed her doctorate (D.Phil) in Human Geography at St. Antony's College of University of Oxford in 2007. Her research interests span Social, Population Geography, Demography, and Development Studies. Anna is currently working on international labor migration, and demographic transition in aging East Asian and OECD countries. Prior to joining IZA in October 2009, she was a research associate in the School of Geography at Oxford.

## New Resident Research Affiliates at IZA

IZA continually expands its activities in supporting and promoting young labor economists. An important part of these efforts is the IZA Scholarship Program, which offers a number of Ph.D. students the opportunity to use the IZA resources and interact with the institute's senior experts and international guest researchers. In the fall of 2009, four new scholarship holders started their work at IZA.

*Ruby Henry* is a Ph.D. candidate at the Toulouse School of Economics. She earned an M.Sc. in Quantitative Economics and Econometrics from Toulouse and a B.A. in Economics from Harvard University. Her research interests include the sensitivity of migrants to discrimination, intergroup marriage, intergenerational transmission of non-cognitive skills, urban housing, and panel data methods. Before joining IZA, she was a visiting scholar at Columbia University.

The following three Ph.D. candidates at the University of Cologne joined IZA as student assistants for the program area "Evaluation of Labor Market Programs" before they became Resident Research Affiliates under the IZA Scholarship Program:

*Jens Hogenacker* studied economics, with a special focus on public economics and statistics, at the University of Cologne. He received his Dipl.-Vw. degree (M.A. in Economics) in September 2009. His current research

is mainly concerned with applied micro-econometrics.

*Nico Pestel* studied economics and political science at the University of Cologne and completed his studies in September 2009, also with an M.A. in Economics. His main research interests include the analysis of income distribution, labor economics, and public economics.

Journalism in 2007. In addition, he studied economics and political science at the University of Cologne and Sciences Po Paris from 2004 to 2009. His research focuses on public economics, with special reference to tax and benefit reforms, labor economics and applied microeconomics.

In addition to the scholarship recipients, two other junior academics have also joined IZA as Resident Research Affiliates for a limited period of time:



Nico Pestel, Jens Hogenacker, Sebastian Sieglösch

*Martin Guzi* holds an M.Sc. in Mathematics from the Comenius University in Slovakia and an M.A. in Economics from CERGE-EI, Prague, where he also worked as a research assistant before becoming a junior researcher at the Academy of Sciences of the Czech Republic. His research interests include applied econometrics and various issues in labor economics, such as unemployment benefits, human capital distribution, schooling choices and economic aspects of human well-being.



Martin Guzi, Ruby Henry, Annabelle Krause

*Annabelle Krause* studied economics and social psychology at Ruhr-University Bochum and the University of Lausanne in Switzerland, where she received an M.Sc. in Economics in June 2009. Her research interests include labor economics, migration and happiness economics. She is currently pursuing her Ph.D. at the Free University of Berlin under the supervision of IZA Director Klaus F. Zimmermann.

*Sebastian Sieglösch* graduated from the Cologne School of Political and Economic

under the supervision of IZA Director Klaus F. Zimmermann.



## Long-Term Unemployed Need Efficient Help

As part of the German labor market reforms of 2005, the Federal Employment Agency (BA) and the municipalities were given shared responsibility for the long-term unemployed within the so-called *ARGE*n (job centers). This practice of mixed administration was ruled unconstitutional by the Federal Constitutional Court, which called upon the legislators to revise the law until 2010. The necessary revision would be a good chance to correct other deficiencies of the current institutional setting. Most importantly, the problem groups of the labor market need efficient help at an earlier stage of their unemployment spell. This help is currently impeded by an organizational maze of unclear responsibilities: Although *ARGE*n have been established in most districts, some municipalities were allowed to opt out (*Optionskommunen*) and some others simply failed to reach a cooperation agreement with the local employment agency. These municipalities are now working on their own and independently from the local employment agency.

Instead of generally legalizing the *ARGE*n by a constitutional amendment, the federal government is planning to replace the *ARGE*n with a model of divided responsibilities. This would in fact institutionalize what came about as an “operational accident”: While 23 municipalities now practice a coexistence of welfare and employment agencies, this “third way” was not intended by the Social Code (*SGB II*), but merely resulted from the failure of the involved government agencies to agree on cooperation within the *ARGE*.

If this failure were legalized, the federal government would miss a great opportunity to substantially improve the provisions for the long-term unemployed. Although Germany’s rate of long-term unemployment has been declining slightly over the past years, it still remains exceptionally high by international standards.

In some ways, this dilemma is due to the fact that the organizational structure has not been sufficiently evaluated by independent research – although this was explicitly called for by the legislators. It is still unclear whether the municipalities or the *ARGE*n are more efficient at managing the long-term unemployed. Some studies find a small advantage for the *ARGE*n, but these results are not perfectly convincing in terms of methodology.

What is clear is that older, unskilled or immigrant workers, who are most prone to long-term unemployment, should receive reintegration assistance immediately after losing their jobs. A single institution should take care of them during the entire unemployment spell. But this approach becomes particularly problematic at the transition from unemployment benefits (*ALG I*) to welfare benefits (*ALG II*) because the unemployment insurance is administered by the BA, whereas the tax-funded welfare benefits are managed by the currently 350 independent *ARGE*n, 69 municipalities under the “opt-out” clause, and 23 non-cooperation cases with divided responsibilities.

The planned coexistence of different administrative bodies would jeopardize the progress that has already been made. The previous side effects would reoccur again: the organizational costs and frictions associated with double administration on the one hand, and confusion among the customers on the other. This is why the long-term unemployed need a one-stop shop. Policymakers are well-advised to create the legal setting for an independent organization that can handle this important task.



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