

## 1) WHY MANY PEOPLE THINK INFLATION HAS BEEN HIGH SINCE THE EURO CASH CHANGEOVER – Helmut Stix

In dieser Studie wird untersucht, warum viele Konsumenten die Inflation seit der Einführung des Euro als deutlich höher empfinden als es den offiziellen statistischen Messungen entspricht. Im Wesentlichen können drei Gründe angeführt werden:

- Die Preise von Gütern, die häufig gekauft werden, sind stärker gestiegen als die Preise von selten gekauften Gütern. Da häufig und regelmäßig gekaufte Güter die subjektive Einschätzung der Inflationsrate stärker beeinflussen, entsteht bei vielen Konsumenten das Gefühl, dass die Inflation zugenommen hat.
- Viele Leute rechnen immer noch in Schilling, wenn sie Preisvergleiche anstellen – und vergleichen damit die Preise von 2001 mit den heutigen.
- Schließlich spielt die Erwartungshaltung eine wichtige Rolle: Konsumenten, die Preiserhöhungen erwartet haben, haben auch mit größerer Wahrscheinlichkeit das subjektive Empfinden von Preissteigerungen.

Länder, die den Euro einführen möchten, sind jedenfalls gut beraten, diese Phänomene zu berücksichtigen, um der in vielen Ländern beobachteten „Euroskepsis“ rechtzeitig vorzubeugen.

New research identifies why many people in the euro area have perceived a higher rate of inflation after the euro cash changeover despite overall low inflation as measured by official statistics. Speaking at the European Economic Association's 2006 annual conference in Vienna this week, **Helmut Stix** presented the key results of his analysis of a representative survey of Austrians:

- The prices of frequently purchased goods have increased more than the prices of less frequently purchased goods. Since people look at the former when making a judgement about inflation, they feel that inflation has increased.
- Many people still use old currencies when making price comparisons – and make the mistake of comparing actual prices now with prices in 2001.
- Preconceptions play a crucial role: people who expected prices to increase are more likely to perceive price rises.

These findings suggest that policy measures in countries that are going to introduce the euro should address these issues in order to prevent developments similar to those experienced in many euro area countries.

The paper empirically analyses why inflation perceptions got disconnected from official inflation measures in the course of the euro cash changeover. It finds first that the level of education, a good proxy for income, is the most important socio-demographic determinant of inflation perceptions: the higher someone's educational level, the lower their inflation perception. Age is less important.

Second, the fact that prices of frequently purchased goods rose faster after the cash changeover than overall inflation became manifested in higher inflation perceptions. In particular, the research finds that people who are confronted with prices of frequently purchased goods perceive a higher rate of inflation. Mr Stix explains:

‘If people who do the daily shopping believe that prices have risen since the euro’s introduction, then they are, in a certain sense, right.

But people tend to attach too much importance to the prices of frequently purchased products when forming their perception about inflation.

At the same time, the weight of items that in fact account for a considerable part of household’s monthly expenses is frequently underestimated.’

Third, there is clear evidence that people who mentally convert euro prices into Austrian schilling prices, and thus compare actual prices with prices in 2001, perceive higher inflation. This is not surprising since such people are using ‘frozen’ reference prices, forgetting that schilling prices would also have increased over the last five years.

Fourth, the results of psychological experiments point towards a substantial role of preconceptions about price increases. The survey data confirm these results: people who believed prior to the changeover that prices would increase later perceived a significantly higher rate of inflation than people who did not expect price increases.

Although these results are for Austria only, they also have implications for other countries, particularly the findings about the role of price comparisons and expectations.

A **European Commission survey from 2005** confirms that price comparisons in euro legacy currencies are still widespread in many countries. In particular, 43% of euro area citizens still mainly use their respective old domestic currencies for mental price comparisons when making major purchases (for example, of a house or car), while only 24% think mainly in euros.

Furthermore, survey results from 2006 indicate that expectations of price increases have already emerged in the new member states: 74% of the population fear ‘abuses and cheating’ on prices in connection with an eventual introduction of the euro.

These figures are surprisingly similar to those observed in the current euro area members, where 70% expected unjustified price increases.

The results from the research imply that the gap between measured and perceived inflation will close sooner or later, if it has not already. For those countries that will face a euro cash changeover, the findings imply the importance of policy measures:

- to prevent price increases of frequently purchased goods;
- to convince the population that the expectations of price increases are not warranted – probably very difficult to achieve;
- and to promote the evolution of a good feeling for the new currency and prices.

Clearly, there might be other important factors, but addressing these three issues will contribute a great deal towards preventing similar developments than those experienced in many euro area countries.

**Notes for editors:** ‘Perceived Inflation and the Euro: Why High? Why Persistent?’ by Helmut Stix was presented at the joint congress of the European Economic Association and the Econometric Society European Meeting (EEA-ESEM) at the University of Vienna, August 2006.

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## **2) WOMEN CHOOSE FIXED SALARIES; MEN PREFER PERFORMANCE-RELATED PAY** New evidence on gender pay differences and attitudes to risk – Armin Falk and Thomas Dohmen

Verdienen Frauen im Durchschnitt weniger als Männer weil sie lieber ein etwas geringeres, dafür fixes Gehalt beziehen als ein leistungsbezogenes, auch wenn dieses höher sein könnte, während sich Männer eher umgekehrt entscheiden?

Diese und ähnliche Fragen haben die Autoren mit Hilfe von umfangreichen Experimenten zu beantworten versucht. Die Teilnehmer an den Experimenten – 119 Männer und 121 Frauen – erhielten zunächst die Aufgabe, innerhalb von 10 Minuten eine Reihe von Multiplikationen zweier Zahlen durchzuführen. Sie konnten wählen zwischen einer fixen Auszahlung von 7 Euro oder 20 Cent pro richtiger Multiplikation. Es gab auch die Möglichkeit, an einem Wettbewerb teilzunehmen, bei dem der Sieger – bestimmt durch die größte Anzahl richtiger Multiplikationen innerhalb von 10 Minuten – 20 Euro erhielt, während die Verlierer leer ausgingen. Die Experimente haben u.a. folgende Ergebnisse gebracht:

- Nur 44% der Frauen haben die leistungsbezogene Variante gewählt, aber 68% der Männer.
- Dies passt gut zu Daten aus Deutschland, wonach 33% aller berufstätigen Frauen im Öffentlichen Dienst (mit fixen, wenn auch eher niedrigen Gehältern) beschäftigt sind, aber nur 21% der Männer.
- Männer sind deutlich risikofreudiger als Frauen.
- Der Wettbewerb ist vor allem für “Egoisten” und für Personen, die ihre eigenen Fähigkeiten überschätzen, attraktiv.

Abgesehen von den interessanten geschlechtsspezifischen Unterschieden zeigt die Studie, dass die Art des Entlohnungsschemas einen wichtigen Einfluss darauf hat, welche Typen von Arbeitssuchenden sich bewerben.

The fact that on average women earn less than men is not necessarily the result of discrimination: when given a choice between a fixed salary and performance-related pay, women choose the former far more often than men, even if they could earn more by opting for the latter.

This is the one of the results of new research by **Armin Falk** and **Thomas Dohmen**, presented at the European Economic Association's 2006 annual conference in Vienna this week. Their study, which seeks to investigate what effect the choice of a pay incentive scheme has on the composition of the workforce, also finds that payment method seems to have a big influence on the type of employees a company attracts.

The researchers conducted a laboratory experiment designed to draw conclusions about people's preferences and character traits, including attitudes to risk, social preferences and relative self-assessment of one's abilities.

The participants in the experiment – a total of 119 men and 121 women – were asked to multiply pairs of numbers together over a 10-minute period. They were able to choose beforehand how they wanted to be paid: either a fixed sum of seven euros or just under 20 cents for each correct multiplication.

The participants could also take part in a kind of tournament, where the opponent was chosen at random. Whoever solved the most tasks within 10 minutes won 20 euros, with the opponent getting nothing.

Competitive situations like these are not unusual in private enterprise – around promotions, for example. Fund managers are also frequently paid according to the same principle: the person whose fund was most successful receives a bonus, which may account for a substantial part of the salary.

The research finds that:

- Only 44% of all the women taking part in the experiment chose the performance-related options, although many of them could have earned more if they had. By contrast, 68% of the men chose this option.
- The results correspond to data from the German Socio-economic Panel, according to which, 33% of all women work in the public sector, a field in which fixed (though relatively low) pay is the norm. In contrast, only 21% of men are employed in this field.
- Men are clearly more prepared to take risks. These findings should at least partly explain why women tend to opt for fixed pay.
- Tournaments primarily attract 'egoists': the fact that, at least in the experiment, the winner takes all with the loser going home empty-handed, apparently led more compassionate participants to opt for a different kind of pay.
- Participants in the experiment who chose the tournament option were in addition comparatively keen to take risks. They also tended to assess their own abilities too positively. That is logical: anyone who thinks they are the best can hardly be afraid of competing with an opponent.

- The method of payment therefore seems to have a big influence on determining what type of employees a company attracts. If, for example, a bank offers a tournament compensation scheme, it is likely to attract above-average financial experts who assess their own abilities too positively.

**Notes for editors:** ‘Performance Pay and Multi-dimensional Sorting – Productivity, Preferences and Gender’ by Armin Falk and Thomas Dohmen was presented at the joint congress of the European Economic Association and the Econometric Society European Meeting (EEA-ESEM) at the University of Vienna, August 2006.

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The full version of this study is available in English at <ftp://ftp.iza.org/dps/dp2001.pdf>

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### 3) DIVORCE LAW REFORMS HAVE RAISED EUROPE’S DIVORCE RATES – Libertad González

In vielen Europäischen Ländern wurden in den letzten Jahren und Jahrzehnten Gesetzesänderungen vorgenommen, welche Ehescheidungen erleichtert haben. In Irland, Italien Portugal und Spanien wurden Scheidungen legalisiert. Scheidungen ohne Fehlverhalten eines Ehepartners wurden in Frankreich, Griechenland, den Niederlanden und in Großbritannien ermöglicht. Schließlich gibt es, mit Ausnahme Irlands und Italiens, in allen Ländern die Möglichkeit einer Scheidung auch auf Wunsch nur eines Ehepartners (unilaterale Scheidung).

Die Wirkungen der Gesetzesänderungen auf die Scheidungsraten waren unterschiedlich:

- Die Möglichkeit einer Scheidung ohne Fehlverhalten hatte einen starken und dauerhaften Effekt und hat die Zahl der jährlichen Scheidung um 4 pro 100 Ehepaare erhöht.
- Die Zulassung „unilateraler“ Scheidung hat demgegenüber nur einen halb so großen Effekt gehabt, der nach zwei Jahren völlig verschwunden ist.
- Insgesamt dürften die Gesetzesänderungen im Zeitraum zwischen 1960 und 2002 die Scheidungsraten in Europa um rund 20% erhöht haben.

The legal reforms that have ‘made divorce easier’ across Europe account for a significant proportion of the increase in divorce rates since the 1960s. That is the central conclusion of new research by **Libertad González** and **Tarja Viitanen**.

Their study, presented at the European Economic Association’s 2006 annual conference in Vienna this week, is important for current discussions of the possibility of harmonising family law within the European Union (EU) as well as recent national reforms that have liberalised divorce, notably in France and Spain.

As the table below shows, divorce rates have increased drastically in Europe between 1960 and the present. In 1960, there were 2 to 3 divorces per 1,000 married couples. By 2002, this rate had more than tripled, with over 7 annual divorces per 1,000 married couples. The highest divorce rates were in Denmark, Sweden, the UK and Finland, with more than 13 divorces per 1,000 married couples in 2002.

**Annual number of divorces per 1,000 married couples**

Country	1960	1980	2002
Italy	0.0	0.9	2.8
Ireland	0.0	0.0	3.5
Greece	1.4	2.7	3.8
France	3.0	4.0	4.0
Spain	0.0	0.0	4.4
Netherlands	2.2	7.7	9.4
Switzerland	3.8	7.2	9.7
Portugal	0.4	2.6	10.4
Germany (including ex-GDR in 2002)	5.8	8.3	10.5
Iceland	3.8	9.9	10.8
Luxembourg (Grand-Duché)	1.9	6.8	11.0
Austria	5.0	7.7	11.1
Norway	2.8	6.9	12.4
Belgium	2.0	5.7	13.0
Finland	4.0	9.0	13.6
United Kingdom	1.9	11.7	13.8
Sweden	4.9	11.0	14.0
Denmark	6.0	11.8	15.0

The researchers examine the extent to which the legal reforms that have made divorce easier since 1950 have contributed to the increase in divorce rates across Europe. Using data for 18 European countries (the EU15 plus Norway, Switzerland and Iceland), they find that:

- The different reforms that ‘made divorce easier’ were followed by significant increases in divorce rates. The effect of ‘no-fault’ legislation was strong and permanent, while ‘unilateral’ reforms only had a temporary effect on divorce rates.
- The introduction of ‘no-fault divorce’ had a strong, permanent effect on divorce rates. The annual number of divorces in a country that introduced no-fault legislation increased by about 4 divorces per 1,000 married couples in the long term.
- On the other hand, allowing for ‘unilateral divorce’ had only temporary effects on the divorce rate. The countries that explicitly introduced unilateral divorce experienced a short-term increase in divorce rates of about 2 divorces per 1,000 married couples during the first two years following the reform, but after that divorce rates went back to pre-reform levels.
- The combined effect of all the legal reforms that have made divorce easier account for about 20% of the increase in divorce rates in Europe between 1960 and 2002.

The recent rise in divorce rates has generated a great deal of attention from researchers and policy-makers. Many worry about the negative economic consequences of divorce for women and children, and there is some evidence that more liberal divorce laws have negative effects on long-term outcomes for children.

On the other hand, recent research suggests that divorce increases physical and psychological well-being for both partners. Thus it seems clear that divorce legislation has potential effects on both economic and psychological well-being.

The reforms that have made divorce easier include:

- Legalising divorce: Ireland, Italy, Portugal and Spain legalised divorce between 1970 and 1997.
- The introduction of no-fault divorce (that is, dropping the requirement that the spouse wishing to divorce proves adultery or other serious 'fault' of the spouse): France, Greece, Netherlands and the UK moved to a no-fault regime in the 1970s.
- The introduction of unilateral divorce (that is, dropping the requirement of mutual consent and allowing divorce on request by only one spouse): all countries but Ireland and Italy had adopted some kind of unilateral divorce by 2003, often implicitly.

The analysis takes account of other differences across countries in factors that may be both fixed over time or changing 'smoothly' and at different paces across different countries. For example, the researchers want to rule out the possibility that changing social norms may be driving both increasing divorce rates and more liberal divorce laws.

Several countries have recently been considering additional reforms in their divorce laws. Reforms liberalising divorce took place in France and Spain in 2005, while there are current initiatives in the United States in favour of making divorce easier in some states (such as New York) and more restrictive on others (such as Ohio).

The results are also relevant in light of current initiatives studying the possible harmonisation of family law within the European Union.

**Notes for editors:** 'The Effect of Divorce Laws on Divorce Rates in Europe' by Libertad González and Tarja Viitanen was presented at the joint congress of the European Economic Association and the Econometric Society European Meeting (EEA-ESEM) at the University of Vienna, August 2006.

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#### 4) 'TOO OLD TO WORK, TOO YOUNG TO RETIRE'

##### The potential impact of raising the retirement age – Guido Schwerdt

Ist die Verlängerung der Lebensarbeitszeit die Lösung für Europas Pensionsprobleme? Nur dann, wenn auch ältere Menschen Arbeit finden und nicht „zu alt zum Arbeiten, zu jung für den Ruhestand“ sind. Die Autoren dieser Studie haben die Jobaussichten von Arbeitnehmern, die wegen Schließung ihrer Arbeitsplätze ihre Arbeitsplätze verloren haben, näher untersucht und sind zu folgenden Ergebnissen gelangt:

- Unmittelbar nach Schließung einer Arbeitsstätte fällt die Beschäftigungsrate der 45-55-Jährigen um drei Prozentpunkte mehr als die der 35-45 Jährigen, wenn man sie mit den Mitgliedern der jeweiligen Altersgruppe vergleicht, die nie ihren Arbeitsplatz verloren haben.
- Dieser Effekt verschwindet aber nach etwa fünf Jahren, und die Beschäftigungsaussichten der Älteren werden sogar relativ besser als die der Jüngeren. Allerdings dürfte dieser Aufholprozess mit einer Verringerung der Lohnerwartungen einhergehen.
- Für Arbeitskräfte, die bald nach der Schließung ihrer bisherigen Arbeitsstätte wieder Beschäftigung gefunden haben, gab es keine signifikanten Unterschiede zwischen den Altersgruppen in Bezug auf die Einkommensenkungen.
- Insgesamt sind die Kosten eines Arbeitsplatzverlustes für die Älteren größer als für die Jüngeren (schlechtere Chancen auf Wiederbeschäftigung, etwas größere Gehaltseinbußen).

Increasing the retirement age in order to solve Europe's pension problems may produce individuals who are 'too old to work but too young to retire'.

That is the central conclusion of new research by **Andrea Ichino**, **Guido Schwerdt**, **Rudolf Winter-Ebmer** and **Josef Zweimuller**, presented at the European Economic Association's 2006 annual conference in Vienna this week.

Analysing social security records for thousands of Austrian employees whose firms went bust, the researchers find that:

- Immediately after a plant closure, employment rates of 45-55 year old workers declined by 3 percentage points more than the employment rates of 35-45 year old workers compared with subjects in the corresponding age cohorts who were never displaced.
- But over time, the displaced old caught up with the young: compared to the never displaced, the employment prospects of the old became more favourable than those of the young five years after plant closure.
- There were no significant differences between age cohorts in the effect of a plant closure on the earnings of the displaced workers who find a new job relative to the never displaced, with the possible exception of evidence for the end of the period of observation (10 years after plant closure) in which the wage losses of the re-employed old appear slightly larger.

These findings can be understood as a combination of demand effects that prevail immediately after displacement and supply effects that kick in later:

- Older workers tend to be paid more than their actual productivity in continuing jobs for incentive reasons.
- After a plant closure, the market offers them a wage that matches their productivity and is thus lower than their previous wage.
- Facing these unattractive offers, the displaced old workers are initially reluctant to lower their 'reservation wage' enough to ensure the same employability as the young.
- But with the passage of time, the shorter time horizon of the old induces them to lower their reservation wage in order to find a job before retiring, and this explains the observed catching up.

While the difference in the effect of a plant closure for the young and for the old changes with the distance from the event, the consequences of a plant closure for the average worker are unambiguously severe and long lasting:

- On average, independently of age, during the first five years after a plant closure, displaced workers have an employment rate that is almost 20 percentage points lower than non-displaced workers, compared to the never displaced.
- Even six to ten years after, the difference in employment rates between these two groups amounts to more than 10 percentage points.

These results are based on 11,578 workers from all the Austrian firms with more than 4 employees that went bust between 1982 and 1988. These workers were matched according to a large set of observable characteristics (including previous wage and employment history) with 36,777 workers extracted from the universe of the 1,087,705 Austrian employees in plants that never closed down in the same period.

This made it possible to compare employment and earnings prospects of elderly relative to similar prime-age workers in the displacement and non-displacement groups.

These results are relevant for the debate on the possibility of increasing the retirement age for 'pay-as-you-go' pension systems with an ageing population.

**Notes for editors:** 'Too Old to Work, Too Young to Retire?' by Andrea Ichino, Guido Schwerdt, Rudolf Winter-Ebmer and Josef Zweimuller was presented at the joint congress of the European Economic Association and the Econometric Society European Meeting (EEA-ESEM) at the University of Vienna, August 2006.

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## 5) MORE COMPETITION MEANS LOWER UNEMPLOYMENT New evidence from across Europe – Gareth Macartney

Die Autoren untersuchen die Auswirkungen verschärften Wettbewerbs auf Gütermärkten auf Beschäftigung und Löhne. Zwischen 1988 und 1998 wurde in den meisten OECD-Staaten eine Reihe von Reformen durchgeführt, die zur Öffnung von Märkten und verschärftem Wettbewerb geführt haben. Dies hat in den 14 untersuchten OECD-Staaten zu einer durchschnittlichen Senkung der Arbeitslosenrate um fast einen Prozentpunkt geführt. Gleichzeitig sind die Reallöhne um etwas mehr als 3% gestiegen. Ferner hat sich gezeigt, dass die Wirkung der Wettbewerbsverschärfung auf Beschäftigung und Löhne umso größer war, je stärker die Gewerkschaften waren. Die Autoren kommen zum Schluss, dass der Abbau von Wettbewerbshemmnissen auf den Gütermärkten für die Verringerung der Arbeitslosigkeit kaum weniger wichtig ist als eine Reform der Arbeitsmärkte.

Opening product markets up to competition has helped to reduce unemployment in many European countries, according to new research from the UK's Institute for Fiscal Studies. This is especially true in those countries where unions are particularly strong.

The study by **Rachel Griffith**, **Rupert Harrison** and **Gareth Macartney**, presented at the European Economic Association's 2006 annual conference in Vienna this week, also finds that increased competition has raised workers' real wages. But in this case, the effect is smaller in highly unionised countries.

Most of the policy focus on reducing unemployment in the European Union has been on removing restrictive labour market regulations and reforming benefit systems. But the idea that barriers to competition are an important factor in explaining high unemployment is part of the motivation behind much of the EU's Lisbon Agenda, including the controversial services directive.

This research provides the first robust empirical evidence that past reforms that have reduced barriers to competition have indeed reduced unemployment and raised real wages. Gareth Macartney, one of the authors, comments:

'Our results suggest that reducing barriers to competition in product markets may be just as important for reducing unemployment as reforming labour markets.

They also show that the presence of strong unions is not a good reason to shy away from product market reforms – if anything there is more incentive to reform as the employment benefits may be larger.'

Increased competition reduces unemployment by reducing the ability of businesses to keep prices high and reduce output. In countries with strong unions, it also reduces the ability of unions to bargain for high wages. Both of these effects tend to increase the number of jobs created and reduce unemployment.

Between 1988 and 1998, reforms that opened up markets and increased competition reduced unemployment across 14 OECD countries by just under one percentage point on average. The effect on real wages was an average increase of just over 3%.

A large part of these gains were made through the EU's Single Market Programme (SMP), which reduced barriers to trade. Participating countries experienced an average decrease in unemployment due to the SMP of 0.9 percentage points between 1988 and 1998, with the larger benefits going to countries where union bargaining is more prevalent.

In the **UK**, the estimated effect was to reduce unemployment by 1.3 percentage points compared with what it would have been without the reforms – accounting for just over a quarter of the cyclically adjusted reduction in unemployment between 1988 and 1998. The effect on real wages in the UK was an increase of 7.1%.

In **France** and **Italy**, where large parts of the economy are covered by union bargaining, the SMP reduced unemployment by 1 percentage point, from what it would have been otherwise. Despite this, France's unemployment experience was poor in the 1990s and unemployment actually increased.

Unemployment in **Belgium**, another country where unions are important, also fell by 1 percentage point due to the SMP. Combined with other improvements in product market conditions, this contributed to an overall decrease in unemployment of 1.6 percentage points, controlling for the business cycle.

Countries where unions have less influence had slightly less to gain. The SMP reduced unemployment in the **Netherlands** and **Denmark** by 0.8 percentage points. In the Netherlands, other product market reforms that cut government interference in business, as well as labour market improvements, carried this benefit through to a reduction in cyclically adjusted unemployment of over 1.2 percentage points.

**Portugal**, with low union coverage relative to other SMP participants, but with very high barriers to trade before the programme, benefited with an unemployment reduction of 1.1 percentage points, again controlling for the business cycle.

The four European countries that did not participate in the SMP – Sweden, Finland, Norway and Austria – experienced an average increase in cyclically adjusted unemployment of 2.6 percentage points between 1988 and 1998. Particularly severe economic recessions in both **Sweden** and **Finland** are in part responsible for this.

**Austria**, despite some small improvements in product market conditions, suffered a 2.9 percentage point increase in cyclically adjusted unemployment. The researchers estimate that at least a third of this was due to changes in labour market conditions, such as increases in employment taxes and unemployment benefits.

Three of these countries joined the EU in 1995, and further work is required to investigate if they subsequently benefited from associated increases in product market competition.

**Notes for editors:** 'Product Market Reforms, Labour Market Institutions and Unemployment' by Rachel Griffith, Rupert Harrison and Gareth Macartney was presented at the joint congress of the European Economic Association and the Econometric Society European Meeting (EEA-ESEM) at the University of Vienna, August 2006.

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The full paper is at: [http://www.ifs.org.uk/publications.php?publication\\_id=3587](http://www.ifs.org.uk/publications.php?publication_id=3587)

The research brings together data on the impact of reforms such as the EU's Single Market Programme to investigate the relationship between reducing barriers to competition and unemployment and real wages over the late 1980s and 1990s. The types of reforms include lowering barriers to entry, reducing tariffs and other barriers to trade and reducing state involvement in the economy.

The countries covered by the research include Australia, Austria, Belgium, Canada, Denmark, Finland, France, Italy, the Netherlands, Norway, Portugal, Sweden, the UK and the United States.

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## **6) EMPLOYEES ARE BETTER OFF IN FIRMS INVOLVED IN THE 'MERGERS & ACQUISITIONS MARKET' – David MARGOLIS**

Fusionen und Firmenübernahmen werden vielfach als "Jobkiller" gesehen. Diese Studie untersucht für den Zeitraum 1993 bis 1999 die Effekte von Fusionen und Übernahmen in Frankreich auf die Arbeitnehmer. Die Studie hat u.a. folgende Ergebnisse erbracht:

- Beschäftigungsverhältnisse sind stabiler in Unternehmen, die in Fusionen und Übernahmen involviert waren als in anderen.
- Die Beschäftigten der übernommenen Unternehmen verlieren mit größerer Wahrscheinlichkeit ihren Arbeitsplatz als die der übernehmenden Firmen, der Unterschied verschwindet aber nach etwa drei Jahren.
- Tendenziell scheiden nach einer Übernahme vor allem Arbeitskräfte aus, die auf dem Arbeitsmarkt gute Aussichten haben (v.a. jüngere, qualifizierte Arbeitskräfte).

Eine mögliche Konsequenz besteht darin, Unternehmen zu identifizieren, von denen Aktivitäten in Bezug auf Fusionen und Übernahmen zu erwarten sind. Es sind in der Regel große, profitable und produktive Unternehmen. Eine Gefährdung von Arbeitsplätzen ist eher in den anderen Unternehmen zu erwarten, die diese Eigenschaften nicht aufweisen. Unter Umständen eröffnet dies die Möglichkeit, rechtzeitig Gegenmaßnahmen zu ergreifen.

Fewer employees lose their jobs in firms involved in mergers and acquisitions (M&A) than those in firms that never undergo any M&A activity. What's more, the people that do leave firms involved in the 'M&A market' tend, for the most part, to be the types of workers that find new jobs relatively quickly after a displacement.

These are some of the findings of new research by **David Margolis**, presented at the European Economic Association's 2006 annual conference in Vienna this week. They run strongly counter to stories in much of the popular press, which tend to see M&A from the perspective of layoffs and downsizing.

Margolis uses a new data set covering all asset transfers involving medium to large firms (roughly \$1.5 million – minimum – in assets transferred) in France between 1993 and 1999 to look at what happens to workers when their firms are involved in M&A activity. Excluding firms that were involved in more than one M&A transaction during the period, he finds several new results:

- Employment is much less stable in firms that never underwent any M&A activity during the period than in those that underwent a single transaction. A person chosen at random in a M&A firm (acquired or acquiring) the year before the transaction has roughly a 70% chance of still being with the (successor) firm three years later, while the changes of a randomly chosen person from a non-M&A firm remaining employed after the same length of time are less than 50%.
- Not all of the separations are layoffs, of course (the data does not make it possible to establish the reason why a person left), but many of the departures from the non-M&A firms may be due to whole firms going under, while M&A firms do retain most of their pre-transaction employment after the transaction takes place, even if they undergo significant restructuring.
- In general, most of the differences in the chances of remaining employed between acquired and acquiring firms are short-term. Although more people leave the acquired firm in the first two years after the transaction, there is no significant difference in the chances of remaining employed from three years on.
- The key difference occurs when one firm is acquired by another firm from a different sector. In this case, the chance of a person staying employed when having worked in the acquired firm remains significantly lower than that of employees of the acquirer. Even five years after the transaction, acquired firm employees have roughly a one-third lower chance of staying employed with the new entity than employees in the acquiring firm.
- When considering who stays and who goes, it seems that the types of individuals who tend to find new jobs the fastest (white-collar workers, low seniority workers and younger workers) are also the ones who are the least likely to stay on post-transaction, with a few exceptions (unskilled blue-collar workers from acquiring firms and women).

What could be driving these results, some of which tend to run counter to preconceived beliefs about the effects of mergers and acquisitions?

Remembering that firms that were involved in multiple M&A transactions over the period 1993-99 have been excluded from the analysis, it may be the case that collective bargaining agreements and the French government's policies concerning layoffs do indeed affect post-M&A employment.

Perhaps less attention needs to be focused on these firms and more on firms that are not viable enough to be involved in the 'M&A market'. Authorities can attempt to identify 'M&A market' firms beforehand, primarily through analysing their balance sheet data – they tend to be larger, more profitable and more productive.

But such an effort should be directed toward identifying non-'M&A market' firms since there are more workers leaving their jobs in these firms than in firms involved in M&A activity, and the workers that do leave 'M&A market' firms, for the most part, tend to be the types of workers that find new jobs relatively quickly after a displacement.

**Notes for editors:** 'Should Employment Authorities Worry About Mergers and Acquisitions?' by David Margolis was presented at the joint congress of the European Economic Association and the Econometric Society European Meeting (EEA-ESEM) at the University of Vienna, August 2006.

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## 7) TRUSTING ENOUGH TO DO BUSINESS

### New experimental evidence that we favour strangers from richer parts of town with fewer foreigners – Christian Zehnder

Vertrauen (oder Misstrauen) gegenüber Fremden ist oft ein wichtiger Faktor für den geschäftlichen Erfolg. Die Autoren haben untersucht, in welchem Ausmaß das Vertrauen, das unbekanntem Personen entgegengebracht wird, von deren Wohnort abhängt. Zu diesem Zweck wurde ein Experiment durchgeführt, in dem tausend Versuchspersonen für jeden Wohnbezirk in Zürich eine riskante Investition tätigen mussten, bevor ihnen der Wohnbezirk ihres „Geschäftspartners“ bekannt war. Diese Investition war nur lohnend, wenn ihr Geschäftspartner vertrauenswürdig war. Auf diese Weise konnte festgestellt werden, welche Bezirke als besonders vertrauenswürdig gelten. Folgende Ergebnisse wurden erhoben:

- Es herrscht große Übereinstimmung zwischen den Versuchspersonen darüber, welche Bezirke als „vertrauenswürdig“ gelten und welche nicht, unabhängig von den Wohnbezirken der Versuchspersonen.
- Die Vertrauenswürdigkeit eines Bezirkes ist umso höher, je höher das durchschnittliche Einkommen und je weniger Ausländer dort leben.
- Das größte Vertrauen haben die Menschen jedoch in Unbekannte aus ihrem eigenen Bezirk.

Diese Ergebnisse haben eine Reihe von Implikationen, unter anderem für die Stadtplanung: Wenn wohlhabende Bezirke eher Investitionen anziehen als ärmere, dann wird die Kluft zwischen armen und reichen Distrikten immer größer, eine Entwicklung, die soziale Spannungen erhöht und kaum im Interesse einer ausgewogenen Stadtpolitik liegt.

Research presented at this week's annual conference of the European Economic Association gives new insights into how we decide whether to trust a stranger enough to do business. The evidence from a 'trust experiment' conducted by economists **Christian Zehnder** and **Armin Falk** with 1,000 inhabitants of Zurich reveals that:

- People clearly discriminate, displaying different levels of trust towards strangers depending on which district of the city they live in.
- People agree to a large extent on which are the good and bad districts, regardless of which district they themselves live in.
- The richer a district's inhabitants and the lower the fraction of foreigners, the higher the trust placed in strangers from this district.
- The districts whose inhabitants are most trusted are also the ones with the most trustworthy inhabitants.
- People place more trust in strangers from their own district. In many cases, this in-group bias is so strong that it dominates the other effects of discrimination.

In business life, we can often only take advantage of a potentially attractive trading opportunity if we trust a stranger. But in many situations, trusting is dangerous: if our trust in a trading partner is not justified, we may be exploited and suffer losses. Thus, correctly deciding which strangers can be trusted is crucial for economic success.

But until now, despite its obvious importance, surprisingly little is known about discrimination in trust decisions. In Zehnder and Falk's field experiment, the participants make a contingent trust decision: before knowing the residential district of their trading partner, they have to make a risky investment decision for each district. Investing is only profitable for the investor if the assigned trading partner turns out to be trustworthy. Thus, comparing the investment levels towards the inhabitants of the different districts makes it possible to identify which districts in Zurich are trusted and which not.

The researchers find that people clearly discriminate when trusting. Subjects display different levels of trust towards strangers depending on which district the strangers live in. The observed discrimination pattern is quite systematic, that is, people agree to a large extent on which are the good and bad districts, regardless of which district they themselves live in.

But what determines whether the inhabitants of a specific district are trusted? It turns out that two factors are key: the income level in the district as well as the fraction of foreigners. The richer a district's inhabitants and the lower the fraction of foreigners, the higher the trust placed in strangers from this district.

Is the discrimination justified? Interestingly, the researchers find that the different investment levels towards the different districts are not only a consequence of mistaken prejudices or taste.

In general, the districts that receive the high investments are also the ones with the most trustworthy inhabitants. Thus, the discrimination pattern in the experiment is at least partly the result of correctly anticipated differences in districts' trustworthiness.

Furthermore, there is also strong evidence of in-group favouritism: on top of the discrimination pattern, people have a strong tendency to send higher amounts to strangers who belong to their own district, compared with strangers from other districts. In many cases, this in-group bias is sufficiently strong such that it dominates the other discrimination effects.

These results are of economic interest. If people discriminate between the inhabitants of different city districts, it may have important consequences, not only for people living in a particular district but also for districts as a whole.

For individuals, it is relevant insofar as many economically relevant transactions are influenced by trust. In the case of hiring two otherwise equal applicants, they may be trusted differentially simply because they live in different parts of the city.

For districts, inasmuch as trust fosters investments and economic engagement, trust discrimination leads to a divergence of different districts. If districts with a high reputation receive high investments, they tend to become richer and even improve their status. But poorer districts, receiving lower investments, may eventually get worse.

From a city development perspective, this is likely not to be optimal. If policy-makers want to counteract this divergence, they must be able to diagnose the differences in reputations. This study shows how this can be done using a controlled field experiment.

**Notes for editors:** 'Trust and Discrimination – A Citywide Experiment' by Christian Zehnder and Armin Falk was presented at the joint congress of the European Economic Association and the Econometric Society European Meeting (EEA-ESEM) at the University of Vienna, August 2006.

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#### **About the 2006 EEA-ESEM Congress**

The 2006 EEA-ESEM congress will feature the work and findings of leading scholars in economics. The event marks the 21<sup>st</sup> Annual Congress of the European Economic Association and the 61<sup>st</sup> European Meeting of the Econometric Society. It will be held in the campus of the University of Vienna, which is in the heart of the city's historic downtown. The Institute for Advanced Studies, Vienna, and the University of Vienna are the local organizers of the meeting.

**More at:** <http://www.eea-esem2006.org/>

#### **About the European Economic Association**

The European Economic Association (EEA) is an international scientific body, with membership open to all persons involved or interested in economics. It publishes the *Journal of the European Economic Association*. [www.eeassoc.org](http://www.eeassoc.org)

#### **About the Econometric Society**

The Econometric Society is an international society for the advancement of economic theory in its relations to mathematics and statistics. It publishes the journal, *Econometrica*. [www.econometricsociety.org](http://www.econometricsociety.org)

**Photos of the congress and press conference are available at the press corner at [www.eea-esem2006.org](http://www.eea-esem2006.org)**

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