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## European Economic Review

journal homepage: [www.elsevier.com/locate/eev](http://www.elsevier.com/locate/eev)

# Employment, wages, and the economic cycle: Differences between immigrants and natives

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## ARTICLE INFO

### Article history:

Received 30 October 2006

Accepted 24 April 2009

Available online 15 May 2009

### JEL classification:

E32

F22

J31

### Keywords:

Immigration  
Unemployment  
Business cycle

## ABSTRACT

In this paper, we analyse differences in the cyclical pattern of employment and wages of immigrants and natives for two large immigrant receiving countries, Germany and the UK. We show that, despite large differences in their immigrant populations, there are similar and significant differences in cyclical responses between immigrants and natives in both countries, even conditional on education, age, and location. We decompose changes in outcomes into a secular trend and a business cycle component. We find significantly larger unemployment responses to economic shocks for low-skilled workers relative to high-skilled workers and for immigrants relative to natives within the same skill group. There is little evidence for differential wage responses to economic shocks. We offer three explanations for these findings: an equilibrium search model, where immigrants experience higher job separation rates, a model of dual labour markets, and differences in the complementarity of immigrants and natives to capital.

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## 1. Introduction

In this paper, we investigate the way different immigrant groups respond to the economic cycle compared to native workers. Our analysis distinguishes between immigrants from OECD- and non-OECD countries, and covers two of the largest economies in Europe: Germany and the UK. Both countries have large immigrant populations, which differ in terms of origin composition and educational background. We show that there are large differences in cyclical responses of unemployment between immigrants and natives in both countries. We demonstrate that substantial differences in cyclical patterns remain, even within narrowly defined skill groups. We also show that developments in the relative wage position of immigrants have been quite different in the UK and Germany, in particular over the last decade.

We then estimate a factor-type model that separates responses to economic shocks from a secular trend and allows us to obtain a summary measure for differences across and within education groups. This analysis confirms the larger cyclical response of unemployment for immigrants, in particular for those from non-OECD countries, in both Germany and the UK. Our results are robust to alternative measures of economic shocks, and are not driven by selective in- and out-migration of individuals over the economic cycle.

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We provide a number of possible explanations for our findings. First, we consider an equilibrium search model of the type set up by [Diamond \(1982\)](#), [Mortensen \(1982\)](#), and [Pissarides \(1985\)](#). In this model, differences in the hiring intensity between groups in up- and downturns occur if job separation rates differ. We provide evidence for differences in job separation rates between immigrants and natives, even within education groups. Second, we consider a dual labour market. As a third explanation, we investigate the possibility of differences in capital–labour complementarities between groups. We conclude that each of these explanations may contribute to the pattern we observe in our data.

The structure of the paper is as follows. In Section 2, we provide some background information about immigration to Germany and the UK, and economic outcomes and composition of immigrants in the two countries. We then discuss the data we use for our analysis. Section 3 illustrates economic outcomes of different groups of immigrants in both Germany and the UK over the economic cycle, compares these to outcomes of native workers, and investigates how much of these differences are due to differences in education, age, and regional allocation. Section 4 estimates a model that summarises these differences in a set of parameters that allows comparisons between groups and across countries. Section 5 hypothesises about possible explanations for our empirical findings.

The differential response of immigrants even within the same skill groups, so far largely overlooked in the economic literature (a notable exception is recent work by [Barth et al., 2004, 2006](#)), has important implications for immigration policy as well as for the analysis of the economic impact of immigration and the adaptation process of immigrant groups in their host countries. We discuss these in Section 5.

## 2. Background and data

### 2.1. Migration to Germany and the UK

Both the UK and Germany experienced large waves of immigration in the period after World War II. The first large wave into Germany was an inflow of ethnic Germans, expelled from former German territory, and totalling 12 million between 1945 and 1949 (see [Oezcan, 2004](#), for details). After 1955, the West German economy grew rapidly and immigration from Italy, Spain, Greece, Turkey, Portugal and Yugoslavia in the late 1950s and early 1960s led to a rise in the number of foreign workers to 2.6 million in 1973, or 12 percent of the total labour force. The period after 1973 was characterised by family reunification, and the early 1980s saw the arrival of the first larger waves of asylum seekers. Towards the end of the 1980s, and accelerated by the fall of the Berlin wall, Germany experienced a new large immigrant inflow from the East. The two largest groups were ethnic German immigrants (so-called *Aussiedler*), who migrated from Eastern Europe and beyond, totalling 2.8 million between 1987 and 2001, and migrants from Former Yugoslavia who came as refugees as a result of the Yugoslav wars of the 1990s. In 2002, there were 7.3 million foreign citizens living in Germany, representing 8.9 percent of the total population (German Statistical Office).

Immigration legislation in the UK after World War II, embodied in the 1905 Aliens Act and the 1948 British Nationality Act, distinguished formally between Commonwealth and non-Commonwealth citizens. Immigration of Commonwealth citizens was most pronounced in the two decades after the war. While the early 1950s were characterised by migration from the Caribbean, in the late 1950s a growing number of immigrants arrived from India, and later from Pakistan and Bangladesh. After the 1971 Immigration Act brought an end to the privileged position of Commonwealth citizens, an increasing share of immigration was due to family unification, which remained for a time largely unrestricted. Recently, immigration has increased again significantly, mainly as a result of the strong British economy and, after May 2004, the accession of the new EU member states. In 2002, there were 4.9 million foreign born individuals living in the UK, representing 8.3 percent of the total population (British Labour Force Survey, own calculations).

### 2.2. Data and samples

Our analysis is based on two large longitudinal data sets. For Germany, we use an administrative data set provided by the Institute for Employment Research in Nuremberg (the IABS), which is a 2 percent sample of all dependent employees that are subject to social security contributions. We focus on West Germany, excluding Berlin, due to the differences in wage structure and immigration experience in East Germany and the time span analysed in this study. For the UK, we use the British Labour Force Survey (LFS). The LFS is a survey of private households living in Great Britain, conducted biannually from 1973 to 1983, and annually between 1984 and 1991. Since the spring quarter 1992, the survey is conducted quarterly as a rotating panel, with individuals included in five consecutive waves. Questions on earnings were not asked before the winter quarter of 1992/1993. Both data sets cover approximately the same time period, 1982–2001 for Germany and 1981–2005 for the UK, and are sufficiently large to analyse minority populations. We provide more details on the data in Appendix A.

For the UK, immigrant status is defined by country of birth. In contrast, official data in Germany distinguish between foreign and German citizenship (following the principle of nationality by descent). In the IABS, therefore, we only observe an individual's citizenship but neither the place of birth nor the year of entry into the country. As an individual born in Germany to foreign parents does not automatically obtain German citizenship, there are some individuals included in our

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