IZA

phone: +49 (228) 3894-0
fax: +49 (228) 3894-180
e-mail: iza@iza.org
web: www.iza.org

Institute for the Study of Labor
Institut zur Zukunft der Arbeit

P.O. Box 7240
53072 Bonn, Germany

CEO and Director:
Prof. Dr. Klaus F. Zimmermann

Award Statement

Prize Laureates 2008

Richard Layard
Stephen Nickell

Institute for the Study of Labor
Institut zur Zukunft der Arbeit

phone: +49 (228) 3894-0
fax: +49 (228) 3894-180
e-mail: prize@iza.org
web: www.iza.org/prize

IZA Prize Committee

Prof. George A. Akerlof, Ph.D.
University of California, Berkeley; IZA

Prof. Richard Portes, Ph.D.
London Business School; President CEPR

Prof. Dennis J. Snower, Ph.D.
President, Kiel Institute for the World Economy; IZA

Prof. Jan Svejnar, Ph.D.
University of Michigan, Ann Arbor; IZA

Prof. Dr. Klaus F. Zimmermann
CEO and Director IZA; President DIW Berlin; University of Bonn

The IZA Prize in Labor Economics 2008 goes to the outstanding European labor economists Richard Layard and Stephen Nickell for their path-breaking work on the relationship between labor market institutions and unemployment. Their research provided a theoretical and empirical framework for the analysis of equilibrium unemployment and the impact of labor market institutions on economic performance. Shaping the views of scholars and policymakers on how to address unemployment, the contributions of Layard and Nickell have served to illuminate the policy discourse in Europe and increased academics' understanding of the nature and causes of involuntary joblessness.

Their 1991 book "Unemployment: Macroeconomic Performance and the Labour Market" (co-authored with Richard Jackman) and their 1999 chapter "Labor Market Institutions and Economic Performance" in the *Handbook of Labor Economics* have become modern classics in labor economics. Layard and Nickell's approach incorporates stocks as well as flows into and out of unemployment in a way that previous models had neglected. Their work thus provides a unified framework for studying the sources of unemployment and the determinants of unemployment dynamics. In particular, it highlights the importance of understanding the impact of labor market institutions on labor market performance. For instance, Layard and Nickell have shown that stricter employment protection regulations do not generally increase the level of unemployment, but increase the persistence of unemployment by reducing short-term unemployment at the cost of raising long-term unemployment. The prize-winners have also pointed out that generous unemployment benefits need not be detrimental if they are granted only for a limited time and are accompanied by adequate instruments that require (and assist) unemployed individuals who are able to work to actively search for a new job. Moreover, Layard and Nickell have shed light on the interaction between wage setting institutions and unemployment. For example, they showed that higher union coverage tends to increase unemployment, but these negative effects of collective wage bargaining can be offset if unions and employers coordinate their wage bargaining activities effectively.

A recurrent theme in Nickell's research is the role of labor market institutions and the interplay between unemployment, wages and investment, the latter being the focus of his early work. In each area he has developed the relevant theory and demonstrated its empirical relevance by using the theory to inform structural econometric models. Nickell pioneered the microeconometric analysis of unemployment duration and the way in which the behavior of the unemployed affects wage formation. His 1979 *Econometrica* article, "Estimating the Probability of Leaving Unemployment," broke new ground for the microeconometric analysis of unemployment duration and unemployment benefits. His seminal 1981 *Econometrica* paper, "Biases in Dynamic Models with Fixed Effects," inspired a whole new econometric and labor economics literature on the estimation of panel data models. In his 1990 *Economic Journal* article on "Insider Forces and Wage Determination" (with Sushil Wadhwani) he showed that the actions of those who already have secure employment have significant impact on the determination of wages, but that persistent long-term unemployment cannot be solely attributed to such insider.

Nickell has also made formidable contributions to the literatures on labor supply, firms' investment decisions, and productivity. All his work uses first-class technique and painstaking data collection. His 1996 *Journal of Political Economy* article entitled "Competition and Corporate Performance" was one of the first articles that provided systematic evidence on the impact of competition on productivity. Nickell has shown that market power tends to reduce productivity, whereas competition has a positive influence on firms' productivity by increasing total factor productivity growth.

Apart from his fundamental work on the determinants of unemployment, Richard Layard has also studied such diverse topics as education, happiness, and income inequality. For instance, in his 1974 *Journal of Political Economy* article on "The Screening Hypothesis and the Returns to Education" (with George Psacharopoulos), he challenged the view that education primarily serves as a signaling device for pre-existing ability differentials by supporting the human capital interpretation of educational investments having direct productivity-enhancing effects. In addition to his academic contributions, Layard has always set a high value on translating scientific results into political practice. In his early career he was Senior Research Officer for the Robbins Committee on Higher Education. He was founder-director of the Centre for Economic Performance (CEP) at the London School of Economics, one of Europe's leading research groups covering all areas of economic policy. Lord Layard actively participated in the policy debate and worked as an economic advisor for several government institutions, such as the British Department for Education and Skills, HM Treasury, or the Russian Government.

Layard is an early advocate of a welfare system based on the philosophy of welfare-to-work. In this respect, he advised the British Labour government from 1997 to 2001 on policies to fight youth and long-term unemployment. He pursued a welfare reform based on a system of conditionality: benefit payments to unemployed are provided in return for their active participation, e.g. in training activities or voluntary sector work. This idea has heavily influenced the "New Deal" programs implemented by the Labour government since the late 1990s.

Layard's recent research focus is on the economics of subjective well-being. He aims to achieve a unified understanding of the insights of economics, psychology, neuroscience and philosophy. Specifically, Layard has analyzed the influence of social comparison as well as income aspiration processes. He pointed out that both have profound implications for optimal taxation of labor income and consumption. Layard has argued that – since individuals' well-being strongly depends on their relative income compared to peers like neighbors or colleagues – people could be stuck in a "hedonic treadmill": in order to increase their relative income and status, many people tend to work "too much" and ultimately impair their life satisfaction.

Lord Richard Layard is currently Emeritus Professor of Economics at the London School of Economics and Director of the "Wellbeing Research Programme" at the CEP. He is a Fellow of the Econometric Society. Since 2000, he has been a Labour life peer in the House of Lords. Stephen Nickell is currently the Warden of Nuffield College, University of Oxford. He has served as Editor of the *Review of Economic Studies* and the *Oxford Bulletin of Economics and Statistics*. Nickell is a Past President of the Royal Economic Society and a Fellow of the Econometric Society. In 2007 he was appointed Commander of the Most Excellent Order of the British Empire.

The IZA Prize in Labor Economics 2008 honors the work of two European scholars whose contributions have impressively demonstrated the practical relevance of labor market research for today's policymakers.

October 2008

George A. Akerlof *Richard Portes* *Dennis J. Snower* *Jan Svejnar* *Klaus F. Zimmermann*