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COMPACT

CONSIDERING THE FUTURE OF LABOR

Evaluation is Essential for a Reform of Active Labor Market Policy

While there is a growing consensus that Germany needs to reform its active labor market policy, concrete reform efforts are still hotly debated. One year after the Nobel Prize in Economics was awarded for methodological progress in evaluating labor market policies, the implications for Germany and the proper policy responses have only recently entered the public discussion.

According to the federal government, the proposed reform of employment promotion is supposed to “avert unemployment” in the future and to “reintegrate unemployed workers into the working life as soon as possible”. To achieve these goals, the government wants to design a more effective placement procedure, reinforce and restructure occupational training, and better integrate the principle of promoting and demanding (“Fördern und Fordern”) into the system of employment promotion. When the federal government introduced an employment promotion reform bill (“Job-AQTIV-Gesetz”) in July 2001, IZA almost simultaneously published a study on the effectiveness of current active labor market policies. This study, originally written for the German Finance Ministry, is now available as a book (C. M. Schmidt/K. F. Zimmermann/M. Fertig/J. Kluge: *Perspektiven der Arbeitsmarktpolitik – Internationaler Vergleich und Empfehlungen für Deutschland*, Berlin/Heidelberg 2001, ISBN 3-540-42159-9). The following article is based on the results of this IZA study.

A lot of money for programs – little knowledge about their success

Germany currently makes substantial funds available for active labor market policies. More than DM 30 billion were spent in 1998 alone, and as much as DM 36 billion per year in 1999 and 2000. If you add the funds that do not count as discretionary expenditures, but generally enter the books as funds for active labor market policies, then the current total amounts to more than DM 40 billion an-

nually. This is reason enough to question the effectiveness and efficiency of these generously funded labor market programs.

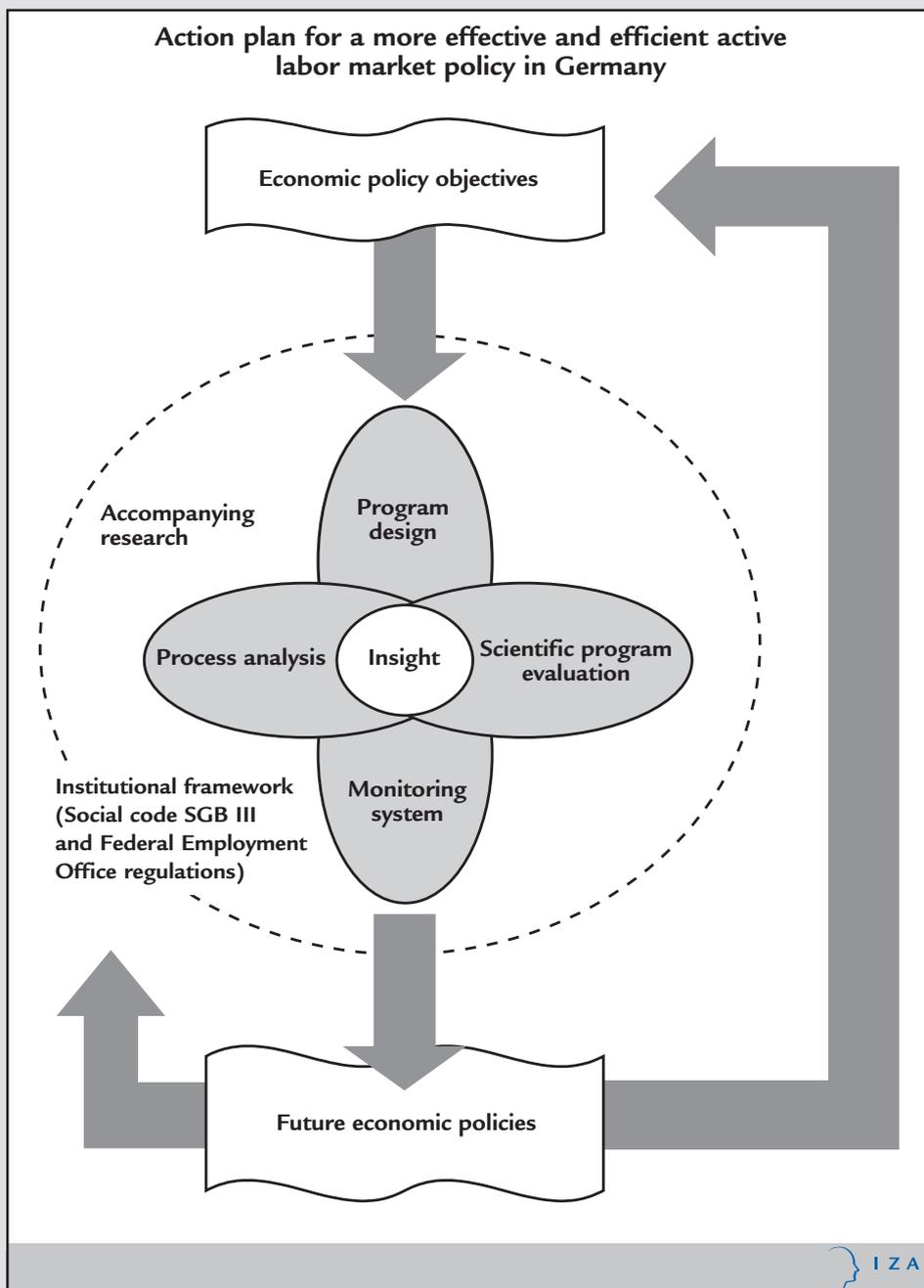
Remarkably, the knowledge about the (cost-) effectiveness of the individual programs is anything but sufficient. Instead, the government agencies involved in labor administration tend to regard the instruments of active labor market policy and the study of their impact as completely separate projects. This renders a proper evaluation all but impossible. Using totally inadequate methods, such as “relief accounting”, the government creates the wrong impression that labor market policy instruments contribute significantly to a permanent reintegration of unemployed workers. But it is not enough to simply measure the “success” of a labor market program in terms of the share of total participants who (temporarily) managed to reenter the primary labor market after joining the program. This practice reveals a fundamental misconception of the underlying evaluation problem: The construction of an appropriate comparison situation is the sine qua non for any serious evaluation of the program’s success.

The majority of active labor market policies are targeted at individual placement problems. It is an often disregarded fact that unemployment, in most cases, cannot be explained by one single cause such as the lack of adequate qualifications. In fact, a closer look at the structure of unemployment shows that the problem of reintegrating unemployed workers is determined by a complex interaction of several different restraints. It is therefore impossible to achieve successful reintegration by giving a large number of unemployed workers access to non-company training programs. Current active labor market policies in Germany are a flawed combination of one-dimensional, non-company specific instruments with too little information on their impact.

An analysis of the institutional composition of active labor market policies in Germany reveals the enormous administrative complexity of some measures, mostly public employment and structural adjustment programs. At the same time, many programs are not sufficiently focused on specific target groups. Yet, international experience is clearly unambiguous in this respect: Promising and potentially cost-



effective programs require a transparent, easily comprehensible, and time-limited allocation of government funds to a precisely defined target group. The extensive need for discretionary decisions and administrative tasks on the part of the program administrators. This is due to multitude of norms, exceptions to the norms, “exceptional exceptions”, or special rules for eastern Germany in the area of public employment programs, which are clearly inefficient and consume substantial resources in the at the local job centers. The upcoming reform of employment promotion ought to replace this counterproductive



process with a more integrated approach as soon as possible.

Analyzing the counterfactual

The crucial question in evaluating the effectiveness of any active labor market policy is, whether the program participants have on an average achieved a more favorable labor market outcome than they would have without participating. The latter is referred to as the counterfactual situation. Only if the actual employment situation of a program participant shows substantial improvement over an adequate counterfactual comparison situation, can this success be attributed to the program, which may then be considered effective.

But this merely constitutes a basic precondition for a successful program. A

program that results in only minor changes of the situation must not be cost-intensive if it were to be implemented permanently. In order to find out whether a certain program is truly worth implementing, a further comparison must confront this observed effect with the direct and indirect costs involved. In general, the high costs of labor market interventions require substantial effects to make them socially justifiable.

The observable units and target quantities relevant for such an analysis are mainly determined by the program type and the available data. The process of scientific evaluation cannot be seen as separate from the design and implementation of the program, but it has to occur simultaneously. The international experi-

ence with evaluating government interventions, particularly in North America, clearly suggests that an experimental evaluation, jointly planned and implemented on a partnership basis by all parties involved, is in all respects superior to a non-experimental ex post evaluation.

International experience

The IZA study outlines the existing international experience with the effectiveness of labor market policies and the lessons to be learned for the German case. There is ample empirical evidence on the effectiveness and efficiency of programs in the United States and, with certain limitations, for Canada as well. Evidence for most European countries is much harder to come by, and very few studies exist for Germany.

This alone would not constitute a serious problem if the insights gained from the U.S. example were easily transferable to the German labor market. But this is extremely difficult because the institutional framework as well as the primary purpose of active labor market policy in the two economies differ substantially. The most striking difference is that Germany's active labor market policy aims primarily at a permanent reintegration of the unemployed into the labor market, rather than the elimination of low-paid jobs that provide insufficient income.

The reason for these different objectives probably lies in the different institutional design of the social security system in both countries. This does not mean that Germany cannot learn important lessons from the North American evidence for the design of its own active labor market policy, but it means that the insights on the effectiveness or efficiency of particular policies are not easily transferable.

From a methodological perspective, the main question is how to determine the effectiveness of each individual policy program. First of all, it is important to note that internal accounting methods, such as the reintegration statistics provided by the job centers, do not satisfy the strict scientific standards. The evaluation of any labor market program requires a specific concept – not just a universal check list. Free access to data is therefore the first step toward a potentially useful evaluation. It is also necessary to take into account in how far the best alternative use of the allocated funds would have contributed to reaching the goal – an approach which is often neglected in the practice of evaluation.

The IZA study identifies three main propositions from the international methodological debate: (i) Any serious evaluation study must create a plausible counterfactual situation that shows what would have happened without the labor market policy in question. Recording the results for program participants alone is useless although it is common practice at least in Germany. (ii) Every empirical analysis requires specific assumptions for the individual situation, which have to be revealed. Combined with free data access for independent researchers, this allows at least for potential control and satisfies the necessary quality standards. (iii) In general, experimental studies are most appropriate for a counterfactual analysis. It is possible to construct non-experimental control groups, but the results typically exhibit a high degree of variability. In this case, too, the assumptions made must be revealed in detail. Despite the methodological progress in the non-experimental approach, evaluation research will continue to depend on experiments to produce convincing results.

Action plan for labor market policy

The IZA study proposes an action plan for a new German labor market policy, in which close cooperation between politics, labor administration, and science is considered crucial (see diagram ▶ page 2).

In terms of methodology and conceptualization, this action plan based on partnership enters new territory, especially with respect to the proposed involvement of scientific insights in planning, implementation, and evaluation of labor market policies. This approach is innovative and at the same time uncomfortable, but it seems to be the only way to achieve a truly successful active labor market policy.

What are the most promising programs?

According to the type of intervention, the German active labor market policy can be classified into the following groups: (a) policies for human capital enhancement, (b) monetary and non-monetary incentive schemes, (c) public employment and structural adjustment programs, and (d) miscellaneous active labor market policy programs (see *synoptic overview* ▶ *aside*).

These interventions aim at labor market integration with an employment component and a wage component. Systematic findings for all areas are only available for North America and thus play a significant role in the analysis. But the European experience is in many respects consistent with these results. It is important

to keep in mind, however, that the American results cannot simply be transferred into the European or German context. Since the competition model holds for the American labor market, wage effects play a major role. In contrast, the European labor markets, and the German labor market in particular, are characterized by wage rigidities and collective wage bargaining, which creates a stronger emphasis on employment effects.

According to the state of the art of international science, public employment programs are clearly problematic. It is difficult to justify them conceptually, their implementation is often associated with administrative complexity, they may lead to displacement effects, and most of them are useless for the purpose of labor market integration. The fact that these instruments are applied so frequently and permanently in Germany and Europe is probably due to the lack of evaluation or to the existence of different (political and

economic) objectives. It is extremely doubtful whether public employment and structural adjustment programs have any positive effect on the situation of the long-term unemployed by bringing them back into regular employment. Given the enormous costs of these programs, their at best moderate effect is certainly too small to guarantee cost-efficiency of these programs.

Policies for training and further education, on the other hand, can have a positive effect. However, every government program varies in its impact on different groups of people. In the American context, for instance, it turned out that substantial improvements could be achieved for disadvantaged female adults, while no effect at all was observed for male or female youths. Further education for high-school dropouts was equally ineffective. Other programs, in contrast, were successful in preventing vocational training dropouts. Likewise, there are no

Programs of Active Labor Market Policy in Germany – Synoptic Overview				
Program	Definition of Entry Requirements	Limitation of Entitlement Period	Focus on Target Group	Administrative Complexity
Subsidization of (further) training	Complex due to exceptions and many undefined legal terms	Insufficient due to “supplementary funding“ and other exceptions	Low	Low
Training programs	Improvable	Clear with no exceptions	Improvable	Relatively low
Integration subsidy	Complex due to various undefined legal terms	Insufficient due to undefined exceptions	Improvable	Relatively high
Hiring subsidy for business start-ups	Complex due to requirements for employer and employee	Clear with no exceptions	Improvable	Relatively low
Integration contract	Clear and simple	Clear with no exceptions	Improvable	Low
Subsidization of self-employment	Clear and simple	Clear with no exceptions	Improvable longer preparation courses	Low
Public employment and structural adjustment programs	Virtually non-existent	Insufficient due to numerous exceptions and special rules	Virtually non-existent	Extremely high

For a more detailed analysis of these programs with respect to the individual criteria, see chapter II of the IZA study.



unambiguous results in the European and German context although a positive employment effect was recorded for some programs.

All in all, wage subsidies and other incentive mechanisms have proven to be most effective. International evidence – and, with some limitations, European evidence as well – suggest, despite limited transferability of the results to the German labor market, that direct employer wage subsidies in combination with targeted on-the-job training may be considered a priori to be promising and potentially cost-efficient. In the German context, in which labor elasticity is low and unemployment is high, it is especially important to encourage employment by subsidizing employer wage costs. It is therefore highly deplorable that the wage subsidy approach has so far achieved little recognition in Germany. The current efforts to evaluate the effectiveness of various approaches to subsidizing the low-wage sector through model projects in several German *Laender* are aimed by their very design at discrediting this policy instrument.

Relying on the applicability of recent international findings to Germany, the main advice to policymakers must be to eliminate public employment programs in favor of employment subsidies accompanied by adequate training programs. It also seems useful to shorten the current benefit entitlement period. If the unemployed accepts a job, the saved funds could be used as employer subsidies. Otherwise, benefits would drop to a fixed, lower level.

Reform proposals fall short

Despite several promising approaches, the reform proposals of the German government fail to go far enough. Some of the proposed changes are not in line with an efficiency-oriented labor market policy and may even be counterproductive if the government wants to achieve its self-proclaimed goal.

1. Plans to extend rather than reduce public employment programs

Recent proposals tend to avoid the question of public employment programs. These programs, combined with structural adjustment programs, account for the lion's share of expenditures in eastern Germany although they are the least promising in terms of reintegration. Instead of a systematic reduction of these excessive programs, the government

plans to extend them to female job re-entrants. This kind of reform is counterproductive. Public employment programs in effect lower, rather than raise, the prospects of successful reintegration.

2. Public employment and structural adjustment programs are useless instruments

The structural adjustment programs, originally scheduled to expire in 2002, have unfortunately been extended until 2006. In the wake of the employment promotion reform, another comparable instrument, referred to as the “job-creating promotion of infrastructure”, may even be added. Although the drafted reform proposal is not very explicit about this instrument, there is reason to fear that this may constitute yet another form of public employment program which could lead the participants even further away from the primary labor market.

3. Focus should be on wage subsidies

Much wider use ought to be made of temporary subsidies to regular employment, particularly of direct wage subsidies to certain target groups (so-called integration subsidies). For the purpose of implementing an active labor market policy characterized by simplicity, comprehensibility, and time limitation, the priority should be a standardization of the rules for integration subsidies.

4. No expansion of wage compensation benefits

Among the preventive measures proposed to prevent unemployment is an expansion of wage compensation benefits. These measures, however, cannot seriously be expected to avoid unemployment. They may instead lead to a mere shift in unemployment spells because they treat the symptoms rather than the cause of the problem. Promising prevention measures have to account for the determinants of the labor market outcome, including the qualification of workers as well as their geographical mobility. A better promotion of vocational training programs for youths, especially for school dropouts, along with incentives for continuous further training and higher geographical mobility of the unemployed will most likely have a better chance of success.

5. Time-intensive integration agreements

A binding “integration agreement” between the unemployed and the job center

certainly makes sense if it includes not only sanctions for non-observance by the unemployed, but also intensive support on the part of the job counselor. However, international experience with this type of program, e.g. in the Netherlands (“counseling and monitoring”) and in the United Kingdom (“New Deal”), shows that it can only be successful if a considerable amount of time is spent on support and guidance of the unemployed. It is impossible to expect a positive impact on the reintegration prospects from a one-time “contract signing” alone.

6. Evaluation of job rotation

Introducing the concept of job rotation according to the Danish model would in principle make sense. In the light of corporate practice, however, its success cannot be guaranteed. Still, this instrument should be tested over a longer period of time. A scientific evaluation of its impact remains nonetheless of great importance.

Conclusion

The action plan for a more effective and more efficient labor market policy in Germany as proposed by IZA assumes close cooperation during the design of the proposed programs and requires equally cooperative implementation and evaluation efforts. In other words, the separation of program design and implementation by policymakers and the subsequent scientific evaluation (on the basis of fragmented data), as it has been common practice in Germany, should be stopped. What we need is a continuous, networked process in which politics and science are equally eager to exchange information at an early stage and to integrate evaluation results into labor market policy. This requires the permanent availability of relevant data for scientific analysis as well as the willingness to acknowledge the findings and implement them – without false taboos – into concrete policy changes. The first, careful steps toward more intensive cooperation are currently being initiated. This can only benefit labor market policy.

Is the German Pension Reform Falling Short? International Pension Experts Met at an IZA Conference in Berlin

Following an invitation by IZA, a number of international pension experts came together in Berlin May 19–21 to discuss the challenges to the present pension systems. The conference participants generally agreed that the recent efforts to reform the German pension system constituted an important, yet still too cautious step. According to the experts, too much strain remains on the pension funds, which will require further reforms in only a few years in order to prevent a large increase in contribution rates. There was widespread agreement, however, that Germany's reform plan represents a move in the right direction.

Over the course of the conference, the debate covered a great variety of topics. Special attention was paid to early retirement as the crucial link between labor market and retirement income. A far-sighted pension policy should counteract rather than reinforce the trend toward voluntary early retirement, which remains strong despite its recent decline. For political reasons, the mathematically required discounting of pensions has not always been implemented. In this context, however, it is also necessary to consider the impact of discounted pensions on the entire economic system.

Richard Hinz from the U.S. Department of Labor referred to the long-term experience

with the so-called 401(k) plans in the United States, after which Germany's recent reforms were modeled. *Richard Ippolito*, George Mason University, showed that pension provision models similar to the one which has now been established in Germany are just as suitable for motivating and committing employees to their companies as the old-style employee pension scheme.

Franco Modigliani, Nobel laureate from the Massachusetts Institute of Technology, presented a concept that would enable policymakers to reorganize the American pension system into a fully funded system within 70 years. Today the American system operates, similar to the German public pension scheme, on a pay-as-you-go basis. In contrast, *Friedrich Breyer* from the University of Konstanz, Germany, dismissed radical changes as unfeasible. *Joseph Stiglitz*, former chief economist of the World Bank as well as *Ken Apfel*, U.S. Social Security Commissioner of the Clinton administration, also remained sceptical in this respect.

IZA Director *Klaus F. Zimmermann* concluded: "Germany's recent decision to introduce a combination of pay-as-you-go and funded system is in principle the right approach to solving the problem of financing our pension system. However, the need for further adjustments is al-

ready recognizable. A mandatory private insurance certainly would have made sense. That our policymakers lacked the courage to take this step is unfortunate and could get us into more trouble over the years to come."

All relevant presentations from the conference are available from the IZA homepage www.iza.org.



ESSLE 2001 – IZA/CEPR European Summer Symposium Took Place for the Third Time

The third IZA/CEPR European Summer Symposium in Labor Economics (ESSLE) took place April 24–28 at the Deutsche Post World Net Management Training Center at Buch am Ammersee in Bavaria. For one week, renowned scholars in the field of labor economics from around the world presented and discussed their current research results.

IZA program director *Torben M. Andersen* (Aarhus University, CEPR and IZA) opened the conference with an analysis

of the different channels through which integration between economies can affect the elasticity of employment with respect to wages, and the subsequent implications for the labor market. *Pierre Cahuc* (EUREQua, CNRS, Université de Paris I, CREST-INSEE and IZA) used a unified framework that was able to mimic both flexible as well as rigid labor markets, to analyze the effects of introducing experience rating to (co-)finance the unemployment program of a stereotypical European labor market. *Regina Riphahn*

(University of Mainz, CEPR and IZA) presented evidence on the effect of job protection on absenteeism by comparing employees who started working for a large Italian bank during and after their probation period. Simulations showed that substantial reductions in absenteeism could be obtained by relaxing job protection laws, but only so for men.

In his presentation *Wolfgang Schwerdt* (CREST, Université de Paris I and IZA) used two matched French INSEE firm

level surveys and an extraction of the German IAB firm panel to estimate the productivity of apprentices during their training in French and German firms respectively. A structural difference in productivity of apprentices in small and large firms was identified, particularly in German firms. Staying within the context of German firms, IZA program director *Thomas Bauer* (IZA and CEPR) used matched employer-employee data to look at the effect of organizational changes – such as the introduction of self managed teams or reduction in hierarchy levels – on wage inequality across and within firms.

Using a French matched employer-employee panel data set, *Jean-Marc Robin* (INRA-LEA, CREST-INSEE and CEPR) estimated an equilibrium job search model with on-the-job search and unobserved worker's productivity. On the demand side, firms differed in their (observable) marginal productivity of labor and were able to counter outside offers from competing firms. *Rudolf Winter-Ebmer* (University of Linz, WIFO Vienna, CEPR and IZA) evaluated an Austrian manpower training program that was created to accommodate the large number of redundancies after the privatization and downsizing of nationalized steel firms. The success of the project provided valuable lessons for the development of future programs. *Shoshana Neuman* (Bar Ilan University, Ramat Gan, CEPR and IZA) used data from 2,220 Israeli firms to investigate in how far macroeconomic factors were able to explain delays in contract renewal. About 86% of new contracts are signed after the expiration date and the average delay is about one third of the stated contract duration, underlining the need for an analysis.

Daniela Del Boca (University of Turin and IZA) examined the impact of employment changes for both men and women on inequality in the distribution of family income. She showed how this relationship has changed over time and across regions using Bank of Italy survey data on household income and wealth. The focus shifted to North America with *James R. Walker* (University of Wisconsin, Madison and IZA). To determine the extent to which people move for the purpose of improving their income prospects, he built a structural dynamic model to describe individual migration decisions. Empirical results using the NSLY show a significant effect of income differentials on migration, for unskilled single women with dependent children who are eligible for public assistance.



Staying with migration, *Don DeVoretz* (Simon Fraser University, Burnaby and IZA) addressed Canada's brain drain by reversing conventional logic and investigating under what conditions highly skilled Canadians would stay in Canada given the substantial returns of moving to the United States.

IZA program director *Rainer Winkelmann* (IZA and CEPR) introduced a new count data model that outperformed all existing models when applied to the evaluation of the effect of the 1997 German health care reforms on the number of individual doctor visits. "Health" was the bridge to the presentation by *Maarten Lindeboom* (Free University of Amsterdam and IZA) who used Dutch longitudinal data to tackle the problem of the interrelation between health and work decisions of elderly workers by specifying and estimating an integrated model for work, health and health reporting mechanisms.

Returning to the old tradition of economic fieldwork and data collection *Lorenz Götte* (University of Zurich) used data from a field experiment on bike messengers in Zurich to investigate if stronger financial incentives increase effort. Stronger incentives did indeed increase work hours but also reduced per hour effort. *Christopher J. Flinn* (New York University and IZA) reported on the equilibrium effects of minimum wage changes on labor market outcomes by building upon a continuous-time model of search with bargaining in a stationary environment. He showed that recent minimum wage increases resulted in welfare improvements for young labor market participants.

John P. Haisken-DeNew (DIW and IZA) explored several different matching techniques to reconstruct PC usage in the German economy from 1984 to 1997, thereby showing how PC technology has been differentially incorporated into industries and occupations over time. Variation in high school completion rates among former West-German Laender was exploited by *Sascha O. Becker* (European University Institute and IZA), to estimate the returns to schooling by using an instrumental variable approach. *Eswar Prasad* (IMF) presented his work in which he related reservation wages of unemployed German workers to macroeconomic factors – including e.g. aggregate and local unemployment rates and the generosity of the unemployment compensation system – as well as individual specific determinants, as e.g. the length of the unemployment spell.

Co-organizer of ESSLE *Juan José Dolado* (University Carlos III, CEPR and IZA) provided a deeper understanding of the recent trends in the evolution and composition of female employment in labor markets across both the EU and US, with special emphasis on the implications for occupational segregation. *Avner Ahituv* (The Hebrew University of Jerusalem) used a simple growth model with different sectors each requiring a specific technology and human capital to illuminate the different effects of technological change on older and younger workers.

Patrick Puhani (University of St. Gallen, CEPR, ZEW and IZA) proposed a methodology that makes less restrictive identifying assumptions than some previous studies, in order to test the hypothesis that rising unemployment rates of the low-skilled in Europe are related to the development of wages in this group. *Laszlo Goerke* (University of Konstanz and IZA) showed that in a world with tax evasion by firms and workers, a change in the legal incidence of taxes has consequences for the economic incidence – violating the "most basic theorem of public finance" – when the penalty for evasion depends on the level of undeclared income or if evasion opportunities are restricted.

This concluded a very successful conference that will be held again next year. The papers presented at ESSLE 2001 are still available at the IZA web page.

Should Immigration of High-skilled Workers be Encouraged ? IZA Study Analyzes Demand for Foreign Skilled Labor

In March 2000 the *Bundesministerium für Bildung und Forschung* (Federal Ministry for Education and Research) asked the Institute for the Study of Labor to carry out a survey about "International Mobility of high-skilled workers". For this the IZA International Employer Survey 2000 was conducted in the fall of 2000. In a poll 850 companies were interviewed on strategies and experiences with the recruitment of international skilled employees in four European countries. 340 of the interviewed companies are based in Germany, and 170 each in: France, Great Britain and the Netherlands. The results of the poll are now available as an IZA Research Report on the IZA-Homepage (*R. Winkelmann/A. Kunze/R. Locher/M. Ward, Die Nachfrage nach internationalen hochqualifizierten Beschäftigten – The demand for foreign high-skilled labor, IZA Research Report No. 4, available in German only*).

In Germany about 39 percent of the interviewed companies have foreign high-skilled employees. In these companies the average share of foreign high-skilled employees among all high-skilled employees amounts to 9 percent. The IT and the research sector have by far the

highest shares of companies with foreign highly qualified labor. In most cases German companies recruit foreign high-skilled labor because of their international experience (knowledge of foreign markets and foreign languages).

Do companies that employ foreign high-skilled employees differ from those that do not? This is in fact the case. There exists a clearly positive relationship between the employment of foreign high-skilled employees and the share of foreign business, the importance of foreign languages and international experience as well as various characteristics that show the extent to which a company relies on technology (Share of the highly qualified, research, telework).

Most foreign employees in German companies come from EU countries. But Eastern Europe is also an important region of origin. About 41 percent of all companies with foreign high-skilled labor employ high-skilled workers from Eastern Europe – 18 percent predominantly from Eastern Europe. Thus Eastern Europe is much more important than other non-EU regions, such as North America or Asia, from where 8

percent and 5 percent, respectively, of all companies hire most of their foreign high-skilled employees. A comparison of the four countries analyzed in the survey shows that the share of the companies that employ predominantly or solely foreign high-skilled labor from non-EU countries, is by far the highest in Germany.

The results of the survey clearly show that the companies' demand for international skilled employees is determined by complex motivations. Even though the specific international experience plays an important role, the absence of skilled workers is also an important reason why companies recruit foreign high-skilled labor. However, the majority of the interviewed companies do not recruit internationally at all. These companies consider the costs of an internationally oriented personnel policy as too high.

Almost two thirds of all companies state that difficulties to obtain a work permit for non-EU foreigners are the reason for not recruiting foreign high-skilled employees. This requires decisive action to be taken by policymakers.



Klaus F. Zimmermann Steps Down as CEPR Director of Labour Economics - IZA Continues Close Cooperation with CEPR

Due to his numerous commitments as IZA Director and DIW President, *Klaus F. Zimmermann* has stepped down from his post as Co-Director of the CEPR Labour Economics Programme. At the European Economic Association 2001 meetings in Lausanne, CEPR President *Richard Portes* took the opportunity to thank Zimmermann personally for his record-setting ten years as Programme Director. "Klaus Zimmermann has been a major force in building up the Labour Economics network and has made a considerable impact on a wide range of CEPR activities. I have valued very greatly his support and leadership in the development of the Centre. CEPR looks forward to Zimmermann, one of the leading German economists, continuing active association with our network." Both Portes and Zimmermann underscored their intention to keep up the intensive cooperation between IZA and CEPR in the future.



New IZA Research Director: Gerard A. Pfann

Reflecting the Institute's strong ambition to further increase its competence in basic research and to continuously strengthen its position in the international research community, IZA has created the new position of a Research Director and succeeded in hiring a highly renowned expert in labor economics for this post. *Gerard A. Pfann* is founder and director of the Business Investment Research Center at Maastricht University. He has acquired a worldwide reputation in conducting research in labor economics and econometrics as well as in managing research institutions. Filling this new

post while continuing to head the BIRC in Maastricht, Pfann will stimulate the efforts of IZA's local research team, coordinate the cooperation between IZA's six main research areas and help to further integrate the IZA Research Fellows into the institute's activities. "IZA is one of most important international research centers for labor economics. With its ideal research environment and its highly efficient staff and research fellow network it offers perfect conditions", explained Pfann his decision to join IZA in its efforts to place even more emphasis on internationally competitive labor market research.



Gerard A. Pfann



Special IZA Focus on Labor Policy - Hilmar Schneider new IZA Director of Labor Policy

Hilmar Schneider, who has been at IZA since July 2001, has assumed the responsibility for a new focus on scientifically founded policy advice as IZA Director of Labor Policy. With its special focus on "Labor Policy", IZA wants to provide a high standard of policy advice concerning a wide range of labor market topics. Labor market policies are designed to

eliminate, or at least compensate for, dysfunctions of the labor market and to facilitate adjustment to structural changes. In practice, however, the individual policy instruments often fail to achieve their goal - and may even yield counterproductive effects. This unsatisfactory outcome gives rise to a strong demand for policy advice on the precise design of

labor market policy programs. "Public policy is in great need of expert consultancy with regard to the design of labor market programs. IZA responds to this demand by increasing its efforts in this area," Hilmar Schneider explained the objective of IZA's special focus on labor policy.



SHORT REPORTS

+++ Free University of Berlin awards Honorary Professorship to IZA Director Klaus F. Zimmermann +++

On July 17, 2001, *Klaus F. Zimmermann*, Director of IZA, was conferred an Honorary Professorship from the Free University of Berlin. Zimmermann (48) is also President of the renowned German Institute for Economic Research (DIW Berlin) and Professor of Economics at the University of Bonn. This additional teaching position underscores the close proximity Zimmermann has kept to the university sphere despite his management assignments at two major German research institutes.

East Germany. In his laudation IZA Director *Klaus F. Zimmermann* stressed the high importance of Walker's research topics with regard to demographic change and the ongoing family policy debate.

+++ Klaus F. Zimmermann member of the "Leopoldina" in Halle +++

In July 2001, IZA Director *Klaus F. Zimmermann* was appointed as a member of the "German Academy of Natural Scientists Leopoldina" in Halle. Germany's oldest academy, the Leopoldina, selects eminent scholars worldwide to become members. The appointment of Klaus F. Zimmermann is a great honor and underscores the international reputation Zimmermann has achieved not only as a scholar in the fields of labor economics, econometrics, industrial economics, and macroeconomics, but also as a research institute director

at the Society's 2000 Annual Conference. The value of the prize is £ 1,000. The article is also published in the *Economic Journal*.

+++ Journal of Population Economics awards Kuznets Prize to James R. Walker +++

The *Journal of Population Economics*, edited by IZA, has endowed the Kuznets Prize in honor of population economics pioneer Simon Kuznets (1901-1985). With this prize, including a two-week stay at IZA and a cash prize of DM 5,000, IZA pays tribute to excellent research published in the *Journal of Population Economics*. The first prize winner is *James R. Walker* (University of Wisconsin, Madison). He receives the Kuznets Prize for his research paper on family policy and fertility behavior (*Journal of Population Economics* 8, 223-251). On the occasion of the official presentation ceremony, James R. Walker gave a lecture on recent fertility trends in

+++ IZA Research Affiliates win EEA Young Economist Award +++

"Who gets the Reward?", asked IZA Research Affiliate *Wendelin Schnedler* in his recent paper on performance pay and job characteristics, ("Who gets the Reward? An Empirical Exploration of Bonus Pay and Task Characteristics", IZA Discussion Paper No. 235). His very own reward came in the form of the Young Economist Award presented to Schnedler at the Annual Congress of the European Economic Association (EEA) in Lausanne, August 2001. Among 400 contributions by young economists, the EEA selected seven outstanding papers for the award. Besides *Wendelin Schnedler*, who attends the Bonn Graduate School of Economics and conducts his research in-house at IZA in Bonn, two other IZA Affiliates were among the prize-winners: *Alois Stutzer* and *Rafael Lalive* (both University of Zurich) were honored for their paper on "The Role of Social Work Norms in Job Searching and Subjective Well-Being" (IZA Discussion Paper No. 300). This extraordinary achievement not only reflects the high quality of IZA research, but it also shows that IZA has succeeded in engaging some of the most talented young European economists in the Institute's research activities.

+++ IZA Research Associate Rob Euwals wins Austin Robinson Memorial Prize +++

IZA Research Associate *Rob Euwals* won the 2000 Sir Austin Robinson Memorial Prize. With this prize the Royal Economic Society (RES) in London honors the work of young economists. Rob Euwals received the prize for his study on "Female Labor Supply, Flexibility of Working Hours, and Job Mobility in the Netherlands" (IZA Discussion Paper No. 83, see also IZA Compact September 2000), which he presented

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Returns to Education and Wage Equations



IZA VISITORS PROGRAM

From April 2000 until September 2001 a number of renowned economists stayed at IZA to discuss issues of labor market research and policy:

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| Avner Ahituv
(The Hebrew University of Jerusalem) | Scott M. Fuess
(University of Nebraska, Lincoln) | Tim Mennel
(University of Bonn) |
| Wiji Arulampalam
(Warwick University) | Ira N. Gang
(Rutgers University, New Brunswick) | Linda Richardson
(Australian National University, Canberra) |
| Christian Belzil
(Concordia University, Montreal) | John P. Haisken-DeNew
(DIW Berlin) | Michael Sattinger
(State University of New York, Albany) |
| Stefan Bender
(IAB Nuremberg) | Dan Hamermesh
(University of Texas, Austin) | Chew Soon Beng
(Nanyang Technological University, Singapore) |
| Antonio Ciccone
(University of Pompeu Fabra, Barcelona) | Joergen Hansen
(Concordia University, Montreal) | Li Shi
(Chinese Academy of Social Sciences, Beijing) |
| Bart Cockx
(Catholic University of Leuven) | Bart Hobijn
(Federal Reserve Bank of NY) | Marion Terrill
(Australian National University, Canberra) |
| Wayne A. Cornelius
(University of California, San Diego) | David Jaeger
(College of William and Mary, Williamsburg) | Mark Trede
(University of Cologne) |
| Don DeVoretz
(Simon Fraser University, Burnaby) | David Jaeger
(Hunter College/CUNY Grad School, NY) | Stephen J. Trejo
(University of Texas, Austin) |
| Bas Donkers
(Erasmus University, Rotterdam) | Zhang Junsen
(Chinese University of Hong Kong) | Petra Todd
(University of Pennsylvania, Philadelphia) |
| Christian Dustmann
(University College, London) | Sherrie Kossoudji
(University of Michigan, Ann Arbor) | Arthur van Soest
(Tilburg University) |
| Gil Epstein
(Bar-Ilan University, Ramat-Gan) | Hartmut Lehmann
(Heriot-Watt University, Edinburgh) | Gerhard Wagenhals
(University of Hohenheim, Stuttgart) |
| Gustav Feichtinger
(University of Technology, Vienna) | Lars Ljungqvist
(Stockholm School of Economics) | James R. Walker
(University of Wisconsin, Madison) |
| Robert Frank
(Cornell University, Ithaca) | Magnus Lofstrom
(University of California, Irvine) | Myeong-Su Yun
(University of Western Ontario, London) |

O P I N I O N

The Global Crisis and the Labor Market



The terrorist attacks on the United States shook the world. The military response by U.S. and allied forces signified the prelude to a long-lasting fight against terrorism. It is impossible to determine what long-term consequences these events will have in the economic, political, and social spheres, nor how they will affect the process of globalization. Any economic analysis is eclipsed by the concerns about the future of our open society. We cannot dismiss the dangerous possibility that the climate of openness in Germany and abroad could get much chillier. It would be fatal if history, rather than just holding its breath, reverted to obsolete mindsets of closed gates and blind xenophobia. That would mean that the opponents of an open society had achieved their goal.

Even before September 11, the U.S. economy was already been on the verge of recession. Considering that the economies in Europe and Japan are currently joining the sharp U.S. downturn – for the first time since the world economic crisis of the 1930s – the global economic situation is certainly fragile. Mass layoffs in some U.S.

industries are already foreshadowing the possibility of a similar impact on the European labor markets.

Among the most vulnerable market segments are airlines, transport, leisure and tourism industries, as well as insurance and financial institutions. At the same time, the security and defense industries stand to gain from the new situation. While the traditional pillars of globalization – trade, capital flows, and migration – are feeling increasing pressure, the global information and communications systems are even more vulnerable as they provide relatively easy targets. A severe blow to these systems would jeopardize the continuation of the globalization process – and prosperity worldwide.

In an attempt to meet the new challenge, the United States is currently experimenting with a revitalization of Keynesianism in order to stabilize the crisis-shaken macroeconomic environment. The recent cuts in interest rates cannot hide the fact that it was monetary policy itself that helped cause the economic crisis, and that it is traditionally more difficult to fight recession than to keep the economy from overheating. Monetary policy has succeeded, nonetheless, at stabilizing the stock markets, thus providing a vital boost to U.S. consumer demand. Fiscal policy has contributed its share in the form of tax cuts and, more recently, substantial spending programs.

The resulting debate is justified, and it is important. A “tamed” version of Keynesianism is more relevant today than ever. In the absence of targeted short-term measures on the macroeconomic level, the labor market effects would be painful and persistent. We are well aware of the fact that an economic crisis tends to affect a disproportionately large number of low-skilled workers. Human capital in the form of qualifications is lost, and the laid-off workers become demotivated. The capital stock is adjusted to the lower demand and, at best, increased to render production less labor-intensive.

It is still too early, particularly for Germany, to discard the current strategy of debt reduction. The Maastricht Treaty has established a high degree of credibility while at the same time allowing for flexibility in times of a short-term economic crisis. We should therefore adhere to the planned expenditures and rely on the automatic stabilizers even if that means a short-term increase in the public debt. Should Germany, against all expectations, suffer from a recession on a more lasting basis, the government would have to take additional effective countermeasures, such as speeding up the tax reform process and strengthening local infrastructure investments. European monetary policy would have to contribute its share as well.

The major threat posed by international terrorism lies in the possible stalling of the globalization process. This may include a decline in international cooperation, a permanent fall in global consumption and investment, and even a withdrawal into the old “Fortress Europe” with its tough stance on immigration. Although the necessary security policy measures must be taken, it will prove equally important to maintain an open policy towards economic immigrants. The draft of the proposed German Immigration Act, the first law to regulate an economic channel of immigration, ought to be completed and introduced into the German parliament before the upcoming federal elections. This would send a positive signal to the rest of Europe, which could be more important now than ever.

All parties involved will have to show courage and determination to protect this openness, from which all of us can profit, even in the face of the recent terrorist attacks and the international community’s response. After all, economic development in all parts of the world will ultimately prove to be the best answer to global terrorism.

K. F. Zimmermann



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