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COMPACT

CONSIDERING THE FUTURE OF LABOR

Should Germany open up to labor migration? It is time to adopt an economic concept of immigration

For the first time in German legal history, the federal government has introduced a comprehensive immigration bill that contains a visible economic element. After years of political standstill, it seems as if Germany is about to experience a sea change in migration policy at precisely a time when other nations are contemplating further restrictions on immigration in the face of international terrorism.

Most economists agree that immigration of foreign labor ought to be controlled both quantitatively and qualitatively. In particular, there is a strong consensus that immigration is necessary for demographic reasons, although there are varying estimates on the exact size of this demand. Earlier this year, an IZA report for the "Independent Commission for Migration of the German Government" analyzed the current and future demand for skilled labor. The study also presented a concept for an economic component of immigration policy. An updated edition of the IZA report has recently been published as a book (Klaus F. Zimmermann/Thomas K. Bauer/Holger Bonin/René Fahr/Holger Hinte, *The Demand for Labor in Time of High Unemployment – An Economic Immigration Concept for Germany*, Berlin/ Heidelberg 2002, ISBN 3-540-42158-0).

Status quo

The shortage of skilled workers in times of high unemployment is a phenomenon caused by a lack of coordination in the labor market. The qualification structure of the domestic labor force is no longer in line with the rapidly changing qualification requirements. There is a large number of low-skilled or inadequately qualified workers who will, even in the long run, not be able to fill the shortages that exist in certain professions. While the legal framework does not yet allow a targeted recruitment of foreign skilled workers, the government has also failed to implement necessary reforms in education policy.

The whole domestic labor pool could profit from an economic immigration policy that aims specifically at eliminating the labor market disequilibrium caused by inadequate qualifications. This kind of policy would widen a growth-inhibiting bottleneck, create new employment while at the same time reducing unemployment in the low-skilled sector because any additional employment of foreign skilled workers would also raise the demand for low-skilled labor.

We also need to consider demographic change. The aging of the domestic labor force would create a striking qualification gap among young, flexible and well-trained employees unless a cautious increase in immigration is allowed to counter this development.

Short-term and long-term labor demand

This constellation suggests a twofold strategy in immigration policy in order to react adequately to the short-term shortage of skilled workers and the long-term demographic development.

Statistics provides various labor shortage indicators that can be used to detect short-term labor market needs. These indicators help to identify some areas of the German market in which a strong demand for labor is likely to exist, such as the following:

- jobs in health care services, e.g. nurses, midwives, hygienists, dietary assistants, and pharmacist's assistants,
- management, administrative and other office jobs, e.g. IT specialists, public accountants, tax consultants, management consultants and managers,
- jobs in the social and educational sectors, e.g. kindergarten teachers, child care workers and social workers.

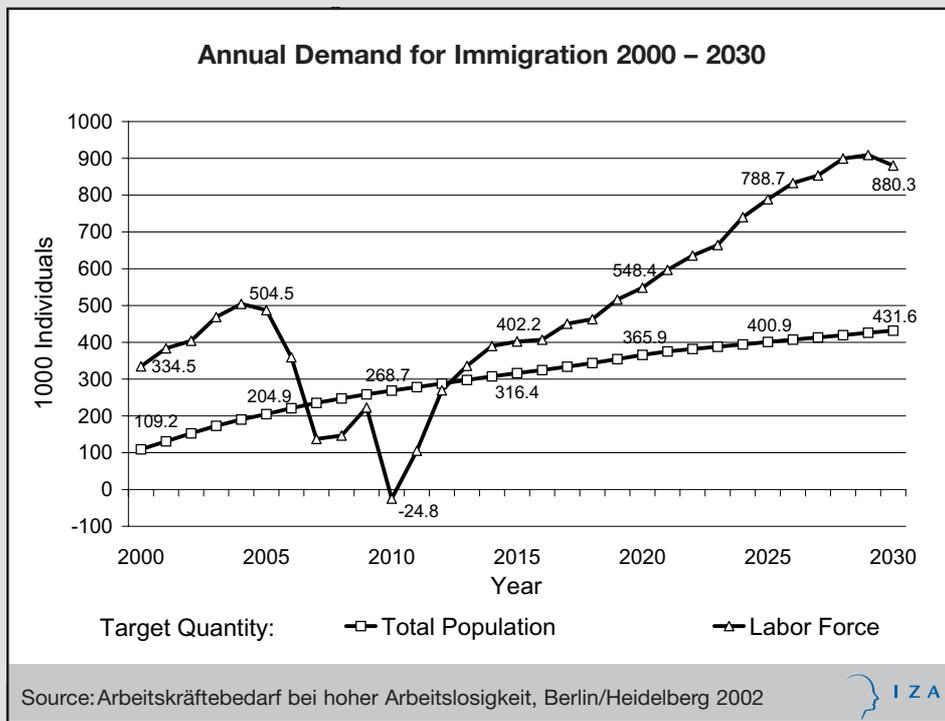
Due to incomplete data, the labor shortage indicators tend to vary considerably. Thus the results do not rule out a strong demand for labor in other professions.

The size and structure of long-term demand for immigrant labor can best be analyzed when estimating the future population structure according to the expected demographic trends and the existing qualification structure. Performing these calculations, the IZA model came to the following conclusions:

- Over the next decade, the process of demographic decline will at first be relatively slow. No later than 2010, however, the need for compensating migration will become significant. A strategic immigration policy that aims at keeping Germany's population constant must allow for an annual migration surplus of at least 200,000 to 300,000 individuals (see ▶ figure 1, page 2).
- Although immigrants are on average much younger than the domestic population, the delaying effect of migration on



Klaus F. Zimmermann/Thomas K. Bauer/Holger Bonin/René Fahr/Holger Hinte, *Arbeitskräftebedarf bei hoher Arbeitslosigkeit – Ein ökonomisches Zuwanderungskonzept für Deutschland*, Berlin/ Heidelberg 2002, ISBN 3-540-42158-0.



the aging of society remains so small that this instrument can only be used in addition to far-reaching economic and political efforts.

- Since the decline in young age cohorts will at first only affect the medium age groups, this demographic disruption will affect the labor force earlier – and relatively stronger – than the overall population. Where older workers cannot easily be substituted for young employees, a shortage of young workers could arise relatively soon. This would then justify the influx of foreigners.

Demographic analyses suggest that an annual net migration between 200,000 and 300,000 individuals would be necessary to achieve noticeable demographic relief. Migration surpluses of this size are about equal to the long-term average in Germany. Considering the long-term average out-migration from Germany, an annual 700,000 to 800,000 immigrants should be targeted in order to keep the population constant within the next two decades. In such a scenario, the size of the labor force would also stay roughly at today's level.

Precise statements about qualifications and other professional requirements for immigrants are difficult to make because any estimate of future demand conditions is inevitably speculative. Given the age distribution of vocational training graduates across professions, the following trends arise from the demographic development:

- Over the next two decades, the number of university graduates will continue

to increase slightly, but it is unlikely to exceed the growth in demand. At the same time, the number of domestic workers with complete vocational training is declining rapidly. A potential growth in demand for medium-skilled labor would further aggravate the shortage of skilled workers triggered by demographic change. Future immigration will thus have to account for the finding that there may be a higher demand for skilled workers than for university graduates. And it will most likely be impossible to meet this demand for skilled labor simply by training unskilled workers because the size of this group will be decreasing more rapidly in the next few years than the group of skilled workers itself.

- It is difficult to determine in which professions there will be a long-term labor shortage that would create a strong demand for immigration. As a rule of thumb, however, growing shortages are most likely to occur in professions that are already characterized by a low average age of employees.

- If we estimate the probability of mobility across occupational groups on the basis of structural changes in the last decade, we notice adjustment processes in the market that could eliminate supply shortages despite the negative impact of demographic change. This means that some of the professions with labor shortages may require immigration only for a limited time. In these cases a policy of permanent immigration could disrupt the functioning internal adjustment processes of the labor market.

Controlling economic immigration

Based on a gross annual immigration flow of up to 800,000 individuals (as proposed by IZA), the share of immigration that can be considered controllable has grown considerably to nearly 400,000 individuals over the past years and is likely to keep increasing (see table). This is in part due to the declining number of ethnic German immigrants ("Spätaussiedler") and refugees. Thus there is a sufficient quantitative range for an economically based immigration policy without violating existing immigration rights. IZA proposes to establish within the controllable portion of total immigration an annual quota of 200,000 entry visas for permanent residents (an estimated 120,000 workers plus family members). This proposal would also integrate several existing entry regulations in this framework so that actual entry through this channel would only show a small increase initially. The main purpose would be to improve selection from an economic perspective.

Permanent immigration should differentiate between employees, investors and entrepreneurs, as proposed by the German government bill. The most useful tool to **select labor immigrants** would be a point system, which would inevitably have to establish minimum requirements with respect to age, qualifications and availability of financial means during the settlement period. A language test could also be mandated. Those who fail the test could be required to pay a deposit until successful completion of a language course. Criteria such as age, education, work experience or valid job offers should have the strongest weight within the point system. In regard to future integration, aspects such as previous stays in Germany, family ties, accompanying children, and – above all – German language competence should also be weighted.

To highlight the permanent nature of the immigration offer, it is necessary to provide adequate integration programs. Based on a "contract" between the immigrant and the society of the receiving country, these programs should send out clear signals to show the immigrants more than ever that they will be accepted as citizens with equal rights (after completing "probation period" followed by a fast-track naturalization process). The positive impact of the "integration package" on the migration decision and the labor market success of immigrants should not be underestimated.

The **immigration of entrepreneurs and investors** should be regulated outside of a point system and occur without delay. The only decisive factor for admission of

an investor should be the amount of capital to be invested. Sums exceeding 500,000 euros could be deposited in a structural fund with the features of a government bond. Entrepreneurs, on the other hand, should commit themselves to investing at least 250,000 euro in a new or an existing company. They must, of course, prove their financial capability to do so. Continuous monitoring of this commitment would also be necessary.

In order to meet the immediate but temporary demand for skilled workers in certain professions, an initial annual quota of 30,000 workers should be introduced. This would have to include all other policy programs aimed at attracting temporary foreign labor. A further differentiation should be made between workers in sectors with a general shortage of labor, executives of multinational companies and scientists, immigrants who wish to attend a university or complete their vocational training, and other special cases.

To control the temporary immigration of labor in sectors with high demand, IZA proposes an auction system. Such a system is superior to other systems (such as a fee system), because it achieves an optimal linkage between demand analysis and demand satisfaction. Companies will only be willing to bid for the right to recruit foreign labor if they cannot satisfy their needs on the domestic labor market. A minimum bid could emphasize this goal. These immigration certificates must be limited in number and should expire after three years. The recruited employees should also be allowed to bring their families. Spouses should receive a work permit linked to

the validity of the immigrant's certificate (national security concerns will not be compromised by an auction system). For the duration of the immigration certificate, the immigrant should have the opportunity to apply for permanent immigration under the point system. This would build the desirable bridge between the systems of permanent and temporary migration. Monetary profits from the auction system could be invested in the national system of education and training.

In order to account for the internationalization of economy and science, we should further facilitate **immigration of executives from multinational companies and highly qualified scientists**. For both groups, IZA proposes a fast-track selection system without quotas to guarantee a smooth start in the German labor market. The main criterion should be a valid job offer.

To attract high-qualified employees to Germany as early as possible, we need to relax the immigration regulations for *university studies and vocational training*. The right and the responsibility to select applicants should be reserved for the universities. Instead of strict language requirements, there should be more classes taught in English. University graduates should be given the opportunity to apply for permanent residence under the point system. If they can present a job offer, this process should be fast-tracked. Foreign apprentices with a valid apprenticeship offer should belong to the same category.

With regard to *special cases of temporary labor immigration*, IZA suggests to streamline

the exceptions to the "recruitment stop" regulation and integrate them in the overall concept of reformed immigration rules. Immigrant groups such as athletes, artists, and teachers will remain exceptions. The special status of seasonal and contract workers should be reexamined and possibly become terminated in the wake of EU enlargement.

Shortcomings of the government draft

The IZA concept of an economically motivated immigration policy does not try to question but to supplement the existing legal framework. The bill introduced by the German government also maintains existing immigration rights and adds a labor market component which, however, is incomplete. From an economic perspective, many details of this bill are questionable, most of all the provision of general "veto rights" for certain government agencies and the right of local business associations to have a say in the admission of foreign entrepreneurs. This would only reinforce protectionist tendencies. The bill remains rather vague on the question of sector-specific immediate labor shortage, and it fails to solve the complex issue of family unification.

Nonetheless, allegations that the proposed bill would lead to a significant increase in immigration are completely unjustified. The opposite is true: What the bill lacks is a consistent and courageous implementation of the economic component – "restriction" is given priority over "openness". This does not mean that we should accept a potential failure of this project. Despite some shortcomings, IZA views this bill as an important first step toward a reorientation of German immigration policy. It should therefore be enacted without further delay.

Germany would be well advised to develop and test an effective instrument for the quantitative and qualitative control of economic immigration before entering the era of strong increases in the demand for immigration. This strategy would also help Germany establish itself as an attractive destination for potential immigrants. After all, Germany has to compete with other receiving countries for foreign skilled labor. This growing global competition has to be taken into account when shaping the country's future immigration policy.

Immigration to Germany: Total Inflow and Controllable Immigration 1990 – 1999 (1000 Individuals)

Year	Total Inflow	Ethnic Germans (Aussiedler)	Other German Nationals	EU Nationals	Asylum Seekers	Other Non-EU Nationals	Deviation from Reference	Controllable Inflow
	(1)	(2)	(3)	(4)	(5)	(6)	=800-(1)	=800-(2)-(3)-(4)-(5)
1990	1256	397	23	140	193	503	-456	47
1991	1199	222	52	147	256	522	-399	123
1992	1502	230	60	141	438	632	-702	-70
1993	1277	219	69	136	323	532	-477	54
1994	1083	223	82	159	127	492	-283	209
1995	1096	218	85	177	128	488	-296	191
1996	960	178	74	172	116	419	-160	259
1997	841	134	91	152	104	359	-41	319
1998	802	103	94	137	99	370	-2	367
1999	874	105	95	137	95	441	-74	367

Source: Statistical Yearbook of Germany (various issues, own calculations by IZA)



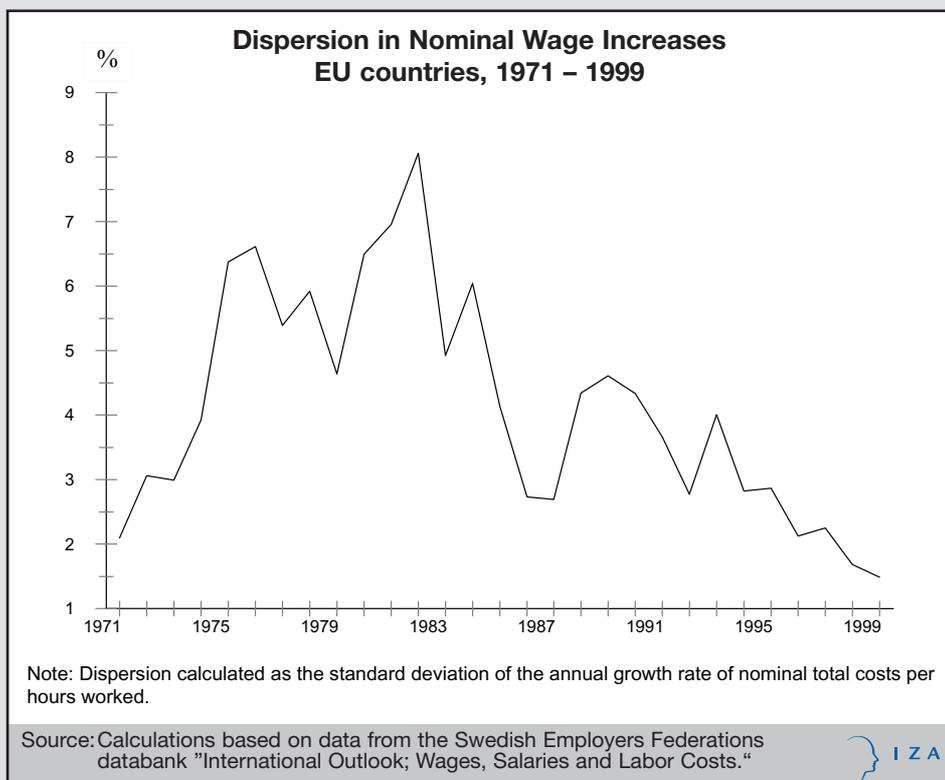
Are Labor Markets becoming European?

In policy debates there is an increasing focus on how international integration will affect labor markets. Some perceive this as a window of opportunities boosting growth and employment, whereas others fear that this may be a threat inducing more inequality and a retrenchment of achieved standards and rights in labor markets. Given the potential policy implications there is a great need to consider labor market implications of international integration more carefully. This is needed in order to understand the

trade is growing rapidly and for EU manufacturing sectors gross trade now constitutes more than 120 percent of value added. Only thirty years ago the share was only half of the current level. Foreign direct investments are also increasing, supporting that production becomes more "international". Secondly, the nature of trade is changing. Traditionally, trade has been driven by differences in factor endowments (natural resources etc), but currently so-called intra-industrial trade is constituting about 3/4 of

trade with emerging economies is driving the increase in international trade. This is not the case. Measured by total trade relative to production, Europe is as closed today as it was thirty years ago. Trade is increasing in relative importance, but within Europe. This suggests that we are not experiencing a globalization process in trade, but rather a Europeanization.

These facts already indicate that the "globalization fear", that is, that trade with emerging economies tending to have a relative large supply of unskilled workers and low wage levels, will be a threat to living standards and in particular job market prospects of low skilled workers seems unjustified. A large empirical literature has considered this issue, and the general finding is that "globalization" has had only a very modest - if any - effect on the position of the unskilled in the labor market.



structural changes taking place as well as to consider how policies should be designed in order to cope with the opportunities and challenges induced by international integration. From a European perspective this question is particularly important given both the speed at which integration is proceeding among European countries, and the structural problems often associated with European labor markets. A key question is whether European integration will force national labor markets to perform more uniformly, that is, will labor markets become more European?

European integration

To discuss these issues it is necessary to consider a few facts concerning international integration. Firstly, international

international trade. Intra-industrial trade is trade in commodities and services from the same industry. The commodities traded are thus in many respects similar, but they are differentiated in various ways so as to maintain a market segment. The fact that European integration is driven by intra-industry trade is of utmost importance to the interdependencies between European countries, since it implies that more and more trade is in commodities which in principle could be produced anywhere in Europe. It follows that competitiveness and comparative advantages will come to play an increasing role for the location of production and thus for employment. Finally, it is worth stressing that for international trade it is somewhat misleading to talk about globalization. Popular debates may leave the impression that

Product market integration and labor markets

Another often-made assertion is that labor markets will only be significantly affected by international integration if there is substantial labor mobility across countries. Since labor mobility between EU countries at present is low, it is tempting to conclude that the labor market consequences of European integration are modest. It is, of course, an open question whether the mobility of labor will increase in the future as a consequence of international integration in the wider sense of quicker dissemination of information, more internationally oriented education etc. However, it is important to stress that even in the absence of labor mobility across European countries there is another equally important channel through which labor markets can be affected, and this channel has been strengthened substantially in recent years. This channel originates in product markets. Product market integration has important implications for the labor markets since it essentially means that the mobility of jobs increases.

The way in which labor markets function depends critically on product market structures for the simple reason that the latter shapes the demand for labor. It is a basic insight of international trade theory that trade in products can be a substitute for factor mobility between countries. According to the factor price equalization theorem, trade may even be a perfect substitute for factor mobility un-

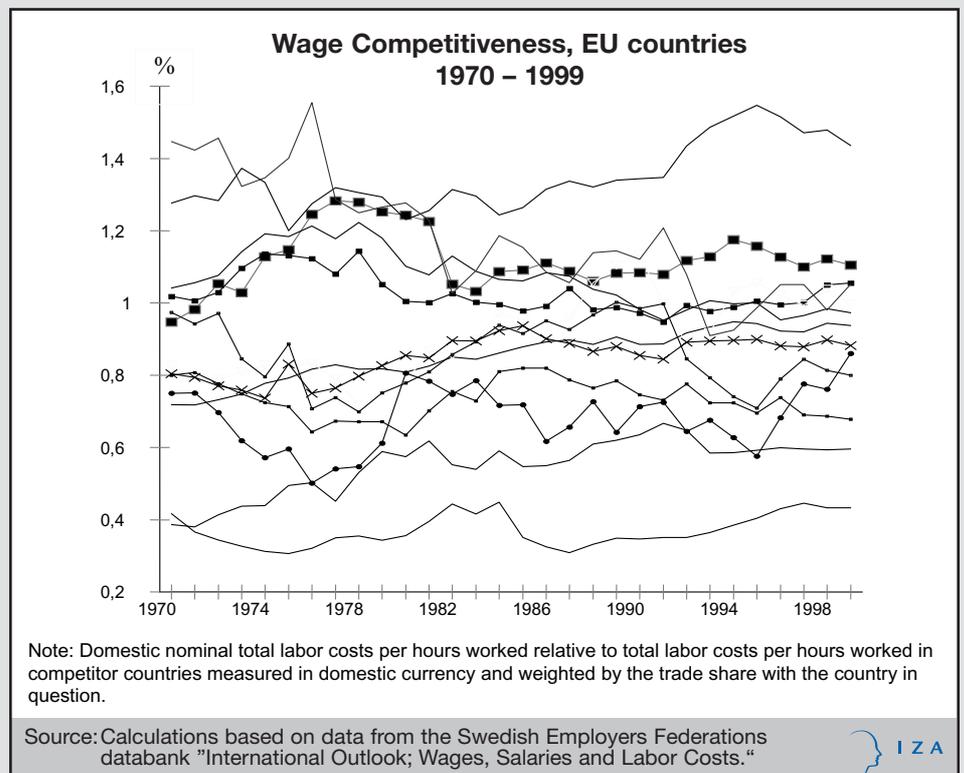
der idealized conditions including perfect competition in product and factor markets, and identical technologies. In the current European situation the factor price equalization theorem is not directly applicable, but still it points to important effects.

International integration is likely to have two major effects on product markets. The first is more intensive competition because various forms of frictions are reduced and this improves the terms at which foreign producers can compete for market shares in the domestic market and vice versa. Second, more integrated markets also enhance the mobility of firms, since it becomes easier to serve a given national market from a production unit located where the most profitable production conditions are available. This applies in particular to goods which underly intra-industrial trade - an increasingly important source of trade among European countries. This mobility may show up in terms of foreign direct investments, outsourcing etc. All of these channels essentially work to make jobs more mobile. Even though people might not be very mobile, jobs are becoming increasingly mobile across European countries.

The effect of this on the employment level is in general ambiguous. More integrated markets offer opportunities for export which tend to improve labor market conditions, but also a threat from imports with the opposite effects. This is, however, not a zero sum game between countries since product market integration also affects market power both in product and labor markets, and under wide circumstances the net effect is an overall increase in employment. In a sense this works like an implicit structural reform, since integration reduces market power in product and labor markets and thereby reduces some of the structural barriers, which have characterized European labor markets. Various countries may be differently affected depending on their initial position.

Integration and European labor markets

The presence of a link between European integration and labor market performance is suggested by casual evidence and empirical analyses on how European labor markets have performed in recent years. Companies taking advantage of product market integration, and the trans-national nature of production is exemplified by cases like the Renault factory moving from Belgium to Spain, and the closure of the Danone production unit in France. A concern for employment is fuelling opposition to such actions.



Other forms of evidence also suggest that changes have taken place. Europe has experienced a much more swift change to a low and stable rate of inflation than might have been expected in the light of the adjustment problems which have characterized European labor markets in the past. Figure 1 (see [p. 4](#)) shows the standard deviation of nominal wage increases for 13 EU countries from 1971 to 1999 (data on Luxembourg and Portugal are missing). The convergence in nominal wage increases is quite noticeable. One reason for the quick convergence to low and stable nominal wage increases without a corresponding increase in unemployment may be that the competitive "threat" has been perceived to be stronger - countries which were out of line would lose jobs relative to the rest. The importance of this is also reflected in the fact that some countries - Belgium and Sweden - are attempting to institutionalize a European norm in the wage formation process, to prevent wage developments out of line with average European trend. The concern for competitiveness and the location of jobs within Europe also plays a dominant role in debates in unions and political circles.

However, all this is indirect evidence, and does not really address the mechanisms through which international integration may affect labor markets. Especially, since convergence in nominal wage increases does not necessarily tell us anything about the adjustment of real wages

which in turn is one important determinant of employment.

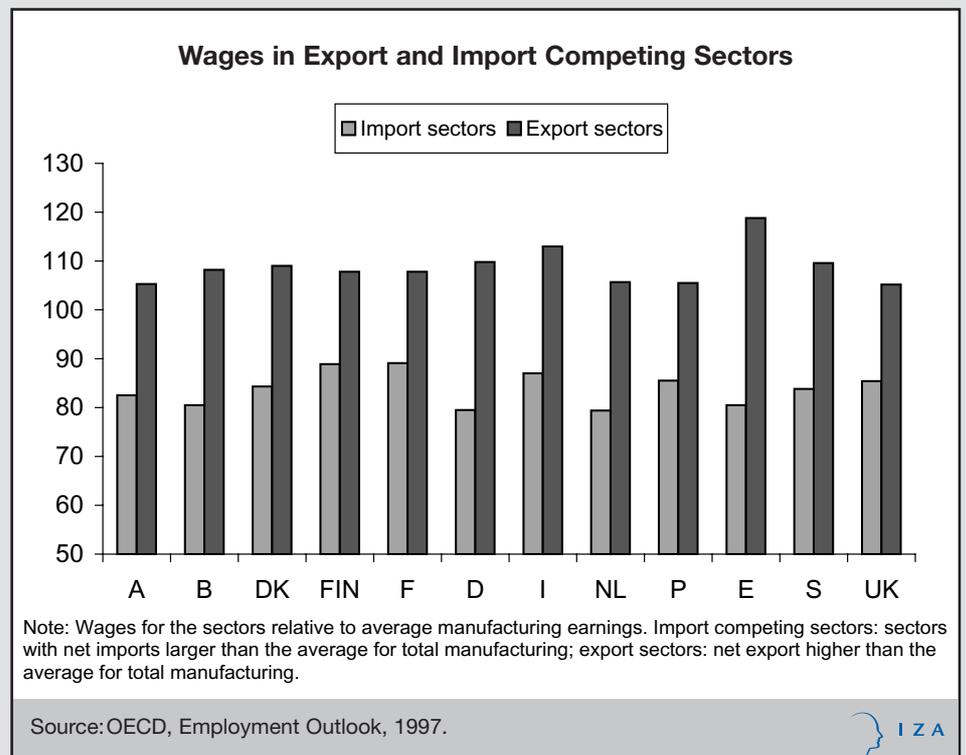
If European integration makes national labor markets more interdependent via the product market link, one would expect to find a convergence in relative wages or wage competitiveness. Considering the wage competitiveness for each of the same 13 EU countries one also finds a tendency towards real convergence - except for two countries, Germany and Greece. Figure 2 (see [p. 5](#)) displays the standard deviation of "wage competitiveness" across European countries, which in a transparent way confirms that a process of convergence is taking place. This evidence suggests that labor markets are significantly affected by product market integration, and one may thus expect further integration to affect labor markets significantly in the future.

Policy implications

Does this mean that integration is unambiguously good news for labor markets? Not necessarily, since the opportunities and challenges caused by integration may affect different groups in the labor market in different ways. One basic reason is that competitiveness and comparative advantages are becoming increasingly important due to international integration. It follows that those groups who face an improved export possibility will tend to be the highly productive or those with favorable compar-

ative advantages, while on the other hand those facing the threat from imports tend to be those who are less productive and have less favorable comparative advantages. Figure 3 shows that empirical evidence confirms that there is such a relationship since wages in export-oriented companies tend to be relatively high, while it is relatively low for those facing the import threat. A straightforward implication is that further integration may increase wage dispersion and cause increased employment problems for the less qualified part of the labor force.

This may in the short-run require a policy response to give the losers compensation, but this is not a tenable solution in the medium to long run. Neither is it the best policy response to prevent further integration. Integration may seem to be the cause of the problem. The fact is that integration brings forth that employment can only be maintained if it is directly or indirectly subsidized or protected, the price of which is paid by consumers. A better response is thus an active approach which deals with the qualification structure of the labor force - in the medium to long run concerns about employment and equality are much better served by addressing the qualification structure of the labor force rather than by resorting to passive measures. A more active approach makes it possible to



reap both the benefits from further integration and maintain objectives wrt to equality and employment.

The importance of the issues raised here calls for further research to enhance our knowledge on how labor market structures and performance will be affected

by the ongoing process of international integration, and the policy options and challenges it leaves. These issues are an active research area within the IZA program "Internationalization of Labor Markets", headed by IZA program director Torben M. Andersen (University of Aarhus, Denmark).



The 2001 German Pension Reform – Will It Last?

In May 2001, Germany enacted a fundamental pension reform. Policymakers finally responded to concerns that the established system of mandatory pension insurance, based on a pay-as-you-go scheme already imposing high burdens on contributors and (via subsidies) taxpayers, would be unsustainable during the forthcoming transition to higher old-age dependency. The reform comprises two parts: a change in the pension formula cutting back public pensions, and the gradual introduction of pension accounts to provide private funded retirement income. A recent IZA discussion paper critically reviews the reform decisions, and undertakes to assess their long-term implications (*Holger Bonin: Will it Last? An Assessment of the 2001 German Pension Reform, IZA DP No. 343*).

The Reform of State Pensions

Adapting the state pension scheme, the ambition of the reformers is to keep payroll contributions below a rate of 22 percent beyond 2030. To achieve this goal, the current indexation of pensions to net wage growth has been abandoned in favor of a procedure that

will tie pensions to the annual change in gross wages net of contributions to the provision of public and private retirement income.

Although gross wages normally rise faster than net wages in a phase of demographic aging, the amendment will moderate pension expenditure. First, it avoids expansive feedback effects of the scheduled income tax reform, and of the cuts in pension contributions made possible by the current policy of transferring revenue from ecological taxes to the pension scheme. Furthermore the new indexation rule discards implicit insurance of retirees against higher contributions to health care. Finally, compared with the previous scheme, it is more elastic with regard to pension contributions. This means that for any given increase in contributions, the new regime generates a higher discount in the subsequent pension adjustment.

While the amendment in the indexation rule is capable of reducing pension expenditure during demographic transition, whether this reduction will be sufficient to keep contribution rates below the promised levels is an em-

pirical question. A second, related question is how the reform will affect the net income position of pensioners relative to workers. One feature of the now obsolete indexation rule is that it keeps the *net replacement rate*, which indicates the average level of pensions relative to net wages, relatively stable. This is not guaranteed with gross earnings indexation. The possibility that the net replacement rate could fall in the consequence of the reform has raised much public concern. Therefore, the reformers made a commitment to take countermeasures if the net replacement rate falls below a level of 67 percent.

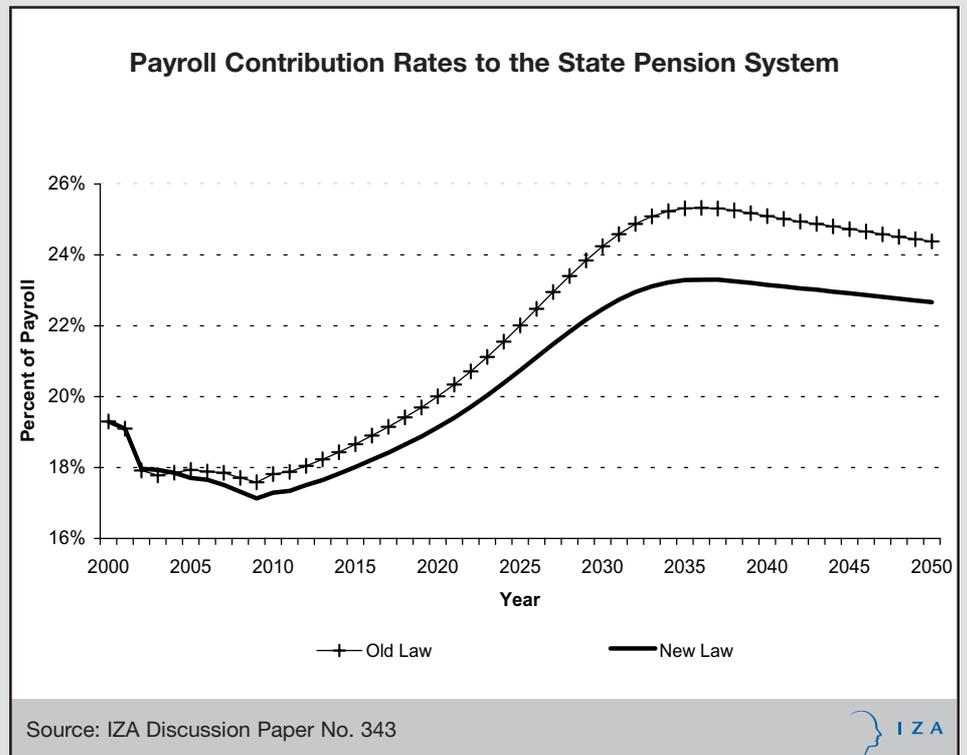
Inconsistent reform targets

If one projects what might be the long-term financial development of the public pension scheme under the new legal setup, it turns out that the contribution and net replacement rate targets announced by the reformers are inconsistent except for some very positive constellation of the socio-economic parameters. A moderate projection of contribution and pension rates, which as a rule preserves the status quo of the economic

and demographic parameters, is on display in Figures 1 ▸ and 2 ▼. Already in this scenario, which ignores the burden of increasing longevity, the payments required for balancing the budget of the state pension scheme, though substantially lower compared to the earlier legal state, clearly miss the contribution rate target beyond 2030.

Figure 2 ▼ shows that the net replacement rate target of 67 percent will also be failed under the new regime. After 2020, the replacement level, as it is currently defined, is predicted to fall below 63 percent. To keep the net replacement rate close to the announced intervention line, one has to employ a statistical concept of net wages that treats the scheduled savings into private pension accounts like a tax. It appears that the reformers base their pension guarantee on this approach, although it uses an economically dubious concept of net income. As savings into pension funds are voluntary, they represent only one way of how individuals can spend their income competing with alternative forms of consumption. The decision of the individual to save does not reduce consumption, but only defers it to a later stage of life.

When the contribution rate to the public pension scheme starts to exceed the target rate while the actual net replacement rate has passed beyond the intervention line, the last resort under pay-as-you-go financing is to raise the public subsidy to the system. However, this will be hardly feasible, considering the already substantial subvention of the pension budget. One might speculate that instead policymakers would tolerate a more substantial discount in pension growth than is currently envisaged, even if this means that the net replacement quota



falls even more than what is deemed tolerable today. This option exists, as complementary income from the newly introduced private pension accounts will be available to pensioners.

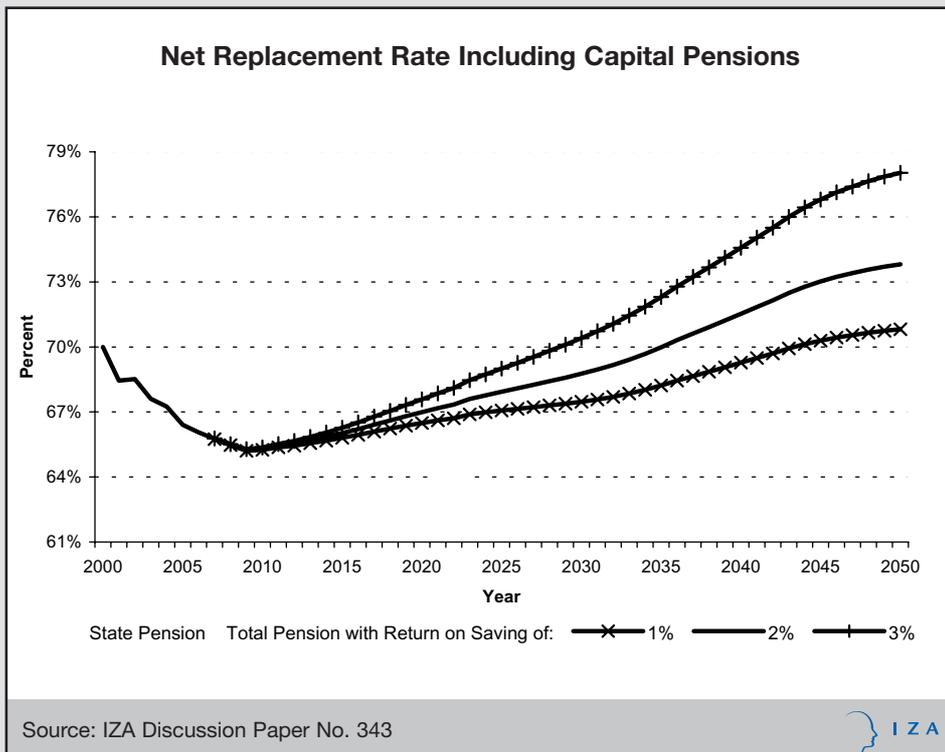
Problematic Savings Incentives

The introduction of individual pension plans is a fundamental step toward the Anglo-Saxon approach of funding Social Security. Under the rules now enacted, workers, up to the earnings cap on contributions to the public pension scheme, would start saving one

percent of their payroll in authorized private insurance or occupational pension plans from 2002. The savings amount is scheduled to gradually increase, until a final value of four percent is reached in 2008. A system of financial incentives combining income tax credits with savings allowances is used to promote the idea of private pension accounts. When the reform is completed, voluntary savings will be matched by a lump sum government grant of Euro 154 plus allowances for each child. At the same time deferred taxation is introduced, which means that payments into private pension plans are exempt from taxation but pensions are not. In addition, a specific rule is applied: whenever the individual tax refund for private savings is larger than the savings allowance, the refund is cut by exactly the amount of the latter. Alternatively, if the savings allowance is larger than the would-be tax refund, no tax rebate is given.

It can be shown that this modification of the deferred taxation scheme makes the subvention of individual savings accounts in effect regressive, and limits support to individuals at the bottom of the income distribution, as it would be the intention of a reformer concerned about the distributive implications of the policy change. Still the parallel system of government allowances and tax breaks is unnecessarily complex. Granting tax refunds for personal savings to all taxpayers, and lifting up the refund only for those taxpayers whose rebate is smaller than the intended amount of support, is the more straightforward equivalent.

Conceptually one might question the policy of subsidies to build up personal pensions for low-wage earners, which is expected to burden the state budget with €10bn per year at



the final stage. This amount might create a higher return if invested into paying off government debt while raising small pensions using standard measures of social welfare. Politically the commitment to subsidising private savings rather than cutting government dissavings appeals as it puts funds out of reach for policymakers. Economically the subsidy policy can be beneficial only if the return to private savings exceeds the interest rates on government bonds. This necessary condition is usually satisfied on perfect capital markets with free choice of portfolio. But the subsidized low-income individuals could have only imperfect access to capital markets, due to incomplete information or a limited range of investment alternatives since the amount to invest is small. Moreover, as the choice of investment vehicles eligible for government support is highly selective, their return could be sub-standard.

Highly Regulated Savings Vehicles

In what is heralded as protection of consumers against the perils of capital funding, the bill introducing private pension plans specifies a long list of conditions to be satisfied to qualify voluntary savings for government support. In particular, the individual pension funds must give a life-long annuity, and guarantee that the nominal value of the fund at retirement is at least equivalent to the accumulated savings. Either obligation imposes costs on the consumer. The former is welfare reducing if it prevents optimal allocation of consumption during old-age. Pensioners could prefer higher payments at entry into retirement or even a one-time disbursement of the full savings amount. Although the security of the private pension accounts is promised only in nominal terms, it will reduce the return to individual savings. Suppliers of pension funds must establish sufficient book reserves, chose less risky portfolios (for example a smaller quota of shares), rely on insurance policies to hedge capital risk.

One might doubt if the cost of consumer protection due to the restrictions on individual pension accounts is really justified. Given the still generous level of state pensions, retirement income would be adequate for most individuals even if their pension plan were a failure. As agents can chose other forms of provision for old-age, it is an empirical issue whether the pension plans eligible for government support will be attractive despite their costly limitations.

Annuities offset state pension loss

A vital question is if the scheduled savings rates suffice to compensate workers for the reduced state pensions. Figure 2 (see ◀ p.7) illustrates the net replacement level for future pensioners in the year of entry into retirement, after the inclusion of the (net) annuity from the private savings plan. Annuities get substantial shortly after the phasing

in of the private scheme completed. The pensioner cohort of 2015 could already replace about one percent of net earnings with a private pension. However, this is not sufficient to compensate strong decline in state pension levels in the first phase of the reform, so that the total benefit rate is below the announced intervention level.

As savings accounts are maturing, personal pension provision takes off. Even supposed a very low real return of one percent per year in real terms, net replacement rates would exceed the 67 percent target after 2025. The mature joint system of state and private pensions converges to a replacement rate of 71 percent, even higher than today. Using less conservative assumptions, pensioners' relative income position gets of course more favorable. With constant returns of two (three) percent, the overall net replacement level surpasses the target rate in 2020 (2018), and exceeds the start value beyond 2036 (2029).

Are individuals forced to save too much? Considering that the public pensions clearly miss the contribution rate target, the answer to this question is hardly yes. Rather on the contrary, only the savings rates now introduced would leave enough scope to downsize the public further while keeping to the 67 percent objective for overall pensions.

Conclusion

The recent pension reform in Germany is unlikely to pass the test of time un-

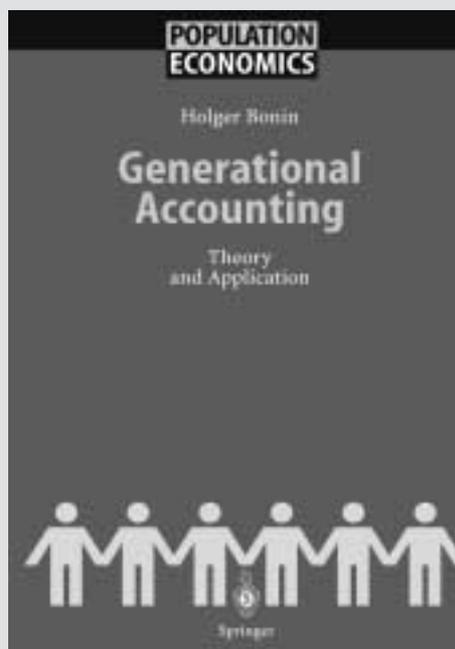
changed. In particular the policy to downsize the state pension scheme is not far-reaching enough. In realistic socio-economic scenarios, contribution rates are still surging when the demographic pressure becomes severe. A commitment to reducing state pension levels further would be a more adequate policy. While the scheduled scale of the individual pension plans is probably sufficient, private funds are over-regulated. This concerns both the subsidization scheme using parallel direct payments and tax credits, as well as the criteria to qualify for government support, which might protect consumers too much at the cost of reduced returns.

There are other unresolved problems. The issue of retirement income taxation has not been concluded. Further, while the rates of return of the pension system, including annuities, are given a boost by the reform, they vary markedly across generations. Distribution policy might want to address two groups in particular: pensioners retiring during the next decade, who are burdened by reduced pension levels in the early years of the reform but do not have time to accumulate compensating savings; and cohorts born in the next decade who will face the peak of pay-as-you-go contribution rates in the period when they are most productive.

But already passing the current reform into law required considerable political energy. Anything more, alas, will have to wait.



IZA Research Associate wins Award



Holger Bonin, *Generational Accounting – Theory and Application*, Berlin/Heidelberg 2001, ISBN 3-540-42266-8

In October IZA Research Associate *Holger Bonin* received the Paul Thomas Prize 2001. With the award the German Academy of Employees (DAA) in Freiburg honors outstanding scientific work of young scholars in the area of Social Security. The value of the biennial award is DM 3,000.

Holger Bonin received the prize for his doctoral thesis, which is now available as a book. The study is based on the method of generational accounting, a concept revealing the implicit liabilities of the public sector in a changing demographic environment. The book contains a complete introduction to the technique.

A comprehensive empirical application uncovers that fiscal policy in Germany is fundamentally unsustainable. Studying the major policy options, the author develops new procedures to measure the fiscal externalities of immigration, and to assess the generational fairness of Social Security reform.

The Economics of Low Income and Low Paid Work

- 4th IZA European Summer School in Labor Economics addressed a hotly debated topic

Application deadline for Summer School 2002: February 01, 2002

From September 10.-16.2001, IZA hosted the XIIth Summer School of the European Economic Association (which at the same time was the 4th IZA Summer School in Labor Economics). This year's topic: "The Economics of Low Income and Low Paid Work" focused on the precarious labor market situation of low-qualified workers.

The objective of the annual summer school is to bring together a larger number of Ph.D. students and senior researchers to study new areas in labor economics. Ph.D. students are given the opportunity to present their papers and to discuss their own research ideas with established researchers. The 31 students from all over Europe and one participant from the US were selected by a committee out of more than 100 applicants.

Once more, this year's lecturers included well-known economists: *Philippe Aghion* from Harvard University, *Juan Dolado* (Universidad Carlos III, Madrid) and *Peter Sloane* from the University of Aberdeen.

In his lectures on "The Dynamics of Income Inequality in Schumpeterian Growth Models", *Philippe Aghion* explained how recent growth theories - based on endogenous technical change and on the Schumpeterian idea of obsolescence - can help to understand the evolution of income inequality. He organized his lecture along two puzzles. The first puzzle

was concerned with the evolution of between-group inequality in the past thirty years, in particular the rise of the college premium in the United States. The second puzzle was the rise of within-group inequality. Aghion presented some of his recent and unpublished work in order to explain the two puzzles. Technical progress and in particular the implementation of General Purpose Technologies stands as a crucial factor in explaining the recent upsurge in wage inequality. Furthermore, Aghion also discussed the relationship between endogenous growth and cross-country income differences.

Juan Dolado gave a lecture on "Minimum Wages and Low-wage Employment". He analyzed the low-wage employment in

Europe and the U.S. over the past three decades as a response to the problem of high and persistent unemployment in Europe and of growing globalization and skill-biased technological change. He conducted a detailed analysis of institutional arrangements, such as minimum wage legislation, collective bargaining, and anti-discriminatory measures to fight discrimination by gender. The lecture also covered a descriptive part dealing with the evolution of low-wage employment in various countries, the effects of minimum wages on employment and the issue of "overeducation" in some EU countries. On the basis of these findings, Dolado analyzed the extent to which education might fail to act as a way out of the low-employment trap.

In his lecture on "The Economics of Low Income and Low Paid Work", *Peter Sloane* gave a review of the economics of low income and low paid work, with an emphasis on labor market segmentation. He discussed different key topics in labor market theory and empirics, such as the measurement of job satisfaction as a consequence of job qualities and externalities from coworkers' education. Peter Sloane dealt with the question of earnings mobility and wage growth in the low wage sector of four European economies (F, G, NL, UK) relative to the United States.

Furthermore, Sloane gave insights into the topic of over- and undereducation.



Philippe Aghion



Peter Sloane

Philippe Aghion explained how recent growth theories can help to understand the evolution of income inequality.

Peter Sloane gave a review of the economics of low income and low paid work, with an emphasis on labor market segmentation.

Juan Dolado gave a lecture on "Minimum Wages and Low-wage Employment"



Juan Dolado

Definitions and measurement of these phenomena were discussed using empirical results for the British labor market. Special attention was paid to the analysis of over-education among graduates with an emphasis on different ethnical groups.

The students presented their research either through giving a talk or hosting a poster session. The theoretical and empirical papers covered a wide range of topics in labor economics, such as the effects of product demand and market power on wage inequality, the effect of skill-biased technological change on unskilled workers, minimum wages and employment, sheepskin effects in a transition economy, the impact of labor market conditions on female participation, fertility and education decisions, poverty persistence and the effects of labor market conditions at the beginning of individuals' labor market career on earnings. In each poster session, up to six students were given the opportunity to display a



poster summarizing the content of their research, and to explain their research informally to individual groups of interested people. As in previous summer schools the poster sessions turned out to be a particularly successful way of discussing research results, both for the presenter and the participants.

Next year's IZA European Summer School will take place from April 15 – 20, 2002. Applications must be sent in by February 01, 2002. For detailed information and application formalities please visit www.iza.org.

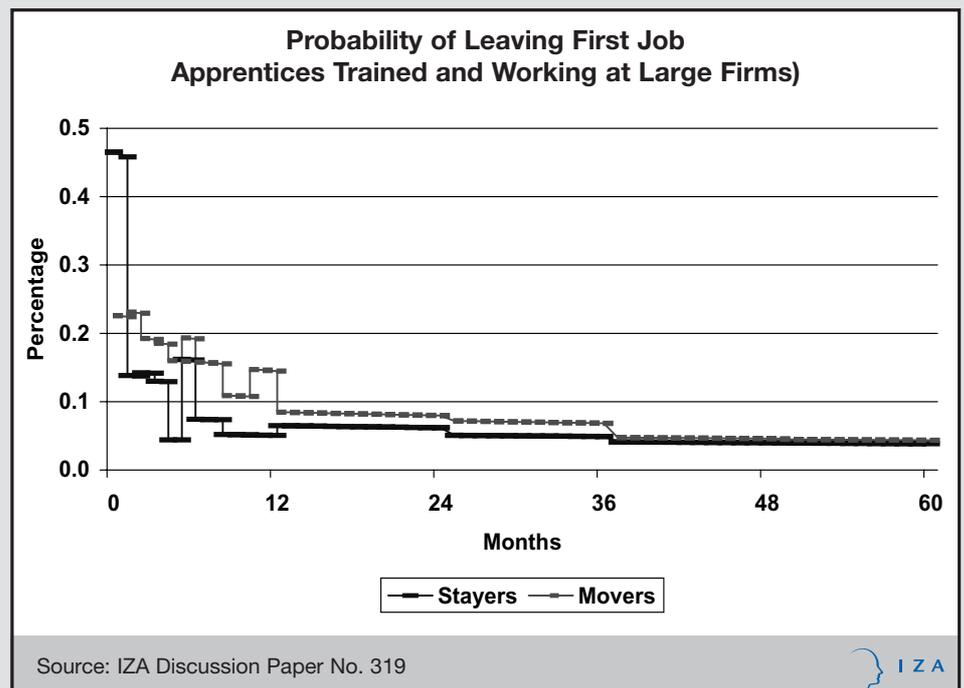


Why Do Firms Train?

Empirical Evidence on the First Labour Market Outcomes of Graduated Apprentices

In international comparisons on education, vocational training, and labor market performance, Germany shows a high involvement of firms in the education and training of the young by means of a well-developed apprenticeship system. An old question in this field has been why firms participating in the German apprenticeship training (GAT) invest substantially in general skills.

A new IZA study provides empirical evidence on this question, using data from the official German social security register data that has become available recently: the IAB Employment Sample. The sample is particularly well suited for this task due to its accuracy, the long observation period (1975-95), and the large number of observations. The IZA Study exploits the large sample size, among other things, to perform occupation specific analyses at a level of disaggregation hitherto unavailable. (For details see: *Rob Euwals and Rainer Winkelmann: Why Do Firms Train? Empirical Evidence on the First Labour Market Outcomes of Graduated Apprentices*, IZA Discussion Paper No. 319).



An appealing explanation for the participation of German firms in GAT is based on the so-called asymmetric information theory of the 2001 Economics Nobel Prize winners George Akerlof,

Michael Spence, and Joseph Stiglitz. For the application to the GAT the idea is that a training firm learns about the ability of its apprentices, where outside firms will not have this information. For that

reason outside firms cannot distinguish between laid off apprentices ('lemons') and apprentices that reject a job offer from their training firms. As a result, the training firm can offer tenured positions to good apprentices with wages that are only marginally better than the market wage. The high productivity of these good apprentices gives the training firm the opportunity to recoup the training costs. Several studies have tried to find empirical evidence for this theory, and, of course, for other theories.

Despite the substantial size of the literature, few "stylized" facts on GAT have emerged. So far, the only robust finding has been that about two-thirds of all apprentices leave their training firm within five years of graduation. More often than not, the empirical evidence has been inconclusive or even contradictory. For instance, there are no robust results available so far, whether jobs are more stable and wages higher for those GAT graduates staying in the training firm than for those moving on to another firm. And yet, this type of evidence is crucial for understanding the nature of the GAT, including the firms' motivation to contribute to it.

The Study argues that the lack of solid evidence is due to the shortcomings of the data used in the previous studies. To understand the effect of the GAT on the

trainees' skills and labor market choices, it is most instructive to study the period immediately following the apprenticeship when the external labor market comes to its fullest force and before a host of other influences has obscured these initial relationships.

Based on the IAB Employment Sample the new study provides robust evidence on two aspects that are important for understanding the firms' benefit from training, and on which previous studies using alternative data sources have offered conflicting evidence.

First, the study analyzes wages after the apprenticeship, distinguishing between apprentices who stay in their training firm ("stayers") and those who don't ("movers"). Which group receives the higher wages after the completion of the apprenticeship? The finding is that stayers employed in large firms command a wage premium of about 4 percent. Whether these higher wages are due to 'symmetric' or 'asymmetric' information, is however hard to tell.

The second question therefore deals with the relationship between apprenticeship training and the duration in the first job – a rarely addressed aspect. This is important as part of the rent-extracting behavior of the training firms might take the form of longer first-job durations for

the apprentices that stay with the training firm. Furthermore, as firms that hire graduated apprentices directly from the labor market still have to learn about the ability of these graduated apprentices, the probability that a mover leaves the first job in the first months should be larger than for a stayer.

The figure (*see* ▶ p.10) shows the development of the leaving probabilities over the first 5 years for an average individual, based on calculations using the IAB Employment Sample. Except for the first two weeks, the leaving probabilities for the movers are indeed larger than for the stayers. This difference disappears only after 3 years. In total, especially for the large training firms the first job durations are much larger for stayers than for movers.

Taken together, the evidence is compatible with a cream-skimming hypothesis for large firms. Based on the IAB Employment Sample the IZA study concludes that apprentices that are trained at a large firm and have their first job with that particular firm have higher wages and longer first job durations than apprentices that are trained at a large firm, but afterwards have their first job at another large firm. (*See also the report on IZA's workshop on apprenticeship training* ▶ p.12).



ESSLE 2002 – Call for Papers European Summer Symposium in Labour Economics

Buch at the Lake of Ammersee September 10-14, 2002 Application deadline 1. Februar 2002

Paper proposals for CEPR's fourth European Summer Symposium in Labor Economics (ESSLE), which takes place September 10-14, 2002, can be submitted until February 1, 2002. The meeting will be hosted by IZA at the conference center of Deutsche Post World Net in Buch at the lake of Ammersee, Germany. Organizers are *Juan J. Dolado* (University Carlos III, Madrid, and CEPR) *Gilles Saint-Paul* (Université des Sciences Sociales de Toulouse and CEPR) and *Klaus F. Zimmermann* (IZA, Bonn University, DIW Berlin, and CEPR).

ESSLE 2002 will bring together around 40 labor economists from across Europe and key researchers from outside the region. Furthermore, ESSLE provides young researchers with the opportunity to meet

and discuss their work with senior economists. We welcome paper proposals in any area of labor economics.

The program combines focus and contributed sessions with time for collaboration and consultation. To foster the desired interaction we request that participants stay for the entire duration of the Symposium.

Travel and accommodation expenses will be covered for all participants according to the usual CEPR travel guidelines, but if you are able to contribute to the costs of your attendance from a research grant at your disposal this will free up space for someone else. Please indicate on your reply form whether you will be able to cov-

er your own travel costs, or whether you will require funding from CEPR.

Note that it may not be possible for us to accept all applications to attend ESSLE as demand usually exceeds the space available. We would therefore like you to simply confirm your interest in submitting a paper for the meeting at this stage. You should also indicate whether you would be willing to act as a discussant. Please complete the application form you will find at www.iza.org, attach an abstract of your paper, and return it to Janet Seabrook by email on jseabrook@cepr.org or by fax at 00 44 20 7878 2999 until February 1, 2002. We will confirm your participation in March 2002.

Apprenticeship Training: A Model for the Future?

– Successful IZA Workshop

On November 9 and 10, 2001, an international IZA Workshop on Apprenticeship Training took place at IZA in Bonn. The objective of this meeting was to bring together both theoretical and applied researchers to discuss their work in the areas of youth education and apprenticeship training. IZA Research Associate *Rob Euwals* and IZA Program Director *Rainer Winkelmann* organized the workshop that contributed to the IZA Research Area 'The Future of Labor.'

Providing vocational post-secondary training for youths, as well as easing the transition from school to work, is an important policy area. Many countries provide training for youths, and several countries consider strengthening their apprenticeship system. In discussions on this issue, the well-developed and

highly regulated German apprenticeship system is regularly presented as a role model. In many countries, and especially in Germany within the extensive Apprenticeship Training system, firms provide general training and thus portable skills. In addition, there is ample evidence that firms actually make substantial net investments to provide such training. The first day of the workshop saw a nice range of theoretical explanations for this puzzle. *Hans Gersbach* (University of Heidelberg and IZA) concentrated on the interaction with product markets, *Damon Clark* (IZA) discussed an employee-employer matching explanation, *Anette Boom* (Free University of Berlin) provided an explanation based on asymmetric information, *Uta Schönberg* (University College London) discussed the impact of unions, and *René*

Fahr (IZA) concentrated on the occupational specific part of the training.

The second part of the workshop gave an empirical overview on apprenticeship and vocational training in an international setting. *Spiros Bougheas* (University of Nottingham) discussed evidence from international labor markets, like academic and sports labor markets, *Rudolf Winter-Ebmer* (University of Linz and IZA) provided evidence from Austria, and *Bart Cockx* (IRES, Catholic University of Louvain, and IZA) provided Belgian evidence. In the last session of the workshop, *Felix Büchel* (MPI for Human Development, Technical University of Berlin, and DIW) and *Rob Euwals* discussed different sources of empirical evidence on the German Apprenticeship System. IZA will continue to analyze international apprenticeship training.

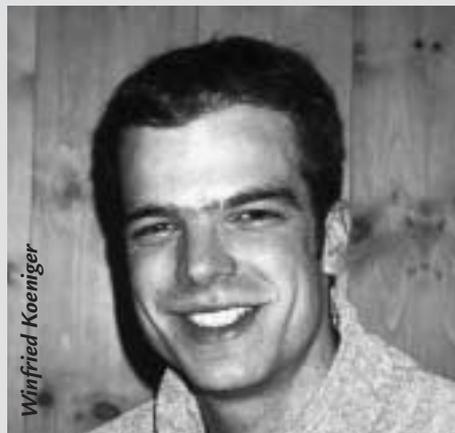
NEW IZA-STAFF MEMBERS



Damon Clark

Damon Clark finished a BA Economics degree at Newcastle University in 1994. From 1995-1997 he studied for an MPhil in economics at Nuffield College, Oxford. In 1997-1998 he worked as a research officer at the Social Market Foundation, an independent think-tank based in London. Since 1998 he has been working on his DPhil thesis at Nuffield College, Oxford. He joined IZA as a Research Affiliate in February 2001 and became a Research Associate in October 2001.

Winfried Koeniger received his PhD in economics in June 2001 from the European University Institute (Florence, Italy). He started his studies in economics at the University of Bonn in 1993, where he received his Diplom in 1997. In his dissertation he analyzed specific interactions between financial and labor markets as well as the effects of trade in developed countries resulting from institutionally differ-



Winfried Koeniger

ent labor markets and endogenous technology adjustment. *Winfried Koeniger* joined IZA as a Research Associate in September 2001.

Gabriele Herbrig finished her studies in Heidelberg as a translator in 1980. From



Gabriele Herbrig

1980 to 1983 she worked with several companies as a translator for French, English and Italian. She then moved to an Institute for Interdisciplinary Research in Heidelberg. Her tasks included translations, the organization of scientific colloquia, press conferences and meetings in Germany and abroad. In August 2001, she joined the IZA staff as Assistant to the Director.

Alexandru Voicu obtained his B.A. in mechanical engineering in Bucharest in 1992, and his M.A in economics from Central European University in Prague in 1995. He received his Ph. D. in economics in May 2001 from Rutgers University with a dissertation on "Bayesian Markov chain Monte Carlo estimation of dynamic labor force participation models." In October 2001, *Alexandru Voicu* joined IZA as a Research Associate.



Alexandru Voicu

NEW IZA DISCUSSION PAPERS

A complete list of IZA Discussion Papers is available on our homepage at www.iza.org
Most papers are downloadable.

- 377 S. J. Trejo**
Intergenerational Progress of Mexican-Origin Workers in the U.S. Labor Market
- 376 G. Corneo**
Work and Television
- 375 J. A. Dunlevy, W. K. Hutchinson**
The Pro-Trade Effect of Immigration on American Exports During the Late Nineteenth and Early Twentieth Centuries
- 374 G. J. van den Berg, B. van der Klaauw**
Counseling and Monitoring of Unemployed Workers: Theory and Evidence from a Controlled Social Experiment
- 373 S. J. Trejo**
Does the Statutory Overtime Premium Discourage Long Workweeks?
- 372 J. Konings, H. Lehmann**
Marshall and Labour Demand in Russia: Going Back to Basics
- 371 S. C. Wolter, A. Zbinden**
Rates of Return to Education: The View of Students in Switzerland
- 370 A. S. Kalwij**
Individuals' Unemployment Experiences: Heterogeneity and Business Cycle Effects
- 369 A. S. Kalwij**
Individuals' Unemployment Durations over the Business Cycle
- 368 J. Angrist**
How Do Sex Ratios Affect Marriage and Labor Markets? Evidence from America's Second Generation
- 367 C. Dustmann**
Parental Background, Primary to Secondary School Transitions, and Wages
- 366 M. C. Regets**
Research and Policy Issues in High-Skilled International Migration: A Perspective with Data from the United States
- 365 H. S. Nielsen, M. Rosholm, N. Smith, L. Husted**
Qualifications, Discrimination, or Assimilation? An Extended Framework for Analysing Immigrant Wage Gaps
- 364 M. Jäntti, S. P. Jenkins**
Examining the Impact of Macro-Economic Conditions on Income Inequality
- 363 H. Antecol, D. A. Cobb-Clark, S. J. Trejo**
Immigration Policy and the Skills of Immigrants to Australia, Canada, and the United States
- 362 J. Angrist, V. Lavy**
New Evidence on Classroom Computers and Pupil Learning
- 361 M. C. Berger, J. S. Earle, K. Z. Sabirianova**
Worker Training in a Restructuring Economy: Evidence from the Russian Transition
- 360 J. Hansen, M. Lofstrom**
The Dynamics of Immigrant Welfare and Labor Market Behavior
- 359 M. Pflüger**
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- 354 J. Kluge**
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- 353 T. Bauer, S. Bender**
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- 352 J. T. Addison, J. S. Heywood, X. Wei**
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- 351 J. D. Brown, J. S. Earle**
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- 346 L. Locher**
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Child Labor and the Education of a Society
- 337 F. Büchel, M. Pollmann-Schult**
Overeducation and Skill Endowments: The Role of School Achievement and Vocational Training Quality
- 336 F. Lima, P. Telhado Pereira**
Careers and Wage Growth within Large Firms



IZA VISITORS PROGRAM

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

- Marco Caliendo**
(University of Frankfurt, Germany)
- Björn Christensen**
(Kiel Institute of World Economics, Germany)
- Melvyn Coles**
(University of Essex, UK)
- Wayne A. Cornelius**
(University of California, San Diego, USA)
- Leif Danziger**
(York University, Canada)
- Marco Francesconi**
(University of Essex, UK)
- Scott M. Fuess**
(University of Nebraska, USA)
- Bart Hobijn**
(Federal Reserve Bank of New York, USA)
- P. N. (Raja) Junankar**
(School of Economics and Finance, University of Western Sydney, Australia)
- Arie Kapteyn**
(RAND Corporation, USA)
- Christoph Knoppik**
(University of Regensburg, Germany)
- Hartmut Lehmann**
(Heriot-Watt University, Edinburgh, UK)
- Espen Moen**
(Norwegian School of Management, Sandvika)
- Shoshana Neuman**
(Bar-Ilan University, Ramat Gan, Israel)
- Nicola Pavoni**
(University College London, UK)
- Jean-Marc Robin**
(INRA, Paris, France)
- Knut Røed**
(Ragnar Frisch Centre for Economic Research, Norway)
- Jennifer Smith**
(University of Warwick, UK)
- Mette Verner**
(Aarhus School of Business, Denmark)
- Edward Vytlačil**
(Stanford University, USA)
- Jonathan Wadsworth**
(CEP, London School of Economics, UK)
- Itzhak Zilcha**
(Tel Aviv University, Israel)

O P I N I O N

The Feminization of Work



The feminization of paid work is not only a trend but a necessity. For quite some time now, the labor market has been suffering from a serious shortage of high-skilled workers. Due to the demographic decline and the aging of the labor force, this gap will continue to widen over the next decades. Despite the current economic stagnation, the expanding information and service industries will create additional demand for high-skilled labor. After all, qualified personnel is especially needed in times of crisis.

Female labor force participation in West Germany has been continuously on the rise over the past half century. Back in 1950, only 20 percent of all married women between the ages of 30 and 50 were in the labor force. Today their share is more than 70 percent. This development especially comes to the fore in the educational sector, where half of all university "freshmen" are now women. It is not surprising that women were rather easily integrated in the first labor market since the general upward trend in qualification levels and the rise in part-time work at a stagnating labor volume, the integration of women in the first labor market

took mostly place without any problems. In East Germany, female labor force participation has traditionally been much higher than in the West, and most women work in full-time jobs. Participation rates in the East, however, have begun to drop and are now approaching the level achieved in West Germany.

The traditional role of men as the sole wage earner is losing its relevance. In 61 percent of all married-couple households in Germany both partners have a job. In one third of these families the woman works full-time. Men remain the sole breadwinners in only 30 percent of all family households.

In international perspective, Germany ranks just above average in terms of the feminization of work. In 2002, the share of working women in the age group of 25 to 54 was 71 percent in Germany – the same as in the Netherlands and well above the EU average of 66 percent. Other countries, however, are still ahead of Germany: the United Kingdom with 73 percent, the United States with 74 percent, and Sweden with as much as 82 percent. Likewise, Germany does not come off well in an international comparison of unemployment rates. According to OECD criteria, Germany's unemployment was at 8 percent in 2000 – slightly better than the EU average (8.9 percent), but considerably worse than the Netherlands (3 percent), the United States (3.3 percent), the United Kingdom (4 percent), and Sweden (4.6 percent).

In the long run, being average will not be good enough. Germany has to be able to use its female participation rate as a trump card in the structural improvement process of its labor market. This process, however, cannot be forced. A "gender equality" law as demanded by the unions would be just as counterproductive as the recently established right of employees to switch to part-time work. Both initiatives lead to an unnecessary stigmatization of female work.

Instead, market-based methods are the most effective way to change the realities of the labor market. A key component of female participation is the issue of child care. In order to alleviate the serious deficit in this sector, coordinated reforms of both the demand and supply conditions will have to be implemented. The German educational system relies too much on the role of the family.

Full-day kindergartens and schools will have to become the norm. In addition, new organizational forms need to be created to support the gifted as well as the less talented students. Corporate child care facilities, individualized working hours and a widespread introduction of working time accounts would allow for more flexibility at the internal company level.

A reform of the German child care system with the goal of ending the predominant practice of subsidizing care providers would also help. Government-paid vouchers earmarked for child care services would give parents more bargaining power over child care facilities, which would have to be certified by a government agency. Enhanced competition could also boost private initiatives and lead to an expansion of the market for child care services.

This would come close to squaring the circle: The child care sector would create a strong demand for low-skilled workers and provide the desperately needed relief in this area. At the same time, the large potential of high-skilled women with children could be better utilized. Additionally, the long-term integration of women in the labor market and the improved use of their qualifications would finally allow women to advance more easily to high-ranking positions in business and society.

K. F. Zimmermann



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of Labor

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 Graphics/Photographs: IZA
 Layout/Printing: Verlag Erik Dynowski,
 Cologne, Germany