



I Z A

COMPACT

CONSIDERING THE FUTURE OF LABOR

School Effects and Labor Market Outcomes in the U.S.

The vast literature on the economic returns to schooling has unequivocally found that earnings increase with educational attainment while placing the emphasis on higher education. On the other hand, it is essential to study high school effects on labor market outcomes since not all high school students attend college, and an even smaller percentage of them finish college. A recent IZA Discussion Paper by *Amelie Constant* (IZA and University of Pennsylvania) and *Spyros Konstantopoulos* (University of Chicago) examines high school effects on labor market success of young adults that are above and beyond family characteristics and presents important new results on this interdependency (for details see: *A. Constant/S. Konstantopoulos, School Effects and Labor Market Outcomes for Young Adults in the 1980s and 1990s, IZA Discussion Paper No. 671, forthcoming in Applied Economics Quarterly*).

Methodological Approach

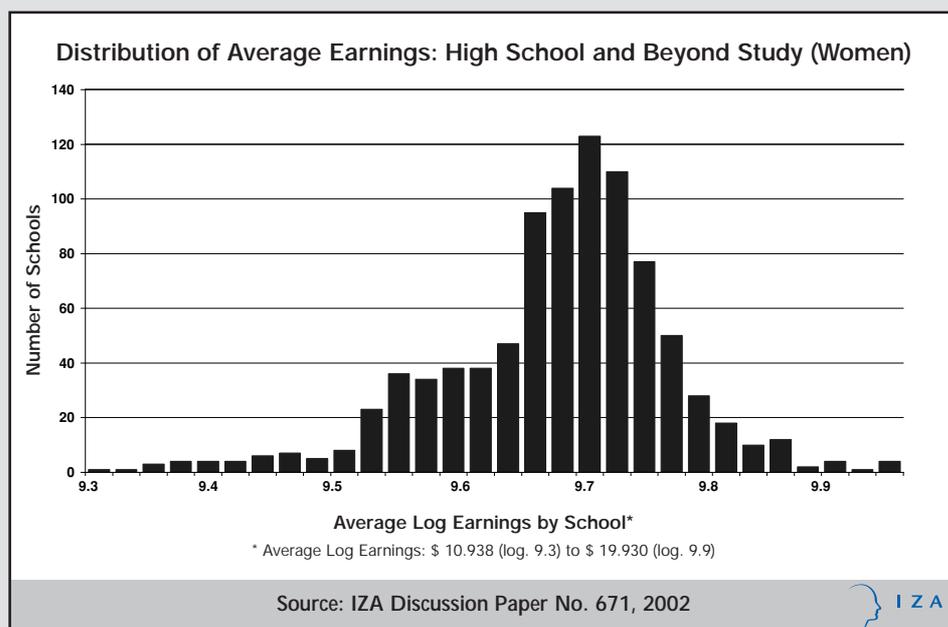
So far, research on school effects has provided ambiguous findings and disparate conclusions. The school effects literature typically involves the identification of specific school characteristics and examines their efficacy in predicting academic achievement or labor market performance via education production functions. Another method to identify school effects is to examine the variation of an outcome of interest, such as earnings, across the distribution of school units. In other words, this approach treats the outcome of interest as a random variable that varies across school units.

Since individuals are nested within schools, the clustering of the data has to be taken into account. An appropriate solution is to investigate school effects in multi-level models. Two levels of hierarchy are involved: a within-school level and a between-school level. At the first level, student characteristics are introduced

into earning models. Conceptually, such models permit analysis and pooling of school specific regressions in a way that takes into account the nesting structure of the data. These regressions describe the earnings of individuals as a function of the particular school's intercept and other individual characteristics such as race, socio-economic background, ability or knowledge represented by achievement test scores etc. Furthermore, selection in the labor force should be taken into account to avoid a possible selection bias, since workers might differ from non-workers in unobservable ways. This problem can be tackled by estimating possible selection in the labor force in a probit model and including these estimates in the elementary within-school regressions. The school specific random effects or residuals at the second level

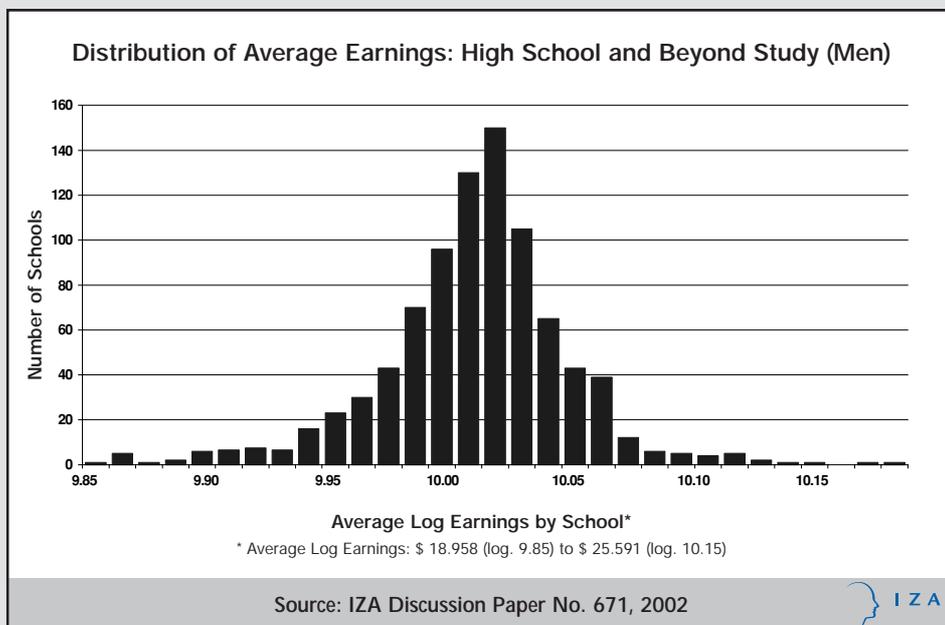
describe the degree to which the average earnings of individuals in a specific school differ from those of the other schools controlling for individuals' characteristics. This implies that the school specific intercepts are treated as random variables in the between-school model and vary across school units.

Hence, the second level, or between-school model describes the variation of the school specific intercepts from the earnings model. Since the school specific effects represent the difference or deviation between a specific school's average earnings and the average earnings of the average school, their arithmetic mean is zero. Then, perhaps the best way to describe the distribution of the school effects is by estimating their dispersion or variance. The variance of this distribution indicates



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tes the degree to which earnings differ from school to school. Hence, it suggests how important the impact of schools is on labor market indicators. With this method the variation of earnings can be decomposed into two parts: the within- and between-school variation. It is this variance decomposition that provides answers to the question whether there are important differences in earnings depending on which particular school has been attended.

School Effects Above and Beyond Individual and Family Characteristics

This framework of analysis was used in the IZA study to identify school effects on the future earnings of young women and men in the 1980s and 1990s separately, controlling appropriately for individual and family characteristics of high school students within each school, as well as for selection into the labor market. Thereby, the paper assesses the extent to which schooling has long-lasting effects on young adults' labor market success that are above and beyond individual and family characteristics. Using the NLS (National Longitudinal Study) and the HSB (High School and Beyond Study), two rich data sets of representative samples of high school stu-

dents, individual and school effects on the annual earnings are estimated.

The results provide convincing evidence that high schools have important differential effects on future earnings. For both men and women, and for both datasets, average earnings vary significantly across schools suggesting the important impact of school effects on future earnings. Furthermore, a wide dispersion of earnings for individuals who attend the same school can be observed, obviously indicating individual differences and perhaps to some extent school specific effects (e.g., teachers, other resources or school climate, school leadership). It should be noted, however, that school specific effects are largely included in the between-school variation.

New Empirical Evidence for the School Effect

Effects of other unobserved characteristics such as motivation, hard work, or ambition were not controlled for in the model used, but it is typically quite difficult, if not impossible, to control for such predictors. It is also possible, since students are not randomly assigned to schools, that the results may be compromised by possible neighborhood ef-

fects. Nonetheless, given the data limitation, a good deal of the variation related to student characteristics is captured. It is noteworthy that the between-school variation of average earnings significantly differed from zero in almost all cases, indicating that the particular high schools individuals attend do matter later in life. The fact that this result was replicated in three out of four cases might also indicate that the results are robust in cohort effects. It should be noted that the between-school variation was at the borderline of the statistical significance in the fourth case. These differential effects of high schools are quite important since students in the samples had finished high school for at least 10 years, and many of them have attended college or graduate/professional schools.

Figure 1 ($\blacktriangle p. 1$) shows the distribution of estimated average earnings for the female HSB sample in 1992. This figure suggests that the estimates follow approximately a normal distribution, although the distribution is slightly asymmetric. The observed variability in the graph indicates that there are differential, enduring school effects on future earnings for individuals who attend different high schools. Figure 2 ($\blacktriangle p. 2$) plots the frequency histogram of the estimated average earnings for the male HSB sample. This graph also indicates that the estimates follow a normal distribution and there is important variability among school specific estimates, which points to important school effects.

Conclusions

Overall, the findings of the IZA study reveal that high schools do make a difference for the subsequent labor market success of their graduates. Average earnings differ significantly across school units, a finding which indicates that schools do matter. In aggregate perspective, schooling is pivotal to human capital formation and lays the foundation for social capital development in an economy. Skilled workers can contribute to a nation's productivity, to a faster growth of a nation's economy, and to a country's competitive position in the global economy. Therefore, although the data used in this study were limited to the United States, the results obtained are relevant to every country that faces challenges in their educational systems.

Applied Economics Quarterly – CALL FOR PAPERS

IZA encourages all Research Fellows to submit manuscripts to the *Applied Economics Quarterly (Konjunkturpolitik)* for possible publication in one of the next volumes. After 49 volumes of publishing mostly in German language, all contributions published by Applied Economics Quarterly will be in English as of 2003. *Rainer Winkelmann* (University of Zurich, former IZA Program Director) has been appointed as the new editor. *Kurt Branas* (Umea University and IZA), *Holger Goerg* (University of Nottingham and IZA) and *Beatrice Weder* (University of Mainz) will join as

co-editors. The international composition of the editorial board reflects the community of economists the journal seeks to reach as well as the journal's commitment to diversity in the type of research it will publish.

The goal of Applied Economics Quarterly is to publish empirical research with relevance for economic policymaking. All areas of economics are considered, including social policy, labor, and population issues. The journal will contribute to current policy debates and enhance economic policymaking

by providing a forum for innovative empirical research. Please submit your paper electronically by email to aeq@diw.de or by regular mail to: AEQ Editorial Office, DIW Berlin, Koenigin-Luise-Str. 5, 14191 Berlin, Germany. For further information, please consult the journal's homepage at www.diw.de/aeq.

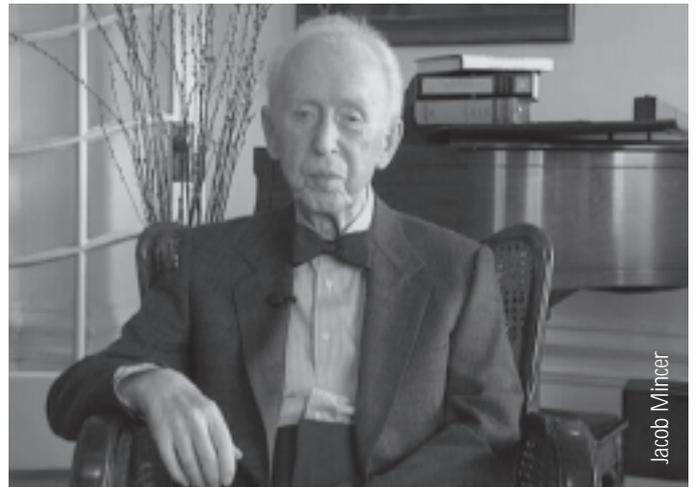
IZA Prize in Labor Economics 2002 Awarded to Jacob Mincer



Klaus F. Zimmermann

Jacob Mincer

Jacob Mincer (Professor Emeritus, Columbia University, New York) was awarded the first IZA Prize in Labor Economics. IZA Director Klaus F. Zimmermann presented the IZA Prize Medal to Jacob Mincer at the laureate's home in New York on November 24. During a celebration with family members, friends and colleagues, Zimmermann praised Mincer's ground-breaking work: "The IZA Prize honors the



Jacob Mincer

Dear colleagues and friends,

I am deeply honored and very happy to be awarded the inaugural IZA Prize in Labor Economics. (...) I would like to convey to you my feelings of gratitude for this high professional recognition.

Almost half a century has passed since I first started my work on labor supply and on human capital as a determinant of wages. The awareness that this work contributed to a reconstruction of the field of labor economics was a source of deep satisfaction throughout my working life. The reformulation of labor economics can be simply described as bringing economic analysis to the study of labor and redefining labor in terms of both quantity and quality, the latter being human capital.

The modernization of labor economics is an unparalleled success story. Its increasing sophistication and expansion keep attracting the best talents. It also attracts institutional support, exemplified by the IZA, in the well-founded hope that research in labor economics will increasingly provide useful insights into labor issues and policies.

Once again, greetings and thanks to all, and wishes for a productive future.

Jacob Mincer



lifetime achievement of an outstanding scholar and pioneer in labor market research", Zimmermann said. In his acceptance speech Mincer underscored the role of IZA as an important institutional supporter of international research in labor economics. (see *IZA Compact October 2002* or www.iza-prize.org for further reports on the IZA Prize).

IZA Director Klaus F. Zimmermann Celebrated 50th Birthday

On December 2, IZA Director Klaus F. Zimmermann celebrated his 50th birthday. Zimmermann is also President of the German Institute for Economic Research (DIW Berlin) and holds teaching positions at Bonn University and the Free University of Berlin. He acts as a policy advisor for influential national and international panels such as the "Group of Economic Analysis" (GEA), an expert body established by the President of the EU Commission. Klaus F. Zimmermann is the author or editor of 24 books and more than 150 essays in refereed journals and anthologies. He has written on various pivotal issues predominantly in the area of labor, migration and population economics. Zimmermann is among the most prolific and influential German economists. He remains determined to continue the systematic expansion of IZA's role as an internationally acclaimed center for labor market research.



Klaus F. Zimmermann

IZA Research Director Gerard Pfann New Managing Editor of European Economic Review (EER)

IZA Research Director Gerard Pfann has become Managing Editor of the European Economic Review (EER) as of January 1, 2003. Founded in 1969, the EER became the official Journal of the European Economic Association (EEA) in 1986. According to the Social Sciences Citation Index, the EER is one of the leading economics journals in Europe. It appears nine times a year and publishes more than 1800 pages.

Besides Gerard Pfann, the editorial team will include Thorvaldur Gylfason (Iceland University) Juer-gen von Hagen (Bonn University), Zvi Eckstein (Tel Aviv University, University of Minnesota, and IZA), and Esther Gal-Or (University of Pittsburgh). The editorial office will be located at BIRC, Maastricht University.



Gerard Pfann



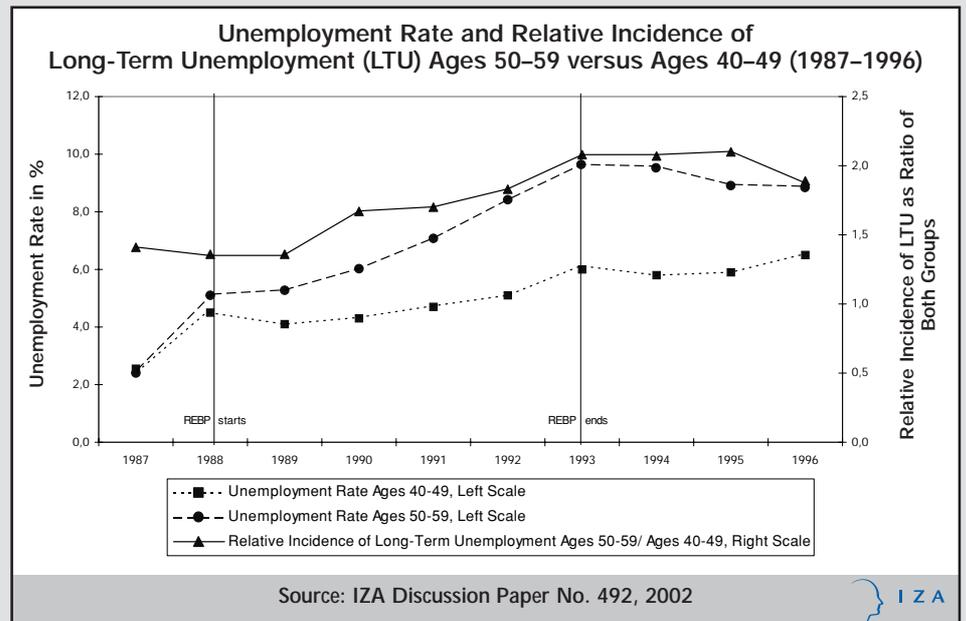
Benefit Entitlement and Unemployment Duration – The Role of Policy Endogeneity

Persisting high unemployment in Germany and other EU member states, in particular among the low-skilled and elderly, requires bold and at times outright unpopular steps in order to achieve the goal of boosting individual initiative in the labor market and to abridge unemployment duration spans. The impact of benefit duration on the length of individual unemployment spells is relatively undisputed among economists. However, rarely the occasion arises of being able to analyze, within a detailed case study, the effects of changes in the political framework and to examine counterproductive incentive structures of a specific unemployment benefit system.

Taking a closer look at the Austrian Regional Benefits Program (REBP) that drastically increased unemployment benefit generosity for workers aged above 50, a recent IZA Discussion Paper by *Rafael Lalive* and *Josef Zweimüller* (both University of Zurich and IZA) sheds new light on the causal effect of benefit duration on long-term unemployment (for details see: *R. Lalive/J. Zweimüller: Benefit Entitlement and Unemployment Duration: The Role of Policy Endogeneity, IZA Discussion Paper No. 492*).

System of Unemployment Benefits in Austria

Austria in general maintains a rather ungenerous unemployment benefit system when compared to other EU member states. The country's rather low wage replacement ratio (unemployment benefits to gross monthly earnings) is comparable to U.S. levels. So are Austrian maximum unemployment benefit duration spans. Austria has been a country with both a low unemployment rate and a low average duration of unemployment, as measured by European standards.



The REBP: A U-Turn in Labor Market Policy

The implementation of the REBP, however, meant a dramatic shift away from a benefit duration period much in line with rather restrictive U.S. standards to a considerably more generous European-style duration span. Purpose-built to respond to the imminent impact of an international steel crisis predicted to hit Austria's traditional iron and steel regions particularly hard, the REBP was regional in scope and ran for five years between 1988 and 1993. The program extended unemployment benefit duration for workers above age 50 with residence in target regions from 30 weeks to a maximum of 209 weeks (four years).

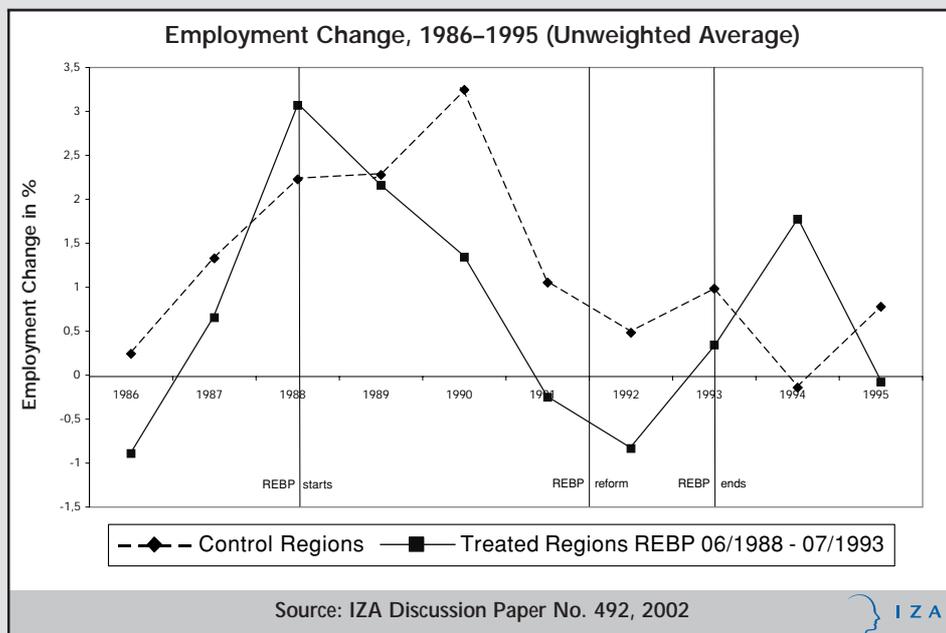
Rising Unemployment

While Austria has been doing relatively well in terms of unemployment figures, the unemployment situation of workers above 50 deteriorated dramatically over the period from 1988 to 1993 (see figure 1▲). The unemployment rate of the age group 50 to 59 was 5.1% in 1988, which was even below the 1988 overall unemployment rate of 5.3%. After 1988 there was a strong and steady increase in the unemployment rate, reaching a maximum of more than 10% in 1993. This is exactly the period during which the REBP was in force. Figure 1 also shows that there was only a moderate upward trend in the unemployment rate of the age group 40–49 in the same time span. This implies a steady increase in the ratio of the unemployment rate of the age group 50–59, relative to the age group 40–49, a trend, which did not stop until 1993, when the REBP was abolished. Moreover, this increase in the relative unemployment rate was exactly matched by an increase in the relative incidence of long-term unemployment.

Sound Basis of Evaluation

A central problem of previous studies had always been that the reasons for changes in benefit rules were typically not accounted for. But when benefit policy is determined by labor market conditions, observed changes in unemployment duration are only partly due to changes in entitlement rules. They are also due to changes in said labor market conditions that lead to new benefit rules in the first place. Hence estimates of the causal impact of benefit generosity on unemployment duration will be biased.

Due to a number of peculiarities, however, this bias can be factored out. In 1991, the program was revised and regions in which the antipa-



ted crisis had not materialized were excluded from the REBP. This tightening of eligibility criteria allowed for the direct comparison of very similar groups of job seekers with different eligibility status. (see figure 2▲ p. 4). The Austrian REBP thus allowed for the unique possibility to discuss the empirical relevance of policy endogeneity in the econometric evaluation of policy measures. The program also offered a rare opportunity to investigate how a policy change as large as the maximum U.S.-European diffe-

rential in benefit eligibility duration affects the duration of unemployment, holding everything else constant.

Repercussions for the Labor Market

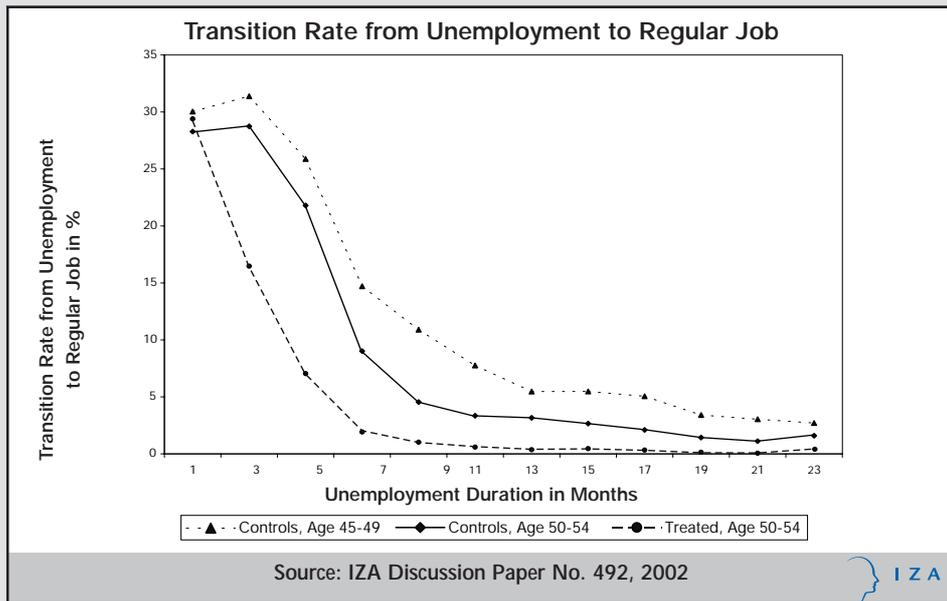
Based on a meticulous analysis of the extensive database that the REBP offered, the study found out that the generous regional unemployment benefit program reduced the incentive to seek and take up a new job considerably. As a direct result, the transition rate to jobs

regressed by 17%, thus increasing average unemployment spells for the relevant age group by a full nine weeks (see figure 3▼). During the tenure of the REBP the country saw the unemployment rate for those aged 50+ almost double to an above average 10%.

After ridding the data of other factors the study also found out that after the abolishment of the program these changes quickly returned to their initial status before the program was set up. The research paper also stresses the fact that accounting for policy endogeneity is crucial. Estimates that fail to do so suggest that the transition rate to jobs, as a result of the Austrian program implemented, regressed by 40% instead of the 17% that the study arrived at after accounting for policy endogeneity.

The Need for Labor Market Reform in Europe

The study provides plausible indication of an incentive-induced correlation between the duration span of unemployment benefits and the length of unemployment spells. Apparently, the scaling-back of unemployment benefit duration boosts individual motivation to set out and find a new job. The resulting abridgement of unemployment spells provides a convincing argument against allegations of illegitimate discrimination against the unemployed in the form of a scaling-back of unemployment benefit programs. The IZA study calls for a systematic review of the length of unemployment benefit programs in Germany and other countries as well.



SHORTREPORTS

+++ Call for Papers: IZA/Upjohn/WDI Research Conference on Microeconomic Analyses of Labor Reallocation, August 21-23, 2003, Kalamazoo, Michigan +++

Studies of labor reallocation have been spurred by a number of recent developments: the perceived increasing pace of structural change, the availability of new microeconomic data (particularly involving the demand side of the labor market), and the example of drastic shifts and dislocation in the transition economies of Eastern Europe and the former Soviet Union. This conference is sponsored jointly by IZA, the Upjohn Institute for Employment Research and the William Davidson Institute at the University of Michigan Business School to promote applied research that uses micro-level data from a variety of economies. Please send paper proposals to Joanne Lowery (lowery@upjohn.org) by April 15, 2003. For details see www.iza.org.



+++ Improving Labor Market Performance: The Need for Evaluation +++

On October 4-5, 2002, the workshop "Improving Labor Market Performance: The Need for Evaluation" was held at IZA. This was the third

evaluation workshop organized at IZA and, like the first one in 1999, co-organized with CEPR. It became apparent that considerable methodological progress has been made over the past three years, but that the now widely available skills in the scientific community are still underutilized due to the scarcity of available (and obtainable) data. The European RTN network on evaluating labor market policies in Europe, under whose umbrella this workshop was organized, once again showed the synergy effects derived from bringing together researchers in the field who share their work with a receptive and knowledgeable audience.



+++ Klaus F. Zimmermann to chair Review Committee of CPB Netherlands Bureau for Economic Policy Analysis +++

IZA Director Klaus F. Zimmermann has accepted to chair an external Review Committee of the CPB Netherlands Bureau for Economic Policy Analysis, The Hague. The international expert committee will evaluate the CPB performance and identify possible areas for further improvement. CPB's main task is to provide independent economic analyses and forecasts that are

relevant for the policy decisions of e.g. government, parliament, and other societal organizations such as political parties, trade unions, and employer's associations. "CPB's effort to sharpen its strategy of scientific research and policy advice through a serious external evaluation sets an example for other institutions in the field," Zimmermann said.



+++ IZA-BIBB Workshop on the "JUMP" Program of the German Federal Government +++

On January 16, 2003, Helmut Pütz, President of the Federal Institute for Vocational Training (BIBB), and IZA Director Klaus F. Zimmermann co-chaired a workshop in which researchers from both institutes discussed the JUMP program of the federal government. The purpose of this program is to alleviate the shortage of apprenticeship openings. BIBB presented some preliminary findings from its accompanying research. IZA plans to cooperate occasionally with BIBB on the topics of vocational training and future demand for qualification.

NEW IZA STAFF MEMBERS



Amelie Constant

Amelie Constant joined IZA as a Research Fellow in August 2002. Since January 2003 she is also a Research Associate at IZA heading the German research activities in a comparative project studying the labor market integration of migrants in Denmark and Germany. She studied Economics at the University of Paris II and received her Ph.D. in Labor Economics and Econometrics from Vanderbilt University in 1998. Since then, she has been a post-doctoral research associate at the University of Pennsylvania. Her research interests are in international migration, assimilation issues, gendered differences in labor market outcomes, occupational mobility, labor market segmentation, and the relationship between schooling quality and earnings.



Thomas Dohmen

Thomas Dohmen started as a new IZA Research Associate in January 2003. He studied economics at Maastricht University, where he received his Master's degree (M.A.) in Economics in December 1998. He also holds an MSc in Economics from the University of Warwick (England). In January 1999, he joined the Business Investment Research Center (BIRC) at Maastricht University as a Ph.D. researcher. In his

doctoral studies, he further specialized in labor economics and applied microeconometrics. Thomas Dohmen visited the Economics Department at the University of Chicago from January 2002 until June 2002. His main research interest is in personnel economics and internal labor markets.



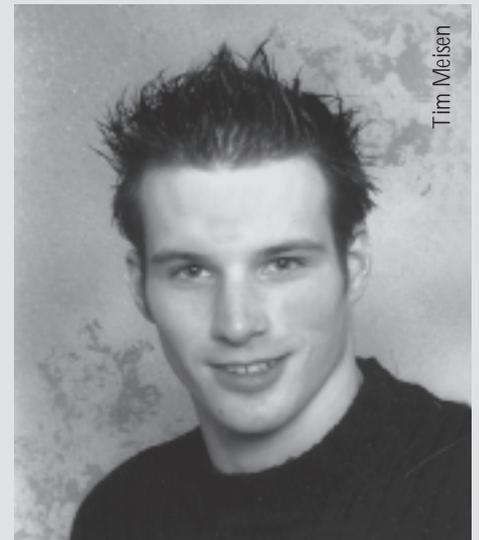
Uwe Sunde

Uwe Sunde, who joined IZA as a Resident Research Affiliate in 2001, has now become an IZA Research Associate and will continue his research on job search, matching, human capital formation, labor market flexibility and wage contracting. In his doctoral thesis, he investigates the effects of individual education decisions on development and earnings inequality, and the effects of individual search behavior on job creation patterns. Uwe Sunde studied economics at the Universities of Warwick, UK and Munich, where he received the degree of Diplom-Volkswirt in 1998. Since then, he has been enrolled in the European Doctoral Program/Bonn Graduate School of Economics, including an extended research visit to the University Pompeu Fabra, Barcelona.



Markus Rickermann

Markus Rickermann studied electrical engineering with a focus on data processing at the Rheinische Fachhochschule in Cologne. After graduating in 1992, he worked for various multinational corporations as a systems engineer, system administrator and network specialist. His previous tasks mainly centered around the development of complex system integrations. In December 2002, he joined IZA as an IT Specialist. Besides his responsibility for user support, he mainly engages in planning, expanding and administering the Windows-based systems at IZA.



Tim Meisen

IZA has long advocated the importance of education and training as well as the employment opportunities offered by new technologies. Both have now been put into practice at the institute: In August 2002, *Tim Meisen* began his three-year apprenticeship as an IT Trainee at IZA. In addition to maintaining hardware and software components, Meisen also takes part in the planning and configuration process of future components of the institute's IT infrastructure.

+++ New IZA Alumni +++

Since December 2002 IZA Research Associate *Astrid Kunze* has been Associate Professor of Economics at the Norwegian School of Economics and Business Administration, Bergen. In January IZA Research Associate *Ashok Kaul* has taken up a research position at the Department of Economics, University Pompeu Fabra, Barcelona. IZA Research Associate *Marcus Hagedorn* continues his research at the University of Pennsylvania, Philadelphia. We thank them for their outstanding achievements at IZA and look forward to maintaining close ties with them as IZA Alumni.

IZA DISCUSSION PAPER SERIES

In November/December 2002 IZA Discussion Papers included the following titles
(a complete list is available on our homepage at www.iza.org - all papers are downloadable):

- 681 Marcus Hagedorn, Ashok Kaul, Tim Menzel**
An Adverse Selection Model of Optimal Unemployment Insurance
- 680 Marcus Hagedorn, Ashok Kaul**
Langzeitarbeitslosigkeit in Deutschland: Fakten, Ursachen und Bekämpfung
- 679 Adriaan S. Kalwij, Rob Alessie**
Permanent and Transitory Wage Inequality of British Men, 1975-2001: Year, Age and Cohort Effects
- 678 Martin Barbie, Marcus Hagedorn, Ashok Kaul**
Fostering Within-Family Human Capital Investment: An Intragenerational Insurance Perspective of Social Security
- 677 Fernando Galindo-Rueda, Anna Vignoles**
Class Ridden or Meritocratic? An Economic Analysis of Recent Changes in Britain
- 676 Alexandru Voicu**
Agriculture: Transition Buffer or Black Hole? A Three-State Model of Employment Dynamics
- 675 Jozef Konings, Olga Kupets, Hartmut Lehmann**
Gross Job Flows in Ukraine: Size, Ownership and Trade Effects
- 674 Deborah Cobb-Clark, Vincent Hildebrand**
The Wealth and Asset Holdings of U.S.- Born and Foreign-Born Households: Evidence from SIPP Data
- 673 Alison Booth, Marco Francesconi, Jeff Frank**
Labour as a Buffer: Do Temporary Workers Suffer?
- 672 Amelie Constant, Douglas S. Massey**
Self-Selection, Earnings, and Out-Migration: A Longitudinal Study of Immigrants to Germany
- 671 Amelie Constant, Spyros Konstantopoulos**
School Effects and Labor Market Outcomes for Young Adults in the 1980s and 1990s
- 670 Maristella Botticini, Zvi Eckstein**
From Farmers to Merchants: A Human Capital Interpretation of Jewish Economic History
- 669 Anna Cristina D'Addio, Isabelle De Greef, Michael Rosholm**
Assessing Unemployment Traps in Belgium Using Panel Data Sample Selection Models
- 668 Jürgen Meckl, Stefan Zink**
Solow and Heterogeneous Labor: A Neoclassical Explanation of Wage Inequality
- 667 Pascal Arnds, Holger Bonin**
Arbeitsmarkteffekte und finanzpolitische Folgen der demographischen Alterung in Deutschland
- 666 Pascal Arnds, Holger Bonin**
Frühverrentung in Deutschland: Ökonomische Anreize und institutionelle Strukturen
- 665 Holger Görg**
Fancy a Stay at the „Hotel California“? Foreign Direct Investment, Taxation and Firing Costs
- 664 Jan Rose Skaksen, Anders Sorensen**
Skill Upgrading and Rigid Relative Wages: The Case of Danish Manufacturing
- 663 Alan B. Krueger, Pei Zhu**
Another Look at the New York City School Voucher Experiment (forthcoming in: American Behavioral Scientist)
- 662 Eric Strobl, Frank Walsh**
Getting It Right: Employment Subsidy or Minimum Wage?
- 661 Eric Strobl, Frank Walsh**
Efficiency Wages and Effort: Are Hard Jobs Better?
- 660 Eric Strobl, Robert Thornton**
Do Large Employers Pay More in Developing Countries? The Case of Five African Countries
- 659 Eric Strobl, David Byrne**
Defining Unemployment in Developing Countries: Evidence from Trinidad and Tobago (forthcoming in: Journal of Development Economics)
- 658 Giorgio Brunello, Rudolf Winter-Ebmer**
Why Do Students Expect to Stay Longer in College? Evidence from Europe
- 657 Adriana Kugler, Juan F. Jimeno, Virginia Hernanz**
Employment Consequences of Restrictive Permanent Contracts: Evidence from Spanish Labor Market Reforms
- 656 Thomas Beissinger, Oliver Buesse**
The Impact of the Unemployment Benefit System on International Spillover Effects
- 655 Wiji Arulampalam, Robin Naylor, Jeremy P. Smith**
Effects of In-Class Variation and Student Rank on the Probability of Withdrawal: Cross-Section and Time-Series Analysis for UK University Students
- 654 Ulf-G. Gerdtham, Christopher J. Ruhm**
Deaths Rise in Good Economic Times: Evidence From the OECD
- 653 Wim Groot, Henriette Maassen van den Brink, Erik Plug**
Money for Health: The Compensating Variation of Cardiovascular Diseases
- 652 Erik Plug**
How Do Parents Raise the Educational Attainment of Future Generations?
- 651 Ekkehart Schlicht**
Social Evolution, Corporate Culture, and Exploitation
- 650 Harminder Battu, Peter Sloane**
Overeducation and Ethnic Minorities in Britain
- 649 Jan C. van Ours, Justus Veenman**
From Parent to Child: Early Labor Market Experiences of Second-Generation Immigrants in the Netherlands
- 648 Thorsten Schank, Claus Schnabel, Joachim Wagner**
Works Councils – Sand or Grease in the Operation of German Firms?
- 647 Christian Grund, Dirk Sliwka**
Envy and Compassion in Tournaments
- 646 Liam Graham, Dennis J. Snower**
The Return of the Long-Run Phillips Curve
- 645 Marika Karanassou, Héctor Sala-Lorda, Dennis J. Snower**
Long-Run Inflation-Unemployment Dynamics: The Spanish Phillips Curve and Economic Policy
- 644 J. David Brown, John S. Earle**
Job Reallocation and Productivity Growth Under Alternative Economic Systems and Policies: Evidence from the Soviet Transition
- 643 Anders Björklund, Marianne Sundström**
Parental Separation and Children's Educational Attainment: A Siblings Approach
- 642 Joop Hartog, Aslan Zorlu**
The Effect of Immigration on Wages in Three European Countries
- 641 Joop Hartog, Luis Diaz Serrano**
Earning Risk and Demand for Higher Education: A Cross-Section Test for Spain
- 640 Joop Hartog, Nicole Jonker, Hans van Ophem**
Dual Track or Academic Route for Auditors: Does It Matter?
- 639 Gilles Saint-Paul**
Are Intellectual Property Rights Unfair?
- 638 Logan McLeod, Michael R. Veall**
The Dynamics of Food Deprivation and Overall Health: Evidence from the Canadian National Population Health Survey
- 637 Holger Bonin, Wolfram Kempe, Hilmar Schneider**
Household Labor Supply Effects of Low-Wage Subsidies in Germany

IZA GUEST RESEARCHERS

From September until December 2002 the following renowned economists stayed at IZA to discuss issues of labor market research and policy:

- Rob Alessie**
(Free University of Amsterdam)
- David Autor**
(MIT)
- Mark Berger**
(CBER, University of Kentucky)
- Arnaud Chevalier**
(University College Dublin)
- Deborah Cobb-Clark**
(Australian National University)
- Amelie Constant**
(University of Pennsylvania)
- Bob Gregory**
(Australian National University)
- María Guadalupe**
(CEP, London School of Economics)
- John C. Haltiwanger**
(University of Maryland)
- Mihail Hazans**
(University of Latvia)
- Hendrik Jürges**
(University of Mannheim)
- John Kennan**
(University of Wisconsin, Madison)
- Kai A. Konrad**
(Social Science Research Center Berlin)
- Barbara Petrongolo**
(London School of Economics)
- Mark Regets**
(National Science Foundation)
- Christopher J. Ruhm**
(University of North Carolina, Greensboro)
- Wendelin Schnedler**
(University of Bristol)
- Jeffrey A. Smith**
(University of Maryland)
- Coen Teulings**
(Tinbergen Institute)
- Andrea Vindigni**
(Princeton University)
- Milan Vodopivec**
(World Bank)
- Doris Weichselbaumer**
(University of Linz)

O P I N I O N

Turnaround in German Labor Market Policy?



The new year has failed to bring any prospects of increased employment in Germany. Although there is some hope that the U.S. economy will pick up in 2003, economic growth in the EU remains sluggish. Germany could even face continued stagnation as the expected boost from the upturn in the global economy may prove too weak to provide the necessary stimulus to domestic demand. If growth in Germany remains far below the threshold that would trigger an increase in employment, the German unemployment rate is likely to climb beyond 4.2 million by the end of the year.

U.S. macroeconomic policy has come up with adequate responses to the global economic crisis for quite some time: Loose monetary and fiscal policies have helped cushion the downturn of the U.S. economy. It is also fortunate that the Federal Reserve has long been aware of its responsibility for economic growth, and that a stable budget has provided ample scope for fiscal policy. European monetary policy, in contrast, has not fully exploited its potential. At the same time, many European governments find their fiscal hands tied by the budgetary requirements of the Stability and Growth Pact.

Nonetheless, there is hope that an adequate re-interpretation of the stability goals could achieve not only sound budgets but also sustainable employment growth over the medium term. Ultimately, the realization of these two objectives will rely on substantial economic growth. A balanced budget is certainly beneficial to economic growth, but the rewards can only be reaped in the medium run. A tight fiscal policy in times of crisis or stagnation will slow down this growth potential. This is especially true if spending cuts are not confined to subsidies and personnel costs but also affect investments in infrastructure, education, research and innovations.

If this fact is ignored, German stagnation may turn into a permanent crisis that could eventually spread throughout Europe. This is why our policymakers must take decisive action to counter this trend. The year 2003 will be the "year of fate" for German economic policy. Political necessities require that effective reforms must be implemented now. The window of opportunity for courageous and painful initiatives will be closed as soon as the next election year approaches. One of the first steps must be to set medium-term rather than short-term budgetary goals. Wage demands must continue to be moderate. In this context, it is worth noting that the German labor unions are cooperating quite constructively in comparison to their European counterparts.

The recent wage agreement for German public service employees, however, is far too generous in light of the already strained public coffers. Since the additional wage costs will further reduce the fiscal scope, particularly for the eastern German states and the municipal governments, the planned reform of municipal government funding must be given high priority. An additional problem is the proceeding east-west wage convergence in the public service sector. The state government of Berlin, given its current budget crisis, has already dropped out of the nationwide wage agreement. This step is an important signal of Berlin's

willingness to work its way out of the financial crisis that has gripped the nation's capital, and to recognize the broader economic context.

Although some of the decisions by the new federal government are certainly debatable, a few initiatives are noteworthy: The process of implementing the labor market policy proposals made by the Hartz Commission has been remarkably fast. Among the measures that took effect on January 1, 2003, are the following: The establishment of "personnel service agencies" to support the local employment offices and speed up job placement, the promotion of temporary work, the removal of restrictions on tax-exempt low-paid work, and the individual reduction of unemployment assistance based on an improved enforcement of entitlement requirements. Further plans include an extension of shop opening hours, a liberalization of the Crafts Code regulations, and the reduction of red tape. All these initiatives deserve praise.

However, this can only be the beginning, not the end of the reform efforts. None of the implemented programs has the potential to deliver a powerful blow to the unemployment problem. Some bring more hope than help. This is true, for instance, for the reform of the "mini-jobs." As these will mainly attract secondary wage-earners, housewives, retirees, and students, the deadweight loss for the government will be substantial. Labor market flexibility may be increased, but unemployment is unlikely to be reduced in the process. In other words, a sweeping reform of the German labor market has yet to occur. Still, there is a good chance for the reform train to finally start moving – it is high time that this chance be seized.

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