



# IZA

# COMPACT

## CONSIDERING THE FUTURE OF LABOR

### IZA Prize in Labor Economics 2003 Presented to Orley C. Ashenfelter

### Prestigious Award for Influential U.S. Labor Economist

On September 22, 2003, numerous renowned scholars and IZA Research Fellows as well as politicians and business representatives followed an invitation by IZA and gathered in Berlin to witness the prestigious IZA Prize in Labor Economics being awarded to one of the most influential economists of our time. *Orley C. Ashenfelter* (Princeton University) has played a crucial role in the evolution of modern empirical labor economics, especially excelling in the methodical advancement of evaluation research (see the official award statement by the IZA Prize Committee ▶ p.2 for more information). With the annual Prize in Labor Economics, IZA recognizes extraordinary achievements in the field of labor economics, while at the same time providing a new incentive to enhance practical research.

The venue for the festive award ceremony was the Museum for Communication in Berlin, where the CEO of Deutsche Post World Net and IZA President, *Klaus Zumwinkel*, presented the Prize to this year's laureate. In his welcome address, Zumwinkel emphasized his company's strong commitment to scientific research and emphatically urged improved collaboration between theory and practice to overcome the serious problems confronting today's labor market. According to Zumwinkel, his company has been fulfilling its societal obligations as one of the world's largest employers – not only by sponsoring IZA, but also by providing thousands of apprenticeships each year.

IZA Director *Klaus F. Zimmermann* thanked the Deutsche Post Foundation for its continuous

support of international labor market economics, in particular through the generous endowment of the IZA Prize. At the same time, Zimmermann emphasized the significance of evaluation research for his institute's mission and daily work. With the establishment of an internal research focus on evaluation of labor market policies, IZA follows the tradition of Orley Ashenfelter and other pioneers in this area. "However, the success of evaluation research hinges on the quantity and quality of accessible data that can be used for independent analyses", Zimmermann exhorted. He urged politicians and labor mar-

ket administration institutions to cooperate in making relevant research data available.

Laudatory speaker *David Card* (University of California, Berkeley), co-author of various joint research publications with Ashenfelter, expressed his delight at the IZA Prize Committee's decision in favor of his former academic tutor. Card stressed that the very existence of this highly prestigious prize and the decision to award it to Orley Ashenfelter exemplify the palpable growth in importance and acknowledgement this field of study has been subject to recently. "Under the guidance of Ashenfel-



*Klaus F. Zimmermann*

*Klaus Zumwinkel*

*Orley C. Ashenfelter*

*David Card*

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ter and others labor economics achieved the best reputation within economics.” He recapitulated Ashenfelter’s extraordinary scientific research achievements, in particular underlining his groundbreaking contributions to the progress of evaluation methodology and his focus on empirically based, as well as politically relevant, research topics.

In his acceptance speech, IZA Prize Winner Ashenfelter led the audience back to the origins of evaluation research, a subject to which

he has dedicated himself over the past three decades. The instrument of creating control groups, whose labor market performance can be compared to the performance of participants in an active labor market program, laid the groundwork for the “success story” of evaluation research. Today the policy implications of evaluation research are becoming ever more relevant, especially when a thorough analysis of data shows that an active labor market program may have no effect at all – or even leave participants worse off. It is

the government’s responsibility to take these analyses seriously and to draw the right conclusions.

To read the complete speeches, or to view photos from the award ceremony, visit the IZA Prize website at [www.iza-prize.org](http://www.iza-prize.org). The next IZA Prize in Labor Economics will be awarded in 2004.

## AWARD STATEMENT of the IZA Prize Committee

The IZA Prize in Labor Economics 2003 is awarded to one of the leading labor economists, *Orley C. Ashenfelter* (Joseph Douglas Green 1895 Professor of Economics at Princeton University, New Jersey), for his fundamental contributions to the field.

Ashenfelter’s intellectual work stands out due to his ingenuity in devising clever ways to derive and test hypotheses of economic models, his exceptional creativity in using and collecting data, and his originality in pioneering the natural experiment methodology. Setting off the development of methods for empirical tests of labor market models Ashenfelter’s scholarly contributions have fundamentally transformed the analysis of labor markets. In a number of seminal articles he has broken new ground in various core areas of labor economics including research on trade unions, wages and employment, the analysis of labor supply, and the study of discrimination, education and training.



Ashenfelter’s 1969 *American Economic Review* article with George E. Johnson derived testable implications from a political model of the function of strikes and has inspired much research about the conditions under which labor disputes are likely to occur. His *Quarterly Journal of Economics* article (with John H. Pencavel) provides a powerful quantitative evaluation of the forces that had accounted for the growth of American trade union membership in the period 1900–1960. These early contributions pointed the way ahead for numerous subsequent studies on various aspects of trade unions. His influential 1972 *International Economic Review* article with George E. Johnson, in which they – accentuating the theoretical argument that the extent of unionism, wages, and labor qualities are jointly determined – assessed empirically a static simultaneous equation model of wage determination, marks the beginning of a more sophisticated econometric analysis of the effect of unions on worker wages than had previously emerged. Path breaking was also Ashenfelter’s 1974 *Econometrica* paper with James Heckman, which skillfully derives theoretical restrictions on the labor supply functions of spouses in a model of family labor supply and tests them in a neat econometric framework.

Serving as the Director of the Office of Evaluation of the US Department of Labor in 1972, Ashenfelter became the founding father of what has by today developed into the separate field of quantitative social program evaluation. His conviction that empirical analyses have to be credible and simple in order to trigger changes in the social system was the impetus for a rigorous development of econometric tools for quantitative evaluation of social programs. This is reflected in two landmark contributions to the literature on the evaluation of government retraining programs, the 1978 and 1985 *Review of Economics and Statistics* articles. These papers developed methods for longitudinal program evaluation that have become known as the “difference-in-differences” approach. The earlier article

pioneered the exploitation of natural variation produced by the social system to investigate important social questions by elaborating the idea of using a comparison group to assess the effect of training. It also identified the bias in the estimation of the effects of training on program participants that is caused by a drop in earnings of trainees relative to the comparison group, which has become known in the economics literature as “Ashenfelter’s dip”. The later paper, which is co-authored with David Card, advanced the natural experiment methodology to partly make up for the lack of experimental data. Apart from expounding new econometric techniques, Ashenfelter has also been a leader in the creative collection of data that are suitable to conclusively answer important economic questions.

The above mentioned achievements are far from representing an exhaustive list of significant scientific contributions. Ashenfelter has enlightened a broader range of topics in labor economics. Many of these contributions are the outcome of fruitful collaborations with former students that he helped train at the Industrial Relations Section at Princeton, of which Ashenfelter was the Director.

Ashenfelter, who has served the labor economics community as former editor of the *American Economic Review* and co-editor of the *Handbook of Labor Economics*, continues to take on important service responsibilities. Currently he is the President of the Society of Labor Economists (SOLE) and editor of the *American Law and Economics Review*.

His scholarly contributions have made Orley Ashenfelter one of the most influential architects of modern labor economics. The IZA Prize in Labor Economics 2003 honors the work of an exceptional scholar who greatly shaped the advance of empirical labor market research.

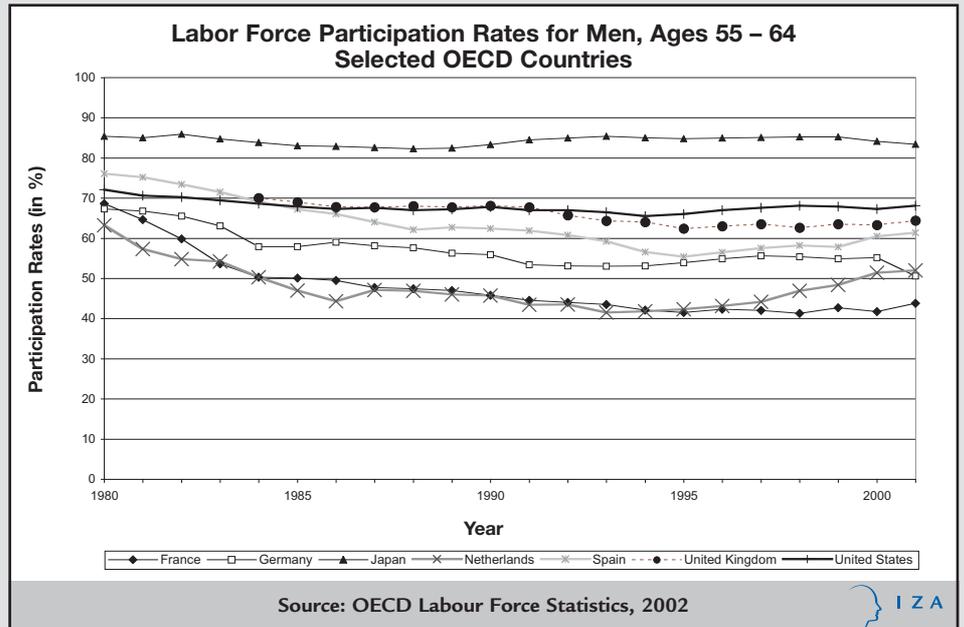
# Caught between Demographic Realities and Early Retirement – Germany’s Attempts at Pension Reform

Germany today faces grave socioeconomic challenges, which the country will need to tackle with determination in order to overcome the legacy of a period marked by harmful political inactivity. One of the most pressing problems is the profound demographic change that has occurred over the past decades. As a result of this ongoing trend, by 2050 more than half of all Germans will be older than 48, and a full third of the population will be older than 60. A sudden and sustained increase in the country’s birth rate, which could counter this development, is highly unlikely. The impact of government programs on the fertility rate is limited, and any reasonable measures to enhance the compatibility of family and job will produce only moderate long-term results. In other words, even if such measures had been implemented earlier, they would hardly have curbed the demographic decline. The same is true for the option of using increased immigration as a vehicle to “rejuvenate” German society. Expansive and well-regulated immigration can play an important role in slowing down the demographic decline, but it cannot stop it, much less reverse it. Allowing immigration of the required magnitude would be politically unfeasible.

At the same time, life expectancy in Germany has surged. Estimates for the year 2030 predict an average life expectancy of 87.6 for women and 83.4 for men – a trend that poses a great challenge to the country’s social safety net provisions. This is especially true for Germany’s pension system. High levels of mandatory contributions seriously impair economic growth. The combination of demographic factors and an average retirement age of just above 60, caused by the country’s continuing love affair with early retirement schemes, is a ticking time bomb that threatens Germany’s pension system. A recent IZA Discussion Paper by *Tryggvi T. Herbertsson* (University of Iceland) and *Michael J. Orszag* (Watson Wyatt LLP) supports this point. Using a simple framework and relying on data from various OECD countries, the study calculates the costs of early retirement in OECD countries – costs that stem from foregone output, a lower tax base and an increased financial burden on pension and fiscal systems. (For details see: *Tryggvi T. Herbertsson/ Michael J. Orszag: The Early Retirement Burden: Assessing the Costs of the Continued Prevalence of Early Retirement in OECD Countries*, IZA Discussion Paper No. 816.)

## The Price of Early Retirement

Until the early 1990s the labor force participation rate for men aged 55–64 was on the decline in most industrialized countries. But while the trend began to reverse in several major countries in the mid-1990s, it continued in Germany (see figure 1 ▲). The labor participation rate for German men aged 55–64



fell from a relatively high 67.3 percent in 1980 to just over 50.6 percent in 2001. In contrast, the rate for Japanese men remained at around 85 percent during the same period of time. This divergence illustrates the dependence of older workers’ labor market participation on a wide range of country-specific factors, particularly the structure of labor markets and employment opportunities.

Taking into account wages as well as the effects of increased employment on wages, the study projects the costs associated with early retirement in OECD countries to rise considerably – from 7.1 percent of output in 2000 to 9.1 percent in 2010 (OECD average). In Germany, this burden will be even higher (see table 2 ▶): The output gap amounted to 13.2 percent in the year 2000 and will only decrease slightly to 12.6 percent in 2010. According to the study, it is therefore of critical importance to design pension systems that provide appropriate incentives to delay retirement. Given the aging population in the OECD area, stabilizing the early retirement burden at its current level would require the labor force participation rate of the 55–64 age bracket to rise by 10 percent – to approximately 56 percent. Radical shifts in the retirement behavior of older workers will be needed just to maintain the current level of costs as a percentage of GDP.

## Germany and the Current Reform Proposals

These complex issues and challenges prompted the German government to set up an independent commission headed by the renowned economics professor *Bert Rürup* (TU Darmstadt) with the mission to draft proposals for Germany’s ailing pension system. In its

final report presented on August 29, 2003, the “Rürup Commission” recommended a series of far-reaching reforms. Identifying enhanced sustainability of the financing mechanisms of Germany’s existing social security systems as a prerequisite for their very survival, the Commission rightly stressed the need to make the financial viability of these programs less dependent on the overall demographic and economic situation in the country. It also warned that social security systems must not inhibit economic growth and employment. However, the Commission highlighted the fact that, with a rising retiree-to-worker ratio, the country’s wage-based funding mechanisms will drive up employers’ social security contributions. In the eyes of the Commission, social security contributions must therefore be disconnected from labor costs. The Commission also called for fair burden-sharing when it comes to paying for the survival of the German social security system in the face of an aging population. The burden should not disproportionately weigh on the young.

## The Commission’s Recommendations

The declared aim of the federal government and the Rürup Commission was to find a way of preventing wage-based pension contributions to exceed the 22 percent threshold while stabilizing pension benefits at 67 percent of previous net income. In order to achieve these objectives, the Commission suggested gradually raising the official retirement age to 67 at an annual rate of one month starting in 2011. It would thus take a 24-year transition period before the target is reached. This would only make sense, however, if the employment prospects of the elderly were substantially improved through profound structural changes

### Costs of Early Retirement in OECD Countries as a Share of Potential GDP (Source: IZA Discussion Paper No. 816)

|                | 1980        | 1990        | 2000         | 2010         |                | 1980        | 1990        | 2000        | 2010        |
|----------------|-------------|-------------|--------------|--------------|----------------|-------------|-------------|-------------|-------------|
| Hungary        | -           | -           | 16.5%        | 19.4%        | Canada         | 5.5%        | 6.7%        | 7.2%        | 10.5%       |
| Belgium        | -           | 15.2%       | 14.1%        | 17.9%        | UK             | -           | 7.5%        | 7.2%        | 10.1%       |
| Austria        | -           | -           | 14.4%        | 15.9%        | Portugal       | 6.0%        | 9.1%        | 8.6%        | 9.4%        |
| Netherlands    | 8.1%        | 10.5%       | 11.2%        | 15.9%        | Switzerland    | -           | 2.9%        | 6.7%        | 9.3%        |
| Finland        | 8.2%        | 9.6%        | 10.6%        | 15.8%        | Ireland        | 4.6%        | 6.9%        | 6.8%        | 8.9%        |
| Czech Republic | -           | -           | 11.1%        | 15.2%        | USA            | 5.6%        | 5.4%        | 5.7%        | 8.1%        |
| Luxemburg      | -           | 12.5%       | 12.6%        | 15.1%        | Norway         | 5.0%        | 4.9%        | 5.2%        | 8.1%        |
| France         | 6.2%        | 11.2%       | 10.3%        | 15.1%        | Sweden         | 5.9%        | 4.7%        | 5.2%        | 7.5%        |
| <b>Germany</b> | <b>7.8%</b> | <b>9.5%</b> | <b>13.2%</b> | <b>12.6%</b> | Japan          | 2.8%        | 4.3%        | 5.4%        | 7.5%        |
| New Zealand    | -           | 7.9%        | 7.8%         | 11.6%        | Turkey         | -           | 5.0%        | 4.0%        | 5.1%        |
| Denmark        | -           | 6.9%        | 8.2%         | 11.3%        | Korea          | -           | 2.2%        | 3.7%        | 5.0%        |
| Greece         | -           | 10.4%       | 10.7%        | 11.2%        | Mexico         | -           | 2.1%        | 2.8%        | 3.7%        |
| Poland         | -           | -           | 7.7%         | 11.1%        | Iceland        | -           | 0.5%        | 1.6%        | 2.2%        |
| Spain          | 4.8%        | 9.7%        | 9.3%         | 11.1%        |                |             |             |             |             |
| Australia      | 7.5%        | 7.5%        | 8.1%         | 11.1%        | <b>OECD</b>    |             |             |             |             |
|                |             |             |              |              | <b>Average</b> | <b>5.3%</b> | <b>6.7%</b> | <b>7.1%</b> | <b>9.1%</b> |

in the organization of the country's labor market and educational institutions. Life-long learning schemes would have to be implemented and accepted by employers. Legislators would have to abolish the entire system of incentives that currently encourage early retirement.

The second major innovation of the Rürup Commission was the proposed introduction of a "sustainability factor" to be incorporated in the determination of pension benefit levels. The sustainability factor would effectively limit the annual growth of pension benefits when the retiree-worker ratio increases. By the same token, this formula would generate extra pension benefits in the unlikely event that the number of contributing workers increases relative to the number of retirees. Overall, the sustainability factor would prevent wage-based pension contributions from exceeding 22 percent before the year 2030.

According to the Commission, this new formula would keep pension growth at 0.5 percent below the rate determined by the currently used calculation method.

If the Rürup Commission's proposals were implemented, average gross pensions would fall from 48 percent to 40 percent in 2030. In practice, this would merely amount to a two percent cut since pensions will fall to 42 percent under the current system anyway. If the "Riester-Rente", a government-subsidized voluntary private pension scheme introduced in 2002, were to be promoted and expanded consistently, it may even be possible to return to a gross pension level of 48 percent by 2030.

#### Is This Enough?

The Rürup Commission's reform proposals would enhance the sustainability of the endangered German pension system. Although the

proposed reforms entail painful benefit cuts and an additional financial burden on retirees, this is the only way to save the system and keep it from seriously impeding economic growth and employment in Germany. Nonetheless, the current reforms can be viewed only as a first step. The current plan of keeping pension contributions above 20 percent of income over the next three decades constitutes an intolerably high burden on labor. In combination with private old-age insurance schemes, the contribution level could be significantly reduced through the abolishment of early retirement practices, the expansion of mandatory insurance to cover all employees including civil servants, an even higher official retirement age, and a stop of pension hikes over the medium term. In this context, IZA recommends raising the official retirement age to 70 over the next 20 years. At the same time there should be more room for individual retirement decisions, based on pension deductions or bonuses calculated by actuarially fair methods. Linking the pension level to the number of children should be considered, even if it is unlikely to have any significant effect in the short run. Since childless retirees have had a financial advantage during their working lives that they can transfer into private savings, a reduction in their pension benefit entitlements should be discussed as a way to lower these windfall gains. The public funds saved in this process could be used to lower the level of pension contributions or to create a family-friendly infrastructure, e.g. better child-care facilities, which would have a positive impact on fertility decisions.

It remains to be seen whether the government will muster the courage to push through the necessary reforms. The currently debated measures have the potential to trigger a comprehensive reform effort, but they may just as well turn out to be another excuse for procrastinating on the revitalization of the German pension system. The window of opportunity for reform is closing fast. It would certainly bode ill for Germany's future should German pension reforms after all succumb to shortsighted interests and a lack of vision among its political opponents.

## Two Top Awards Go to IZA President Klaus Zumwinkel



IZA-President *Klaus Zumwinkel*, CEO of Deutsche Post World Net, has been named "Manager of the Year 2003". The distinguished award committee of the German "manager magazine" announced its decision in November.

In its award statement the committee underlined that Zumwinkel succeeded in transforming a former "clumsy" government-run agency into a profitable, expanding global company. Since Zumwinkel took office in 1990, the Deutsche Post more than quadrupled its revenue, and at the same time productivity per employee has increased by more than 250 percent. Within a short period, Zumwinkel

successfully transformed today's largest logistics group from a deficit-ridden into a highly profitable company. In almost all nine rating categories he received the top score.

Also in November, Klaus Zumwinkel received the Heinrich-von-Stephan medal from Germany's Minister for Economic Affairs *Wolfgang Clement* in "honor of his great service to the development of postal services in Germany". Since 1952 this award is presented to outstanding persons from science, business, postal and telecommunication services. The medal was established in commemoration of the German postal reformer and co-founder of the Universal Postal Union, Heinrich von Stephan.

IZA congratulates its President on these two top awards.

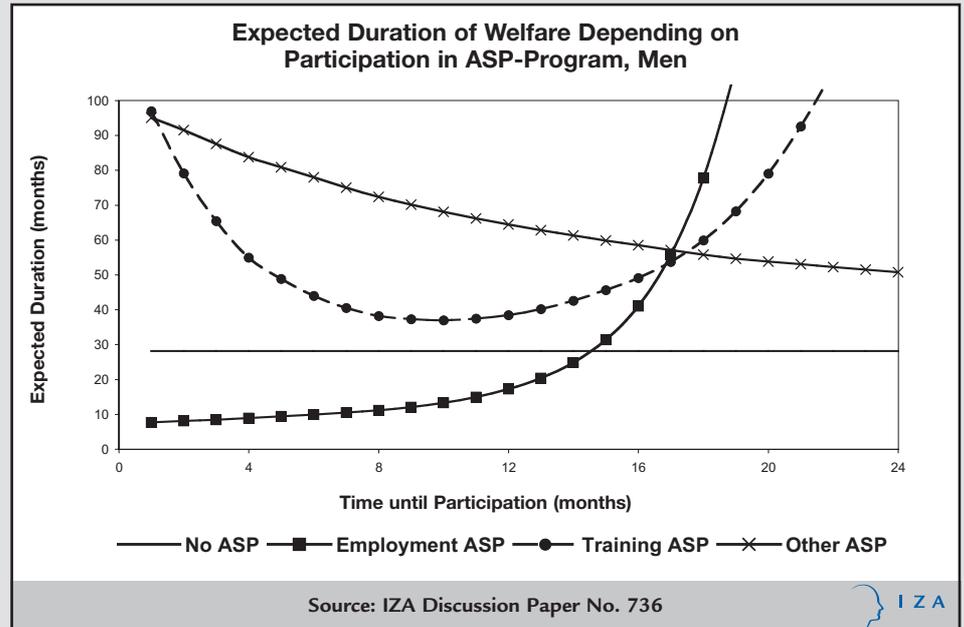
# The Employment Effects of Active Social Policy – A Case Study for Denmark

A recent IZA Discussion Paper by *Iben Bolvig* (Aarhus School of Business), *Peter Jensen* (Aarhus School of Business and IZA) and *Michael Rosholm* (University of Aarhus and IZA) analyzes the effects of active social policy (ASP, the counterpart of active labor market policy - ALMP) on the dynamics of welfare dependence (for details see: *Iben Bolvig/Peter Jensen/Michael Rosholm, The Employment Effects of Active Social Policy, IZA Discussion Paper No. 736*). It evaluates the impact of various ASP measures (employment and training) on the duration of welfare spells and subsequent employment spells, based on data from Denmark. The results show that employment measures improve the chances of leaving welfare dependence whereas training measures have detrimental effects on the exit rate from welfare spells. Additionally, the optimal timing of ASP is investigated, and it is shown that there is a case for assigning individuals to early participation in employment programs, as the net effect is larger the earlier participation begins.

Denmark has an extensive welfare assistance program with a quite generous income support system. During the 1990s, this program has been augmented by a host of active social policies that are supposed to help welfare recipients regain their economic independence. The measures applied in active social policy include counseling and monitoring, labor market training, subsidized employment, relief jobs in the public sector, etc. In this context the main question is whether active social policy can help people regain their economic independence. More precisely: Does ASP help people to return faster to employment and to keep their employment following welfare dependence? In both cases the IZA study provides answers by duration analyses of welfare spells and subsequent employment spells, respectively. The analysis is based on a longitudinal register-based data set covering Aarhus, the second largest municipality of Denmark. By modeling the duration of the welfare spells and the subsequent employment spells, the study can evaluate the impact of the various social policy measures as well as the importance of individual characteristics, such as age, gender, education, family status, and immigrant or refugee status.

## The Effects of ASP on the Duration of Welfare

According to the analysis, the transition rate from welfare to employment is more than three times as high after a period of employment-based ASP compared to no ASP. For training measures, on the other hand, the study finds a negative post-program effect after completing the program: having attended



training measures lowers the transition rate from welfare to employment to half of the transition rate for non-participants. For both types of measures the study finds so-called locking-in effects during the program. The ASP effects differ between subgroups. There are, for instance, no locking-in effects of employment-based ASP for male participants, and the post-program effect of training measures is insignificant for female participants.

A simple modeling of the post-program effect of ASP measures could lead to the false conclusion that one should wait a certain time during unemployment before participating in a government program. The figures suggest that the welfare-to-work transition rate could be up to 6.5 times higher among non-participants if they entered the program after 10 months on welfare. By the same token, the largest post-program effect of training measures would be realized when participants enter the program after almost 8 months on welfare. In this case, however, the transition rate would be the same as for non-participants. It would seem that training measures have little if any impact on the course of unemployment.

Yet, in the end, looking at the net effect of program participation on the expected duration of welfare dependence is the relevant way to evaluate the efficiency of ASP measures. The net effect is the difference between the expected duration for a non-participant and the expected duration for a person participating in a certain program. Against this background it can be seen that an early introduction of ASP measures promises the highest benefit.

## Expected Duration of Welfare and the Optimal Timing of ASP

The expected durations of welfare, dependent on participation in ASP programs, are shown in the figures (see above ▲, p. 6 ▸) for men and women, respectively. For men only employment programs have a positive net effect - and only if participation starts during the first 14 months on welfare. Hence, there is a strong case for targeting men for early participation in employment programs. According to the analysis, none of the other programs can be recommended for men, as they all imply large negative net effects. For women the positive net effect is largest after 6 months on welfare. This is caused by two things: first, by participating earlier, the positive post-program effect can be enjoyed for a longer period, and secondly, early participation implies more weight on the locking-in effect, which is strong for women. Nevertheless, the net effect of employment programs is positive for women irrespective of when the participation period begins. The effects of training and other programs are once again unequivocally negative.

The results concerning the subsequent employment spells show evidence of a considerable short-term recidivism of welfare dependence. Furthermore, the results show that the ASP measures applied during the welfare spells only have weakly significant effects on the duration of the subsequent employment spells. When an effect is present, the ASP measures have negative effects, i.e. participation in ASP tends to shorten the duration of subsequent employment (even though selectivity into the different ASP measures is taken into account).

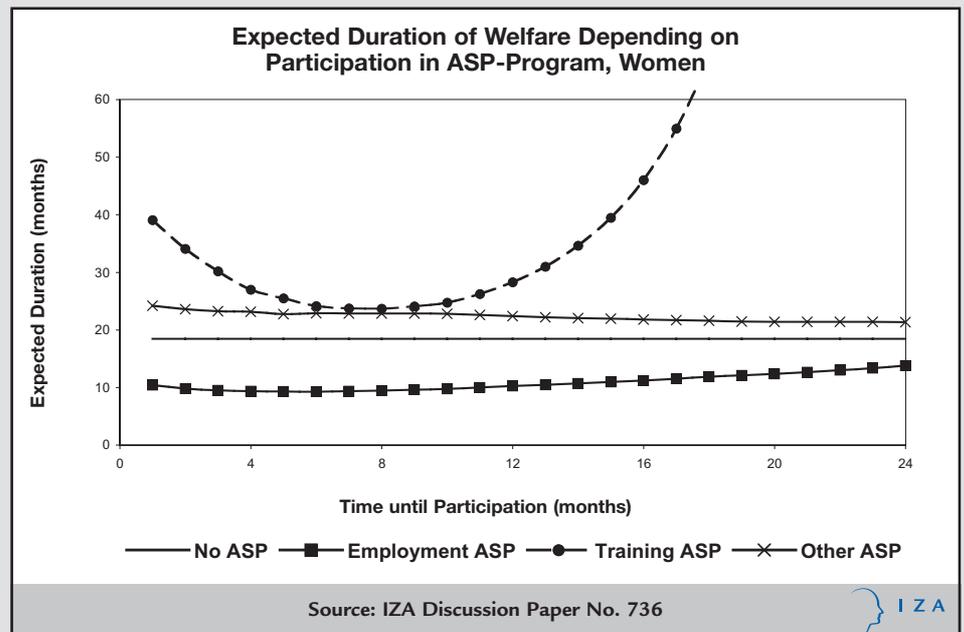
## Conclusions and Policy Implications

The results from the study confirm that the effects of active social policy depend significantly on the type of measure that is applied. Employment measures have weak or insignificant locking-in effects, whereas training measures have strong locking-in effects. Employment measures have positive post-program effects, while training measures have negative post-program effects. Broadly speaking, employment measures improve the chances of leaving welfare dependence whereas training measures have detrimental effects on the exit rate from welfare spells. This shows that only employment measures have the desired net effects whereas training and other measures definitely prolong welfare spells.

It needs to be pointed out that the optimal application of ASP measures, as modeled in the present study, contrasts with the present reality in Denmark. The analysis not only underscores the importance of a close evaluation of labor market policy, but it also shows that a better timing can significantly improve

the effect of labor market program. These insights should also be incorporated in the re-

forms of active labor market policy in Germany.



## New Book: “Reformen – jetzt!” (Reforms – Now! How to Get Germany Back on Track)

Germany is out of balance. Mass unemployment, a social security system that can no longer be financed, soaring public debt, and a government hesitant to approach the necessary reforms – all this is cause for concern. Now more than ever, the country needs foresighted reform concepts to solve the problems that policymakers have not yet had the courage to tackle.

Initiated and edited by IZA Director *Klaus F. Zimmermann*, this book is a forum for influential economists to present their views as pioneering intellectuals and lateral thinkers. Their contributions illustrate the key questions on the future of government, economy and society. They offer unvarnished diagnoses and propose therapies that are as inconvenient as they are honest. And most importantly of all, they help restore confidence that Germany can get back on track.

What the country needs is lasting remedies, not just quick-relief medications. This volume introduces central elements of a long-term reform agenda into the German debate. Furthermore the book documents the recent IZA Labor Market Policy Program as well as the IZA Appeal to German policymakers “Courage to Reform!” which has by now been signed by more than 300 renowned economists.

### Content

- Klaus F. Zimmermann**  
Deutschland 2010: Nach der Reform ist vor der Reform (Reform Agenda for Germany)
- Hilmar Schneider**  
Arbeitsmarkt: Wider die unheilige Allianz von Politik und Tarifkartellen (Labor Market Reform)
- Bert Rürup**  
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Generationengerechtigkeit: Das Beispiel Pflegeversicherung (Intergenerational Fairness)
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Gesundheitsreform: Solidarität und Eigenverantwortung stärken (Health Reform)
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*Klaus F. Zimmermann (ed.),  
Reformen – jetzt!  
So geht es mit Deutschland wieder aufwärts,  
Wiesbaden (Gabler-Verlag) 2003, 215 pages,  
EUR 29,90 – ISBN: 3409125248  
(only available in German).*

# European Summer Symposium in Labour Economics 2003 Offered Broad Perspective on Labor Market Issues

September 3-6, 2003 saw the fifth edition of the IZA/CEPR European Summer Symposium in Labour Economics (ESSLE) at the Deutsche Post World Net Management Training Center in Buch on Lake Ammersee. The organizers, *Juan J. Dolado* (Universidad Carlos III, Madrid, CEPR and IZA), *Gilles Saint-Paul* (Université des Sciences Sociales, Toulouse, CEPR and IZA) and IZA Director *Klaus F. Zimmermann* (University of Bonn, DIW Berlin and CEPR) put together a program which covered macroeconomic as well as microeconomic dimensions of labor markets. More than 40 highly renowned international scholars presented and discussed their current research results.

On the macroeconomic side, presenters analyzed such issues as the effects and causes of wage inequality, looking at how on-the-job search affects between and within-group wage inequality. A different team documented that the recent surge of wage inequality in the U.S. has been accompanied by an increase in the wage-hour correlation whereas consumption inequality has remained relatively stable. It was shown that these effects can be reproduced within an overlapping-generations framework with incomplete markets. Using the model, it was found that the surge in wage inequality is equivalent to a 5 percent decline of lifetime income for the worst-affected cohorts.

Technological progress was another macroeconomic topic. One research team constructed a general equilibrium search model to explain labor turnover and found that a hybrid

model of investment-specific (benefiting old and new jobs) and neutral (mainly embodied in new jobs) technological progress best explains the empirical evidence.

In the area of wage setting, one presentation exemplified how the sustainability of transnational bargaining agreements of unions depends on product market integration and the substitutability among traded goods. Others documented how firing frictions shape the preferences of firms and workers for wage rigidity, and in particular that firing costs increase the attractiveness of wage rigidity.

On the microeconomic side, covering a wide array of issues, one team linked youth unemployment and crime in France, while another presentation focused on the impact of access to guns on crime figures in the U.S.

In the area of stability in work and family life, it was shown via a simultaneous estimation framework that job instability as well as marital instability lowers wages whereas higher wage income increases both stability at work and stability within the family. The study indeed found evidence of a marriage premium on wages. However, another presenter declared such a marriage premium as virtually non-existent for high-wage men. It was also found that labor market decisions such as human capital accumulation are strongly influenced by the "marriage market". Focusing on single mothers, another presenter discovered that their labor market participation rate varies substan-

tially across countries after controlling for demographic and income differences, pointing to important institutional differences in western countries.

Another focus of ESSLE 2003 was on training, investigating the gender differences in training participation across EU countries. Scholars found out that women are not less likely to train while elderly men are, as opposed to elderly women who are not. On the topic of education, another team investigated whether educational policies have an important spillover in a sense that more educated parents are more likely to have more educated children. However, since the authors found no such effect, high correlations between parents' and children's education are likely to result from selection rather than causation. Another presenter used the natural experiment of fee abolition in post-war Germany to estimate the price elasticity of the demand for education. It was found that a change in fees of about five percent of average annual income is associated with an overall change of enrollment rates ranging between 3.5 and 5 percent.

The last presentation turned to internet job search and their effect on labor markets, finding that either internet job search is ineffective in reducing unemployment duration or people who use the internet looking for a job are negatively selected.

All papers presented at ESSLE 2003 are downloadable from the IZA homepage [www.iza.org](http://www.iza.org).



## Advisory Committee to IZA Summer School Founded Call for Papers 2004

IZA has established an Advisory Committee to the European Summer School in Labor Economics, composed of representatives from some of Europe's leading institutions in economics: *Peter Jensen* (University of Aarhus, Denmark) representing the European Society for Population Economics (ESPE), *Claudio Lucifora* (Università Cattolica del Sacro Cuore, Italy) for the European Association of Labour Economists (EALE), and *Rudolf Winter-Ebmer* (University of Linz, Austria) for the Centre of Economic Policy Research (CEPR). The European Economics Association (EEA) will also nominate a representative. IZA Research Director *Armin Falk* (University of Bonn) represents IZA in the Advisory Committee, whose contributions will further enhance the quality of the training provided by the Summer School.

Advanced graduate students from European universities, who are engaged in the prepara-

tion of a doctoral dissertation or approaching that stage, are invited to apply for the 7th IZA European Summer School in Labor Economics (**April 19-25, 2004**).

The objective of the Summer School is to bring together a large number of Ph.D. students and senior lecturers to study new areas in labor

economics. Students have the opportunity to present their work and discuss ideas with established researchers in a relaxed and open atmosphere. Next year's speakers will be *Armin Falk* ("Experimental Labor Economics") and *Christian Belzil* ("Empirical Labor Market Models with Dynamic Self-Selection"). **The submission deadline is February 2, 2004.**



Rudolf Winter-Ebmer



Claudio Lucifora



Armin Falk



Peter Jensen

## IZA Research Fellow DeVoretz Will Hold Willy Brandt Guest Professorship at Malmö University in 2004



Don J. DeVoretz

IZA Research Fellow *Don J. DeVoretz*, a renowned expert in migration economics, has accepted the offer to become Willy Brandt Guest Professor 2004 at Malmö University, Sweden. Financed by the City of Malmö, the Willy Brandt professorship

has been established at the university's "International Migration and Ethnic Relations" program (IMER) to strengthen and develop research in the field and to create close links to international migration research. The professorship is named after former German Chancel-

lor Willy Brandt, who was a leading figure in the struggle for human rights and had strong ties with Scandinavia after having lived in Norway and Sweden during the Nazi regime in Germany.

Don DeVoretz is currently professor of economics at Simon Fraser University, Burnaby/Canada and has held various visiting appointments at the University of the Philippines, the University of Wisconsin, and the Norwegian School of Economics. He is also Co-Director of the RIIM Program "Immigration and Integration in the Metropolis", in which IZA participates as the partner research institute in Germany. While holding the Willy Brandt professorship, DeVoretz will also intensify ongoing research projects with IZA.

## Armin Falk Starts as New IZA Research Director

Since October *Armin Falk* has been Research Director at IZA. He is also a full professor at the University of Bonn with his research focused on behavioral labor economics, personnel economics, and experimental economics. Some of the topics he has dealt with in the past few years have been concerned with the reasons for downwardly rigid wages, relational contracts, the nature of market interactions and the psychology of incentives. One of the projects he is currently working on comprises a field experi-

ment measuring social capital and trying to explain its determinants. Other studies explore the behavioral economics of monopsonies and minimum wages, the power and limits of tournament incentives and the economic effects of peer pressure in the workplace. As part of his new position, Falk will continue his research in these areas in cooperation with research associates at IZA as well as scholars and students from Bonn University. The goal is to establish a strong research team at IZA tackling these issues while at the same time bringing IZA and the university even closer together. In fact, "an enhanced cooperation between IZA and the University of Bonn will be one of our main objectives in the immediate future," says Falk. This will be achieved via Falk's involvement with the experimental lab at the university, his various teaching activities in the areas of experimental economics and behavioral labor economics, and through his vast personal network. In addition, his efforts will aim at further strengthening IZA's international scientific reputation.



Klaus F. Zimmermann Armin Falk

## Book Presentation: "Arbeit in einer alternden Gesellschaft" (Labor in an Aging Society)

At the presentation of "Arbeit in einer alternden Gesellschaft" (Labor in an Aging Society), a book co-edited by IZA, *Hans-Olaf Henkel* underscored the high relevance of this topic beyond pension policymaking. Henkel is President of the Leibniz-Gemeinschaft, an influential umbrella organization of German research institutes. He called for the abolishment of the official retirement age in favor of raising or cutting pensions based on the time of retirement. IZA Director *Klaus F. Zimmermann* joined Henkel in recommending to eliminate special layoff protection rules for older employees and to scrutinize the seniority principle in wage-setting. Both factors constitute

employment obstacles for older job-seekers. *Martin Kohli* (Free University of Berlin), renowned German sociologist and co-editor of the book, criticized the "corporatist triangle" of politicians, unions and employers that has led to the widespread practice of early retirement in Germany.

*Matthias Herfurth/Martin Kohli/Klaus F. Zimmermann (eds.), Arbeit in einer alternden Gesellschaft. Problemfelder und Entwicklungstendenzen der Erwerbsbeteiligung Älterer, Opladen: Leske+Budrich 2003, 301 pages, EUR 24,90 (ISBN 3-8100-3861-4).*

## New Research Associate: David Huffman

*David Huffman* joined IZA as a Research Associate in September 2003. He received his B.A. from Oberlin College (Ohio) in 1996, graduating with High Honors in Economics.

In August 2003, he completed the requirements for his Ph.D. in Economics from the University of California, Berkeley. His research interests include Behavioral Economics, Labor Economics, Experimental Economics, and Consumer Choice. His current research projects include a field study, using San Francisco bicycle messengers, which investigates the impact of loss aversion on labor supply, and a field study of social sanctioning between groups. He also studies the impact of payday, and the frequency of paydays, on consumer spending.



David Huffman

## Thomas Bauer Accepts professorship at Ruhr University Bochum

*Dr. Thomas Bauer*, IZA Program Director for the research area "Mobility and Flexibility of Labor", has accepted a professorship in economics at the Ruhr University Bochum starting in October 2003. IZA Director *Klaus F. Zimmermann* honored Bauer's outstanding academic achievements and his contributions to establishing the IZA Summer School in Labor Economics as well as organizing the Guest Researcher's Program and the IZA Research Seminar Series.



Thomas Bauer Klaus F. Zimmermann

## IZA DISCUSSION PAPERS

From July until December 2003 IZA Discussion Papers included the following titles  
(a complete list is available on our homepage at [www.iza.org](http://www.iza.org) - all papers are downloadable):

- 925 Anna Piil Damm, Michael Rosholm**  
Employment Effects of Dispersal Policies on Refugee Immigrants, Part II: Empirical Evidence
- 924 Anna Piil Damm, Michael Rosholm**  
Employment Effects of Dispersal Policies on Refugee Immigrants, Part I: Theory
- 923 Uwe Dulleck, Paul Frijters, Rudolf Winter-Ebmer**  
Reducing Start-Up Costs for New Firms: The Double Dividend on the Labour Market
- 922 Joachim Merz, Derik Burgert**  
Working Hour Arrangements and Working Hours – A Microeconomic Analysis Based on German Time Use Diary Data
- 921 Peter Egger, Michael Pfaffermayr, Andrea Weber**  
Sectoral Adjustment of Employment: The Impact of Outsourcing and Trade at the Micro Level
- 920 Øivind Anti Nilsen, Kjell G. Salvanes, Fabio Schiantarelli**  
Employment Changes, the Structure of Adjustment Costs, and Plant Size
- 919 Michael Fertig**  
The Impact of Economic Integration on Employment – An Assessment in the Context of EU Enlargement
- 918 Vibeke Jakobsen, Michael Rosholm**  
Dropping out of School? A Competing Risks Analysis of Young Immigrants' Progress in the Educational System
- 917 Rob Euwals, Hans Roodenburg**  
A Note on the Redistributive Effect of Immigration
- 916 Stefan Wolter, Samuel Mühlemann, Jürg Schweri**  
Why Some Firms Train Apprentices and Many Others Do Not
- 915 Reinhard Hujer, Christopher Zeiss**  
Macroeconomic Impacts of ALMP on the Matching Process in West Germany
- 914 Ana Rute Cardoso, Pedro Portugal**  
Bargained Wages, Wage Drift and the Design of the Wage Setting System
- 913 Sergiy Pivnenko, Don J. DeVoretz**  
The Recent Economic Performance of Ukrainian Immigrants in Canada and the U.S.
- 912 Daniele Checchi, Antonio Filippin**  
An Experimental Study of the POUM Hypothesis
- 911 Joachim Wagner**  
Are Nascent Entrepreneurs Jacks-of-All-Trades? A Test of Lazear's Theory of Entrepreneurship with German Data
- 910 Pilar Diaz-Vazquez, Dennis J. Snower**  
On-the-Job Training, Firing Costs and Employment
- 909 Marco Leonardi**  
Firm Heterogeneity in Capital/ Labor Ratios and Wage Inequality
- 908 Marco Leonardi**  
Product Demand Shifts and Wage Inequality
- 907 Arnaud Dupuy, Lex Borghans**  
Supply and Demand, Allocation and Wage Inequality: An International Comparison
- 906 Doris Weichselbaumer, Rudolf Winter-Ebmer**  
A Meta-Analysis of the International Gender Wage Gap
- 905 Doris Weichselbaumer, Rudolf Winter-Ebmer**  
Rhetoric in Economic Research: The Case of Gender Wage Differentials
- 904 Stephen Jenkins, Philippe Van Kerm**  
Trends in Income Inequality, Pro-Poor Income Growth and Income Mobility
- 903 Sourafel Girma, Holger Görg**  
Evaluating the Causal Effects of Foreign Acquisition on Domestic Skilled and Unskilled Wages
- 902 Paul Frijters, Michael A. Shields, Stephen Wheatley Price**  
Immigrant Job Search in the UK: Evidence from Panel Data
- 901 Peter F. Orazem, Milan Vodopivec**  
Do Market Pressures Induce Economic Efficiency: The Case of Slovenian Manufacturing, 1994-2001
- 900 Mark C. Berger, Glenn C. Blomquist, Klara Sabirianova Peter**  
Compensating Differentials in Emerging Labor and Housing Markets: Estimates of Quality of Life in Russian Cities
- 899 Marika Karanassou, Héctor Sala, Dennis J. Snower**  
Unemployment in the European Union: Institutions, Prices, and Growth
- 898 Gerard J. van den Berg, A. Gijsbert C. van Lomwel, Jan C. van Ours**  
Nonparametric Estimation of a Dependent Competing Risks Model for Unemployment Durations
- 897 Martin Brown, Armin Falk, Ernst Fehr**  
Relational Contracts and the Nature of Market Interactions
- 896 Solomon Polachek**  
What Can We Learn About the Decline in U.S. Union Membership from International Data?
- 895 John M. Fitzgerald, David Ribar**  
Transitions in Welfare Participation and Female Headship
- 894 Rainer Winkelmann**  
Parental Separation and Well-Being of Youths
- 893 Klara Sabirianova**  
Skill-Biased Transition: The Role of Markets, Institutions, and Technological Change
- 892 Barry T. Hirsch**  
What Do Unions Do for Economic Performance?
- 891 Lennart Flood, Elina Pylkkänen, Roger Wahlberg**  
From Welfare to Work: Evaluating a Proposed Tax and Benefit Reform Targeted at Single Mothers in Sweden
- 890 Massimiliano Bratti, Luca Mancini**  
Differences in Early Occupational Earnings of UK Male Graduates by Degree Subject: Evidence from the 1980-1993 USR
- 889 David Wildasin**  
Fiscal Policy, Human Capital, and Canada-US Labor Market Integration
- 888 Winfried Koeniger**  
Collective Dismissal Cost, Product Market Competition and Innovation
- 887 Bernd Irlenbusch, Dirk Sliwka**  
Transparency and Reciprocal Behavior
- 886 Juan José Dolado, Marcel Jansen, Juan F. Jimeno**  
On-the-Job Search in a Matching Model with Heterogeneous Jobs and Workers
- 885 Amelie Constant, Klaus F. Zimmermann**  
The Dynamics of Repeat Migration: A Markov Chain Analysis
- 884 Jaan Masso, Almas Heshmati**  
The Optimality and Overuse of Labour in Estonian Manufacturing Enterprises

## IZA GUEST RESEARCHERS

From July until December 2003 the following renowned economists stayed at IZA to discuss issues of labor market research and policy:

- Michael L. Bognanno**  
(Temple University, Philadelphia)
- Carmel U. Chiswick**  
(University of Illinois, Chicago)
- Barry R. Chiswick**  
(University of Illinois, Chicago)
- Deborah Cobb-Clark**  
(Australian National University, Canberra)
- Leif Danziger**  
(York University, Ontario)
- Gil S. Epstein**  
(Bar-Ilan University, Ramat-Gan)
- Peter Fredriksson**  
(Uppsala University)
- Giovanni Gallipoli**  
(Institute for Fiscal Studies, London)
- Ira N. Gang**  
(Rutgers University, New Brunswick)
- Adriaan Kalwij**  
(Tilburg University)
- Ashok Kaul**  
(Universitat Pompeu Fabra, Barcelona)
- Spyros Konstantopoulos**  
(Northwestern University, Evanston)
- Shoshana Neuman**  
(Bar-Ilan University, Ramat-Gan)
- Luca Nunziata**  
(University of Oxford)
- Ronald L. Oaxaca**  
(University of Arizona, Tucson)
- Jan C. van Ours**  
(Tilburg University)
- Gerard A. Pfann**  
(University of Maastricht)
- Solomon Polachek**  
(Binghamton University, New York)
- David Ribar**  
(George Washington University, Washington D.C.)
- Edward Vytlačil**  
(Stanford University)

## O P I N I O N

## Why we will all work more



It is an easily identifiable international labor market trend that the demand for low-skilled labor is decreasing while high-skilled workers are still in short supply. Although the problem is not confined to Germany, the German labor market has been hit particularly hard by this development. Compared to Americans, Europeans work fewer hours. This difference has largely evolved over the past 20 to 30 years. Since the late 1970s, annual working time in Germany has dropped by 25 percent. About the same is true for France and the United Kingdom. In the Netherlands, the massive expansion of part-time work has also led to a decrease in average working hours. Sweden, on the other hand, has managed to overcome its welfare state crisis by increasing average working hours against the general European trend. Germany should be heading in the same direction.

The recent failure of German unions to negotiate a shorter workweek signifies the end of a sustained period of working time reductions.

Many decision makers in business and politics are finally realizing that the widespread practice of sending older employees into early retirement with generous compensation is a political dead end. With its large number of vacation days and public holidays, Germany has long lost its image of a hard-working nation. Why is unemployment so high in a country where people obviously work less than others? Doesn't the long-term population decline call for a policy reversal towards more lifetime working hours?

In the long run, the demographic challenge will make an increase in the overall individual working time inevitable, either through a longer workweek, fewer vacation days, or delayed retirement. Although there should be some flexibility in choosing between these options, a higher retirement age seems necessary to save the pension funds from collapse by reducing pension benefits in case of early retirement. In our emerging knowledge and information society, older employees are no less productive than their younger colleagues. But they will have to be prepared to accept different, possibly lower paid jobs towards the end of their working lives.

Much of the debate on working time centers on the idea of a factory worker whose hours are recorded on a timecard. It ignores the fact that the actual working time has long been rising due to voluntary unpaid overtime and de facto unregulated working schedules. More and more workers are paid for completed tasks rather than time spent at their workplace. Work is no longer just a means of breadwinning, but it is becoming an integral part of people's private lives. In this respect, the public debate lags far behind economic realities.

We must think and act in a more differentiated manner: Workers without proper qualifications should be able to work less, but they should also earn less so that more people have

a chance to find a job. High-skilled workers, on the other hand, should work more because they are in short supply. If they work more for the same hourly wage, they will become less expensive for the employer, and the demand for skilled labor will continue to rise. If we succeed in training more high-skilled personnel, employment will increase. But since our training capacities are limited, the problem can only be solved by allowing more immigration of high-skilled workers.

Longer working hours at the same pay for skilled labor can only be a first step. It will be unsustainable in the long run because wages will have to rise in order for employers to attract and retain highly qualified personnel. To solve the key problems, our society will eventually have to accept a higher income inequality. This may sound unreasonable, but it could work because it would reintegrate the unemployed into the working society.

The new trend in working-time policy will be marked by diversity. Increased working hours will no longer be a problem for high-skilled labor. Part-time jobs, potentially for different firms at a time, will also be on the rise. Individuals without proper training will perform mostly low-paid tasks. As quasi-one-man enterprises, their jobs will be much less secure than they are today. Due to lower wages, they will have to work more to earn a living.

*K. F. Zimmermann*



**IZA**

Institute for  
the Study  
of Labor

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