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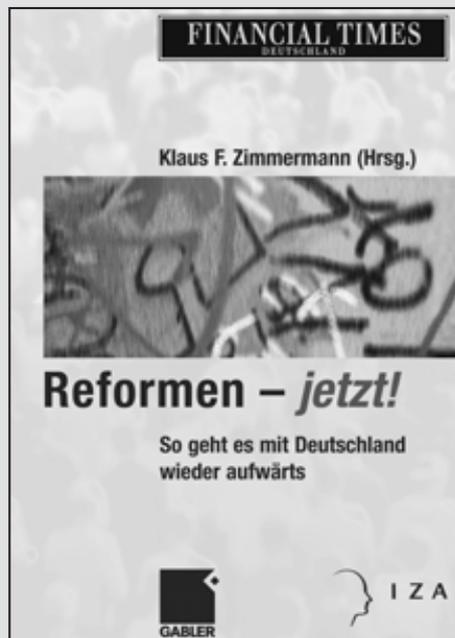
CONSIDERING THE FUTURE OF LABOR

## Reforms – Now! Economists Call for Lasting Modernization of Germany

In a highly topical volume dealing with the reform efforts in Germany, edited by IZA Director *Klaus F. Zimmermann*, a number of prominent economists underscore the need for radical changes in all areas of society to get Germany back on track. The authors introduce central elements of a long-term reform agenda into the German debate. They do not focus on consensus-building emergency solutions, which seem to have dominated the German political stage in the past, but on lasting reforms in all fields from labor market to education and migration policy.

In May 2003, Zimmermann had initiated a call to political decision makers under the motto “Den Reformaufbruch wagen!” (“Dare to Embark on Reforms!”). Several of the more than 300 scholars who participated in this initiative have contributed to the book. They present concepts from their field of expertise to move Germany back into the top league. As pioneering intellectuals and lateral thinkers, they offer unvarnished diagnoses and propose therapies that are as inconvenient as they are honest.

*Hans-Georg Petersen* (University of Potsdam and German Institute for Economic Research/DIW Berlin) calls for a radical simplification of the German tax system by gradually reducing taxes on income and profits to a flat rate of 25 percent by 2015. A simple flat rate would send out a positive signal to international investors and corporations, who would become more inclined to invest in Germany and create new jobs.



*Klaus F. Zimmermann (Ed.),  
Reformen – jetzt!  
So geht es mit Deutschland wieder aufwärts,  
Wiesbaden (Gabler-Verlag) 2003,  
(ISBN: 3-409-12524-8, only available in German).*

The attractiveness of Germany as an investment and business location is also discussed by *Thomas Straubhaar* (President, Hamburg Institute of International Economics/HWWA and University of Hamburg) in his article on migration policy. He demands a quick answer

to the urgent question of how to regulate immigration in Germany. Public fears of uncontrolled and unlimited immigration make it all the more important to create a reliable legal framework for allowing immigration on the basis of actual economic needs.

In his article on higher education, *Gert G. Wagner* (Berlin University of Technology and DIW Berlin) focuses on the question how to qualify high-skilled workers in order to achieve a competitive advantage for Germany. He calls for a better differentiation of university programs and enhanced competition among universities in order to sharpen the individual profile of each institution. His proposed university reform is based on a three-tier structure similar to the Anglo-Saxon system: a bachelor program to qualify graduates for a professional career, a specializing masters program, and a highly qualifying Ph.D. program at newly established graduate schools. A key focus should be the promotion of an academic elite.

The reform discussion of the past year has shown that Germany's international competitiveness also depends on the financial sustainability of its social security system. Against this background, *Friedrich Breyer* (University of Konstanz and DIW Berlin) calls for abandoning the strategy of the “lowest common denominator” in reforming the health care system. Instead, a more comprehensive reform of the system's funding structure should be introduced into the public debate. In his view, the concepts of a citizen's insurance (“Bür-

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Friedrich Breyer



Kai A. Konrad



Hans-Georg Petersen



Rüdiger Pohl



Bernd Raffelhüschen



Bert Rürup



Friedrich Schneider



Hilmar Schneider



Thomas Straubhaar



Gert G. Wagner



Klaus F. Zimmermann

gerversicherung”) and health premiums (“Gesundheitsprämien”), which have so far been at opposite ends of the discussion, are in fact reconcilable.

In his article on pension reform, *Bert Rürup* (Darmstadt University of Technology) favors an advancement of the previous system over radical change. Rürup explicitly warns against such pseudo-solutions as including civil servants in the statutory pension insurance. Instead, the multi-pillar pension system should be pursued more consistently. Expenditures should be aligned with the target level for pension contributions rather than vice versa; the retirement age should be adjusted to the increasing life expectancy; and capital-funded schemes as a supplement to the statutory pension provisions should be expanded.

A capital-based funding model is also supported by *Bernd Raffelhüschen* (University of Freiburg and University of Bergen) for the case of the long-term care insurance. The historical mistake of establishing a statutory long-term care insurance at the expense of future generations has to be corrected within the next years. Otherwise those who currently contribute to the insurance will later demand benefits that may be impossible to finance.

In sum, the proposed measures strengthen the individual responsibility and relieve society as a whole from unbearably high labor costs. Consequently, work in Germany would become cheaper and more competitive again. This is a central aspect of the article on the labor market by *Hilmar Schneider* (IZA). According to Schneider, Germany’s high hourly wages are not only due to the unions’ collective bargaining policies, but

also a consequence of the linkage between the statutory social security insurance and labor costs. However, the unions as self-proclaimed “guardians of social justice” vehemently adhere to the generous unemployment and welfare systems thus bearing much of the responsibility for the lack of a low-wage sector that would be vital for low-skilled workers. The current system protects the existing wage structure by restricting wage competition from the lower income level through an implicit minimum wage. Schneider’s main proposals to revitalize the labor market are to abandon corporatism, to establish a low-wage sector stimulated by the workfare principle, and to cut unemployment benefit entitlements.

In the opinion of *Friedrich Schneider* (University of Linz), lower labor costs will also reduce illegal employment. The mounting tax wedge and the growing regulation of the official labor market lead to a continuous increase in shadow economic activities. Legal sanctions are much less effective than positive incentives to reconvert illegal employment into taxable labor while providing tax breaks to those who are already employed in the regular market.

*Rüdiger Pohl* (President, Halle Institute for Economic Research/IWH and University of Halle-Wittenberg) assesses an overall negative effect of active labor market policies in eastern Germany. He proposes to make the five eastern states pioneers in more flexible collective labor agreements. With regard to infrastructure, Pohl recommends concentrating most of the available resources on the growth-generating urban areas in order to add momentum to the catching-up process.

In his article on EU constitutional reform, *Kai A. Konrad* (Social Science Research Center, Berlin/WZB) complains that the old EU member states have failed to combine their common interests to implement important structural reforms prior to EU eastern enlargement. The existing incentives for pursuing inefficient reallocation activities must be eliminated. It is therefore imperative to maintain the unanimity principle of the Council of the European Union and the participation of national parliaments in financing the EU.

IZA Director *Klaus F. Zimmermann* (University of Bonn, Free University of Berlin and DIW Berlin) finally combines the different positions put forth in the book to form the “Agenda 2010 II” – an agenda that should be sustainable in the long run and go beyond short-term repairs of an outdated system. Courageous and far-reaching reforms, including a modernization of the basic principles of German federalism, will move “Deutschland Corp.” back on the road to success. The concepts must start at the point where policy-makers have so far given up.

# IZA Research Program Restructured – New IZA Program Directors Appointed

Research activities at the Institute for the Study of Labor fall into six thematic areas, each of which is coordinated by a renowned Program Director responsible for conducting original research projects and organizing events on selected topics. The team of IZA staff researchers engages in basic research both on an independent basis and in cooperation with the distinguished group of IZA Research Fellows and Affiliates. All work is published, assessed in terms of its possible labor policy implications, and systematically evaluated by an IZA in-house working group to formulate specific policy advice. While all basic research is coordinated by IZA Research Director *Armin Falk* (University of Bonn), all policy-related matters are supervised by IZA Director of Labor Policy *Hilmar Schneider*.

In January 2004, IZA has restructured some of its research areas and appointed two new Program Directors. A Deputy Program Director inside IZA will assist each of the six Program Directors in their various coordinating duties. The main task of these deputies is to align the research work at IZA with the activities conducted within each program area.

Reflecting the growing importance of Behavioral and Personnel Economics, IZA has established a new research focus on this subdiscipline. Program Director for this area is *Bentley MacLeod* (University of Southern California, Los Angeles), one of the leading experts in the field. IZA further profits from the fact that Research Director *Armin Falk*, Professor of Economics at the University of Bonn, also heads the internationally renowned Bonn Laboratory for Experimental Economics. This constellation will certainly have a stimulating effect on the research activities at both the university and IZA.

In view of the growing economic importance of international migration flows, IZA has also established a Migration Program Area. Head of this area is *Barry Chiswick* (University of Illinois, Chicago), a distinguished expert in the field.

The evaluation of labor market policies will remain one of the central elements of the IZA research agenda. Its main objective is to provide an objective assessment of the effectiveness and efficiency of policy programs. *Hilmar Schneider* is currently responsible for all research done in this area.

In addition, the other research areas were partly reorganized to reflect recent trends

in the discipline. For instance, the program area headed by *Hartmut Lehmann* (University of Bologna) will add a focus on labor markets in emerging economies to its previous research on transition countries. Questions on “The Future of Labor” will remain at the core of the same-named program area under the direction of *Dan Hamermesh* (University of Texas at Austin). It will increasingly deal with necessary policy adjustments. The program area headed by *Dennis Snower* (Birkbeck College, London) will not only examine the relationship between welfare state and labor markets, but also consider the influence of other institutions and regulations on labor market trends.

Given the outstanding expertise of the three IZA Directors *Klaus F. Zimmermann*, *Armin Falk* and *Hilmar Schneider* in the fields of migration, personnel economics and policy evaluation, these respective program areas receive special emphasis within the IZA research agenda. Research on these topics is pursued with particular determination in order to yield specific policy proposals.

The following list provides more information on the contents and the personnel responsible for each program area.

## Program Area 1: Evaluation of Labor Market Programs



Program Director (acting):  
*Hilmar Schneider*, IZA



Deputy Program Director:  
*Holger Bonin*, IZA

Modern welfare states spend substantial amounts on labor market policies aimed at promoting employment and wages. For successful policy development, monitoring of program outcomes is essential. In an era of limited funds, the program area meets the demands by decision makers and taxpayers for clean empirical evidence on labor policy effectiveness. Which participants in a program actually benefit from

it? And how does the initiative affect those who do not participate? Econometric evaluation gives answers to these questions in the absence of controlled policy experiments. Simulation based on empirical regularities in individual behavior enables evaluation even before implementation of new programs. Using these techniques to carry out rigorous cost-benefit analyses, IZA provides independent advice to policymakers, with the goal to contribute to a more targeted allocation of financial resources.

## Program Area 2: Behavioral and Personnel Economics



Program Director:  
*Bentley MacLeod*,  
University  
of Southern California,  
Los Angeles



Deputy Program Director:  
*David Huffman*, IZA

What makes some employment relationships successful, and causes others to fail? What is the role of government and the law in enhancing the performance of existing and new employment relationships? These are key questions for personnel economics. Its primary goal is to understand the relationship between institutions and employee performance. Recent research in behavioral economics has begun to enhance our understanding of the psychological foundations of incentives, and demonstrates that performance does not depend only upon the relationship between measured performance and pay, but also upon many other features of the workplace environment, including employee morale, job security, and the perceived “fairness” of one’s pay. The purpose of this program is to find ways to model and measure these institutions and then to assess the importance that they play in determining employee performance. The results from this research can inform both businesses and government on the best way to manage their employees and improve existing laws and regulations.

**Program Area 3:  
Migration**



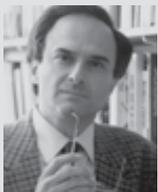
Program Director:  
*Barry Chiswick,*  
University of Illinois



Deputy Program Director:  
*Amelie Constant,* IZA

The Migration Program Area focuses on the many dimensions of growing international and internal migration. It is concerned with the determinants of the supply and demand for migration, including immigration law and the legal status of migrants. It is also interested in the many aspects of the adjustment of migrants and their descendants in the destination, including public policies regarding absorption and assimilation. Moreover, the program area is concerned with the impact of migration on both the origin and the destination. The implications of the analyses for immigration policy, absorption and assimilation policy, and other public policies will also be developed.

**Program Area 4:  
Labor Markets and Institutions**



Program Director:  
*Dennis Snower,*  
Birkbeck College, London



Deputy Program Director:  
*Winfried Koeniger,* IZA

This program area analyzes the effect of institutions on labor market outcomes. A particular emphasis is on the analysis of the institutions on the micro level and their macroeconomic consequences for economic performance. Furthermore, the program area is concerned with the politico-economic determinants of institutions such as unions, employment protection legislation, minimum wages, unemployment insurance and other institutions of the welfare state. A related focus of attention is the interaction between labor markets and product or financial markets and their respective institutions as markets become ever more global.

**Program Area 5:  
Labor Markets in Emerging and  
Transition Economies**



Program Director:  
*Hartmut Lehmann,*  
University of Bologna



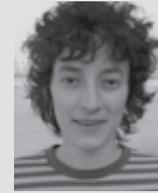
Deputy Program Director:  
*Alexandru Voicu,* IZA

The analysis of labor markets in transition economies is still a wide and flourishing field within labor economics. The program pursues several strands of this analysis: looking at special adjustment mechanisms in the labor market, emphasizing the differences between Central European countries and the countries of the former Soviet Union; evaluating the success of labor market reforms in the light of Western experience; discussing the lessons that can be drawn from these reform efforts for EU economies; and last, but not least, analyzing labor issues that are connected to EU accession of the Central European countries. IZA research in this area will also be extended to labor markets in the emerging economies of Africa, Asia and Latin America in order to study e.g. the analysis of the nexus between labor market reforms and poverty alleviation, and the impact of universal labor standards on formal employment in these countries.

**Program Area 6:  
The Future of Labor**



Program Director:  
*Dan Hamermesh,*  
University of Texas at Austin

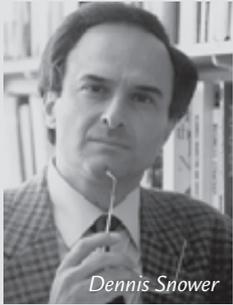


Deputy Program Director:  
*Ana Rute Cardoso,* IZA

The future of labor is shaped by three distinct factors. On the demand side, globalization and fast-paced technological progress lead to reorganization and new forms of work. On the supply side, training, mobility and population aging determine the scope and social consequences of these adjustments. Additionally, the interplay of supply and demand is subject to a third major factor: the responses of various labor market institutions and government policies. This research program focuses on critical developments taking place in the labor market, providing enhanced understanding of labor market dynamics. How will work patterns and time use evolve? What are the ingredients of successful career paths in the labor market? What institutional changes and economic and social policies can improve the working of the labor market? How will collective employment relations evolve? What is the role of ethnicity/race/gender in the future of labor markets?



# Dennis Snower Will Become President of the Kiel Institute for World Economics – IZA Fellows Head Several German Institutes



IZA Research Fellow *Dennis Snower* (Birbeck College, London), who has held a central position at IZA as Program Director since 1998, will become President of the Kiel Institute for World Economics (IfW). One of the world's most renowned labor economists, Snower will take over the IfW Presidency from *Horst Siebert* (University of Kiel), who held this office from 1989 until 2003.

Snower is the second IZA Program Director to assume a leading position at one of Germany's top economic research institutes. In the fall of 2002, *Christoph M. Schmidt* (Univer-

sity of Bochum), who received his habilitation under the supervision of IZA Director *Klaus F. Zimmermann*, became President of the Rhine-Westphalian Institute for Economic Research (RWI Essen). *Thomas Bauer* (University of Bochum), another former IZA Program Director and successful habilitation candidate under Zimmermann, was recently appointed to the RWI board as well. IZA Fellow *Thomas Straubhaar* (University of Hamburg) has managed the Hamburg Institute of International Economics (HWWA Hamburg) since 1999 while keeping close ties with IZA.

In addition, IZA Research Fellow *Bernd Raffelhüschen* (University of Freiburg; University of Bergen), a renowned expert in the field of generational accounting and an influential political advisor on social security issues, has been offered the presidency of the Halle Institute for Economic Research (IWH). Raffelhüschen

would succeed *Rüdiger Pohl* (University of Halle-Wittenberg), who managed the institute with great success over the past ten years.

IZA Director and DIW President Klaus F. Zimmermann commented on these personnel decisions: „IZA is proud to have some of its most active Research Fellows and former Program Directors in such key positions. I am especially pleased that my good friend Dennis Snower has chosen to accept the IfW Presidency. Owing to his scientific excellence and expertise on questions of incentive-based welfare state reform, he will certainly stimulate the German modernization debate.“



## IZA Issues Discussion Paper No. 1000 – Benefit Sanctions Can Reduce Unemployment

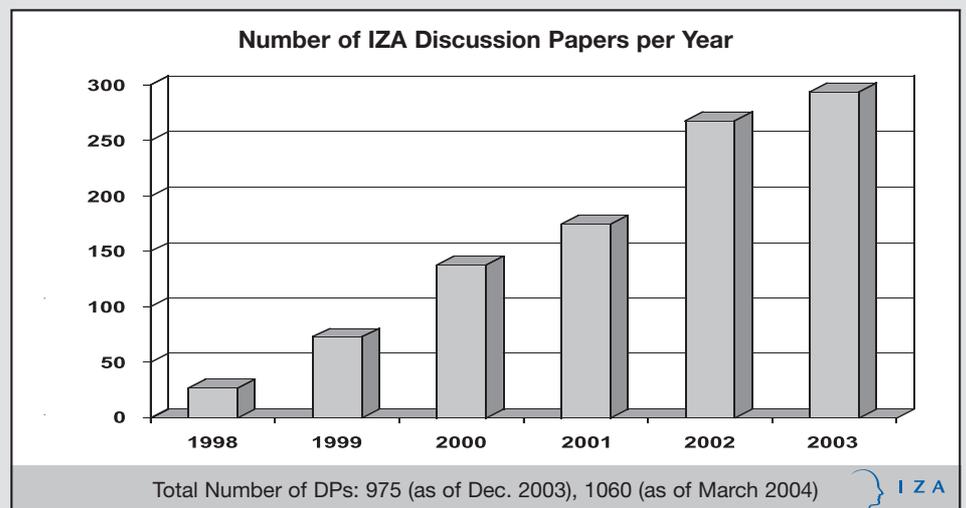
In February 2004, the Institute for the Study of Labor published paper No. 1000 of its successful IZA Discussion Paper Series. Currently, IZA publishes 4-5 Discussion Papers every week, resulting in a dynamic expansion of the series since its start in 1998. This reflects IZA's central role as a communication platform for labor market research worldwide. The IZA Discussion Paper Series covers all relevant topics in labor economics and invites the IZA "family" of staff members, Research Fellows and Affiliates to submit their research findings before publication in a refereed journal.

The series thus facilitates the dissemination of high-quality research to the scientific community and the interested public. The papers have a worldwide circulation and are available free of charge from IZA's website at [www.iza.org](http://www.iza.org). IZA currently ranks third in terms of abstract views at RePEc, the largest online database for working papers in economics. In 2003, IZA Discussion Papers were downloaded more than 100,000 times from our own homepage, not including downloads via the SSRN network.

Co-authored by one of the most active contributors to the series, Jan van Ours, IZA Discussion Paper No. 1000 analyzes job search behavior in the presence of unemployment benefits and unemployment benefit sanctions

using a search-theoretic framework. It is based on laboratory experiments in which the arrival of job offers is exogenous. The focus lies on wage offer acceptance behavior (for details see: *Jan Boone/ Abdolkarim Sadrieh/Jan van Ours, Experiments on Unemployment Benefit Sanctions and Job Search Behavior, IZA Discussion Paper No. 1000*). In theory, the job search behavior of an unemployed worker is influenced by a system of benefit sanctions in two distinct ways. First, if an unemployed worker is con-

fronted with a benefit sanction, a reduction of the benefits, a worker will be more likely to accept a given wage offer than he would be if his benefits were constant and no system of benefit sanctions existed. This is the so-called "ex post effect". Second, to avoid being confronted with a benefit sanction a worker will be more likely to accept a given wage offer than he would be if his benefits were constant and no system of benefit sanctions existed. This is the so-called "ex ante effect".



The experiments in the study show that both ex post and ex ante effects are relevant. The magnitude of both effects depends on the structure of the system of benefit sanctions and on the specific wage offers. In most cases, the ex ante effect (which is hard to estimate using econometric techniques on real world data) is larger than the ex post effect. In the

experiment, two unemployment benefit systems are compared where one system has the same benefit every period and the other a lottery over a high and a low benefit. In both cases, the expected unemployment benefit per period is the same. It is shown that the outflow out of unemployment is far higher for the lottery scheme. The policy implication is that

introducing benefit sanctions can reduce unemployment even when the expected unemployment benefit level is unchanged. The study also finds that reservation wages are higher than the theoretical optimum for a risk-neutral individual. This effect is most pronounced in the treatment with constant unemployment benefit levels.



## IZA Further Expands Its Web Resources in Labor Economics

The IZA online information services are gaining popularity, not just among economists, but increasingly among journalists, political institutions and the interested public. The institute's homepage contains all available IZA publications and provides download links or bibliographic references. More than 1,000 IZA Discussion Papers are now available online. A comprehensive search engine helps the user to find papers easily. Standard features of the IZA website include information on nearly 400 IZA Research Fellows and their research focus, a permanently updated "Who is Who in Labor Economics" database, a substantial collection of thematic links, as well as an overview of international events in labor economics and related fields of research. Processing this information is an essential part of IZA's mission to provide access to labor market research and its findings through a central internet gateway. IZA Research Fellows have the opportunity to use a complete virtual workplace environment that is accessible through a separate network. The IZA website currently offers a total of about 3,000 English and 2,000 German pages. The constantly increasing number of daily page hits and downloads documents the growing interest in these services.

### New: Facts and Figures

In March 2004, IZA has added important new functions to its web presentation. In response to the strong demand for up-to-date statistics, a special category with "Facts and Figures" now provides information on relevant labor market questions in the form of commented figures. They include national and international economic indicators as well as a

survey of forecasts by German economic research institutes. The content is constantly updated and expanded. IZA thus provides a single gateway for the informed public to access important data and statistics. Available in both English and German, the site is targeted not only at economists, but also at students, teachers, professors, and economic journalists, who are looking for information on specific topics to underscore their arguments. We welcome any comments or suggestions to expand our "Facts and Figures" section.

([www.iza.org/en/webcontent/charts](http://www.iza.org/en/webcontent/charts))

### New: "Who is Who in Labor Economics" with Additional Features

The "IZA Who is Who in Labor Economics" now features more than 600 economists worldwide. The database is searchable by name, institution, research interests, and publications. All labor economists are encouraged to register for this directory. Upon approval, they are authorized to manage their own profile online. This function ensures that the information is updated more regularly. Networking today plays a larger role in academic science than ever before. The "Who is Who" helps labor economists to find partners for joint research projects, and it provides non-scientists with information on available experts in certain fields of labor economics.

([www.iza.org/whoiswho](http://www.iza.org/whoiswho))

### New: IZA Literature Database on Migration

As part of its research program, IZA is actively involved in various studies in the field of mi-

gration. Since 2003, IZA has collected bibliographic references of migration literature in a database that soon became the largest of its kind worldwide. This database is constantly updated and, in contrast to other well-known literature databases, it includes recent working papers. Thousands of searchable references make online literature queries on this topic a lot easier. Additional bibliographic databases on other labor market topics are also planned.

([www.iza.org/migration](http://www.iza.org/migration))

### Technical Improvements

A series of technical improvements has increased the accessibility of the IZA website to 99.7%. Content and layout are presented in a way that ensures an adequate performance, even with a slow internet connection. More emphasis is placed on the quality of information and services than on the latest technical gadgets. The functionality of the improved IZA search engine guarantees precision in searching and a transparent display of the results. Authors of IZA Discussion Papers can submit their work online for publication in the series. Moreover, anyone interested in IZA publications and activities may register online for the IZA Newsletter and for regular email notifications of new IZA Discussion Papers.

With its functionality and information density, the IZA website represents an online gateway to labor economics that is almost unparalleled.



## New IZA Book: "How Labor Migrants Fare"

In the globalized economy, labor migration has become of central importance. A key issue in the analysis of immigration is how the migrants fare in the economy in which they migrate, and how they assimilate towards the behavior of the natives. A new IZA volume, edited by IZA Director Klaus F. Zimmermann and IZA Research Fellow and Associate Amelie Constant, collects fundamental papers of the *Journal of Population Economics* and provides answers to these questions.

Using data from the United States, Canada, and many European countries, Australia and New Zealand, the chapters study the development of earnings, employment and, unemployment, self-employment, occupational choices and educational attainment after migration. The book also investigates the role of language in labor market integration and examines the situation of illegal, legalized and unwilling migrants. Policy effects are also studied, including the effects of selection criteria of labor market success and the effects

immigrants have on the public sector budget of the receiving country. Hence, the book provides a broad picture of the performance of migrants on the labor market.

Klaus F. Zimmermann/Amelie Constant (eds.), *How Labor Migrants Fare*, Berlin (Springer) 2004, (ISBN 3-450-00665-6).

# Beware of Pseudo Solutions to the Social Security Problem – Bert Rürup Speaks at the “IZA Tower Talk”

With Bert Rürup (Darmstadt University of Technology), head of the German government commission for “sustainability in financing the social security systems”, IZA was able to present another renowned speaker at the IZA Tower Talk on January 21, 2004. During his speech and the subsequent discussion with IZA Director of Labor Policy Hilmar Schneider in the Bonn “Post Tower”, Rürup addressed a range of remedial approaches designed to enhance the sustainability of Germany’s social safety net provi-

reserves created for civil servants’ pensions), which in combination cause the sustainability gap, would have to be reduced substantially.

The proposals put forward by his expert commission would go a long way in achieving this goal, Rürup claimed. On the one hand, a sustainability factor considerably more far-reaching than a mere demographic formula would have to be introduced to keep social security contribution payments below 22 per-

centage that under these circumstances the pension system could be stabilized in the long run but “not on a level that would ensure an adequate standard of living.” To this end, improvements in education and training, increased real capital formation and longer working lives are as indispensable as cutting today’s pension levels. However, Rürup tied any pension cuts to two conditions: “They must be predictable, so that people can make necessary preparations in advance, and we need to ensure that the rates of return of our pay-as-you-go system remain positive.” Rürup also insisted that there was no alternative to supplementary privately funded pension plans. Only mixed social security systems are capable of achieving the goal to maintain current standards of living, Rürup contended.

He rejected proposals to transform the current social security insurance scheme into a “citizen’s insurance”, which would force civil servants into the system, and dismissed the notion of a tax-financed base pension as well as the suggestion to tie the individual contribution level to the number of children. Just like the complete abandonment of the pay-as-you-go model in favor of a fully funded pension system, Rürup regarded these proposals as “fallacies of social security reform” that ought to be rejected as unrealistic and financially unfeasible. In particular, family policy should not be managed via the social security system. As a pivotal task of society, it needs to be dealt with by society as a whole.

But while Rürup pleaded the case for a reform of Germany’s social security system from within, he regarded the German health care system as obsolete and in need of more radical reforms. Although Rürup saw now empirical evidence of an approaching “cost explosion” in the German health care sector, he warned that the entanglement of health care and labor costs would seriously inhibit economic growth. Since the current health care reform avoids the question of funding, it can only be seen as a first step toward a more fundamental redesign of the entire health insurance system. As a much more effective approach, he favored the introduction



sions. But he also warned of alluring but illusory pseudo solutions, which would merely exacerbate the problems in the near future. Rürup advocated sustainable reforms of the existing pay-as-you-go scheme while pleading the case for leaving the system fundamentally unchanged. Moreover, he called for a complete restructuring of the German health care system to make it financially feasible again.

“There is no such thing as a secure pension”, Rürup stressed. Sustainability can only be achieved if “a given contribution level can be maintained without having to scale back benefits.” To this end, sustainability gaps resulting from generational imbalances need to be closed. But this can only be achieved if future generations are relieved from contribution payment obligations. Thus, the explicit (interest rates resulting from governmental borrowing) and the implicit national debt (e.g.

cent in the future. On the other hand, a “clear signal” should be sent out by gradually raising the official retirement age to 67.

Companies will have to learn to be competitive with employees aged 55-64 and to avoid age-related premature layoffs and early retirement schemes, Rürup said. He conceded



**Bert Rürup** is Professor of Financial and Economic Policy at the Darmstadt University of Technology. He has been a scientific adviser of the German government for many years, among others as head of the “Commission for Sustainability in Financing the Social Security Systems” (2002-2003), head of the “Expert Commission for the Reorganization of Old Age Taxation” (since 2002), head of the “Advisory Council for Social Pensions” (since 2000) and as a member of the influential German “Council of Economic Experts” (since 2000).

of a “health premium” model that would separate labor costs from health care costs. The only “advantage” of the much debated citizen’s insurance, according to Rürup, is its name – which suggests “warmth, security and solidarity” and makes people believe that the costs are indeed split up fairly between all citizens. Last but not least, a “genuine” health care reform would have to account for the responsibility to foster future growth in an expanding health care sector, thus contributing to overall employment growth.

Rürup concluded the well-received event with an appeal to economists to be patient with regard to cost efficiency. Neither should deductibles, waiting periods or individual insurance premiums be off limits nor the systematic exclusion of benefits that have so far been covered by the unemployment insurance system, although they are not directly related to the matter. A glance at other countries’ unemployment insurance systems could be helpful to form an opinion about further steps towards a viable reform. With its “unemployment accounts”, implemented in 2002, Chile, for instance, showed an interesting alternative to Germany’s state-run system. The Chilean unemployment insurance model, which only applies to private sector employees, is based on individual accounts as known from the pension insurance system. The model’s main features provide thought-provoking impulses for the German debate on unemployment insurance reform.

As opposed to the pay-as-you-go scheme, the Chilean system administers an individual account for every worker. Insurance contributions will be saved in this account, and all capital not used during unemployment spells will be paid out upon retirement. The insured worker thus profits directly from quick reemployment and short periods of benefit receipt. In contrast, the pay-as-you-go system typically rewards those who are unemployed for longer periods of time as they receive more insurance payments over the course of their working lives. They have fewer incentives to seek quick reemployment because no bonus is awarded for keeping unemployment spells short.

The Chilean unemployment accounts are only applicable to laborers and other private-

to initiate necessary reforms early enough. But economic science, Rürup stressed, has the obligation to develop realistic concepts and introduce them into the public debate.



## Chile Successfully Reforms Its Unemployment Insurance System – Impulses for the German Debate?

The German unemployment insurance is in desperate need of reform, especially with regard to cost efficiency. Neither should deductibles, waiting periods or individual insurance premiums be off limits nor the systematic exclusion of benefits that have so far been covered by the unemployment insurance system, although they are not directly related to the matter. A glance at other countries’ unemployment insurance systems could be helpful to form an opinion about further steps towards a viable reform. With its “unemployment accounts”, implemented in 2002, Chile, for instance, showed an interesting alternative to Germany’s state-run system. The Chilean unemployment insurance model, which only applies to private sector employees, is based on individual accounts as known from the pension insurance system. The model’s main features provide thought-provoking impulses for the German debate on unemployment insurance reform.

As opposed to the pay-as-you-go scheme, the Chilean system administers an individual account for every worker. Insurance contributions will be saved in this account, and all capital not used during unemployment spells will be paid out upon retirement. The insured worker thus profits directly from quick reemployment and short periods of benefit receipt. In contrast, the pay-as-you-go system typically rewards those who are unemployed for longer periods of time as they receive more insurance payments over the course of their working lives. They have fewer incentives to seek quick reemployment because no bonus is awarded for keeping unemployment spells short.

The Chilean unemployment accounts are only applicable to laborers and other private-

sector employees (about 56 percent of the total workforce). They are mandatory for all employment contracts made after October 1, 2002 and voluntary for all previous employment relations. Within the first twelve months, 50 percent of all potential unemployment accounts have already been opened. This outcome exceeds all expectations and may be attributed to the large number of temporary job contracts, which usually last less than twelve months and were therefore renewed within the last year.

Chile’s unemployment accounts are based on the following four principles:

1) **Individual accounts:** The entire contribution by the employee (0.6 percent of gross income) and two thirds of the employer’s contribution (1.6 percent of gross income) are deposited directly into the employee’s account.

2) **Solidarity fund:** A solidarity fund was set up to supplement the contributions of low-wage earners. It is financed with one third of the employer’s contribution (0.6 percent of gross income) and a government subsidy (about US\$ 9 million). In order to receive benefits from this fund, the employee must be laid off from a permanent job, have insufficient capital on the account, be willing to participate in training programs, and accept any job offer (within certain wage limits) from the insurance’s own job center.

3) **Decreasing benefits:** Unemployed workers are entitled to a benefit period of up to five months, depending on how long they have been insured. Benefit payments are reduced each month (between 50 percent and 30 percent of the average wage during the past twelve

months) in order to provide additional job search incentives.

4) **Private management:** The Chilean government decided on a privately managed investment company since it had neither the experience nor the interest in another state-run institution. The firm that was chosen after an advertised bidding for the next ten years is a cooperation of seven companies managing the pension funds, which are also based on individual retirement accounts. Since all personal funds are protected from access by the firm or the government, the private savings are not affected by economic or political crises.

The Chilean pension system looks back on 20 years of experience with personal accounts. These insights have been incorporated in developing the unemployment accounts. By using the existing infrastructure, start-up investments were minimized. The unemployment accounts also profited from the good reputation and public acceptance of the pension system.

Chile’s new unemployment insurance system is off to a promising start. But since the first benefits have only recently been paid out, it is too early to tell whether the project will eventually succeed or fail. Only an evaluation of data gathered over the next few years will show whether the envisioned goals can be achieved.

# Tax Incentives: A Way to Raise Female Employment?

In the public debate on viable reforms of the German pension system, a better integration of women in the labor market is an aspect that has not yet received the attention it deserves. This is despite the fact that increased labor force participation by women (as well as older workers) would help cope not only with the looming shortage of high-skilled labor, but also with the problem of financing our pay-as-you-go system of social security. A recent IZA Discussion Paper investigates potential policy tools, especially in the form of tax incentives, to raise female employment (*Pietro Garibaldi/Etienne Wasmer, Raising Female Employment: Reflexions and Policy Tools, IZA Discussion Paper No. 951*).

The share of employed women in the working age population varies strongly across the European Union. It is currently around 40 percent in countries such as Spain, Italy and Greece and around 70 percent in Nordic countries. Accordingly, there should be a large untapped potential of female employment in many Southern European countries, but also in Germany, where the participation rate is about 58 percent. At the intensive margin, recently collected empirical evidence on time use shows that the average North American and German women spend the same share of time on leisure activities. Yet, the allocation of time between labor market and home production varies strongly between the two, with North American women spending on average 5.3 more hours per day on labor market activities than German women. Most of this gap results from differences in the extensive margin, with a large share of women in Germany devoted to full-time home production (child-care, preparing meals, cleaning, etc.).

While there is a large consensus on the need to raise the time spent in the market by European women, there is some confusion over how this goal should be achieved. Reducing the high tax wedge and improving assistance in the job search process are among the frequently proposed policy options. Part-time work is another suggestion. But part-time jobs are typically associated with less health insurance, less employment protection and lower unemployment benefits. These concerns, however, are rarely explicitly formulated.

Two key features of the labor market, heterogeneity of individual utility in non-market time and the existence of imperfections in the labor market, must necessarily be considered. A recently developed theory of labor supply for a frictional labor market showed that when labor market participation involves an irreversible entry cost and market production is indivisible, the entry and exit decisions differ asymmetrically, and the participation decision is described by a double margin. Or in other words, once an individual has entered the labor market, she will wish to stay because getting a job was difficult and can be thought of as a sort of capital that would be lost upon exit.

## Labor Supply on the Extensive Margins in an Imperfect Labor Market

To discuss two widely debated policies, the effects of marginal income taxes and policies

aimed at facilitating entrance in the labor market, an extended baseline model of labor supply with market friction is used.

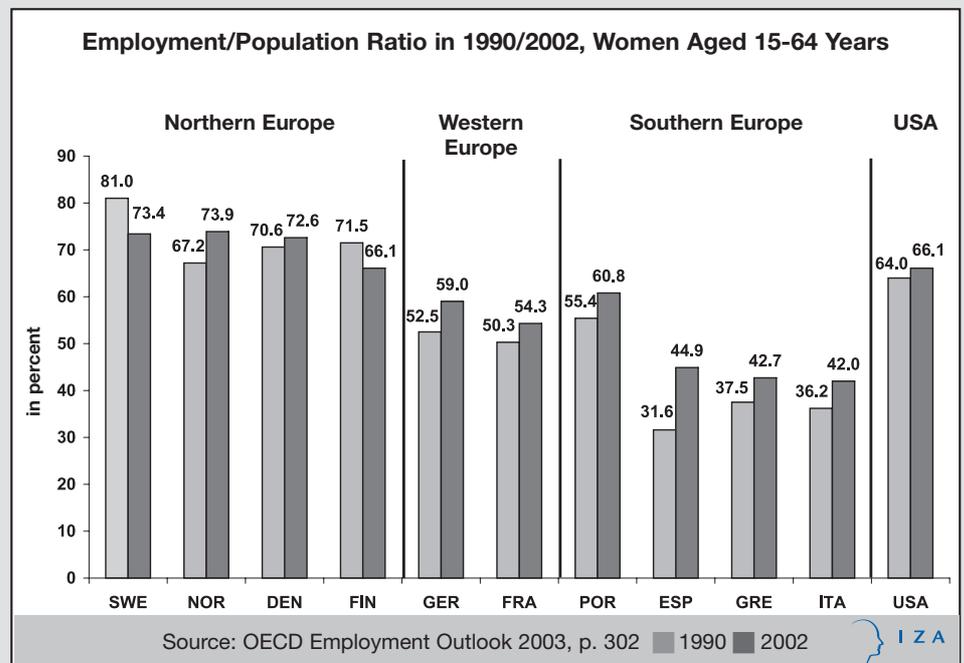
The assumption is made that a mass one of women enjoys utility from home production and market production. Women have a unit of time to be spent in market and home production, which are to be perfect substitutes. Market production is assumed to be a full-time activity, and the emphasis is on the extensive margin of labor supply. In market production people are paid a gross wage net of taxes. A full day in home production yields a per period utility and cannot be taxed.

The key worker decision involves the time to be spent in market production. In absence of frictions in the market, the participation decision is described by a single reservation value, so that all individuals with home production below the utility of full-time market activity

vide an incentive to exit the market with the prospect of easier re-entrance in the future. Thus, the effect of such subsidies would be highly ambivalent.

## The Effects of Taxation

The case for tax cuts is quite different. Here the effects are unequivocal: The incentive mechanism of a tax cut would encourage more people to choose full-time employment over home production. Both the participation rate as well as labor market production would rise. This assumption is confirmed by studies dealing with employment rates in high substitution industries (e.g. personal services, cooking, cleaning, and retail). Here, the negative incentive of the tax wedge is especially pronounced, whereas a reduction of the tax burden in these sectors would lead to a higher labor market participation rate for women as well as to a stronger demand for their skills in the regular labor market.



participate full-time in market activity. In reality, information on the location and the availability of jobs is not perfect, and the gathering of information is akin to paying an irreversible entry cost. The entry cost is determined by both technological and policy dimensions. Job search assistance, training and mobility subsidies represent the policy dimension: both aim at reducing the irreversible cost paid for market entry. The existence of the irreversible entry cost induces a distinction of the entry and exit decision.

## The Effects of Reducing the Irreversible Entry Cost

The first of two possible policies for increasing employment is to subsidize labor market entry, which can also be interpreted as a mobility subsidy or as a form of job search assistance. Subsidizing these entry costs seems problematic, however, as they not only facilitate entry into the labor market but also pro-

## Part-Time Work

The government can encourage part-time employment by reducing taxes on part-time jobs compared to full-time jobs. Intuitively, more workers will take part-time jobs. Subsidizing part-time employment thus leads to an increase in total employment as the number of employed women rises.

But the impact of this outcome on market production is ambiguous. On the one hand, subsidizing part-time work induces women who are in home production to enter part-time jobs in the labor market (crowding in effect). On the other hand, women who are working full-time in the market may consider switching to part-time employment (crowding out effect). The overall effect on market production thus depends on how the great mass of women is positioned around the initial equilibrium. If initially the number of women who marginally prefer full-time home produc-

tion is larger (smaller) than the number of women who marginally prefer full-time market production, the crowding in (out) effect dominates and market production increases (falls).

### Conclusions

While there is a large consensus in Europe on the need to raise the time spent in the market by European women, there is some confusion about the ways in which these goals should be achieved. One possibility is to introduce subsidies on labor market entry. They increase women's entrance in the labor market, but they also increase exits from the labor market, with

ambiguous effects on employment. Furthermore, subsidizing part-time work increases employment but has ambiguous effects on hours and market production. Finally, reductions in taxes on market activities that are highly substitutable with home production have unambiguous positive effects on market employment and production.

Policymakers should take into account that female labor market participation can be increased by reducing the irreversible entry costs, e.g. by subsidizing mobility or job search assistance, or by lowering taxes on part-time employment. In the case of Germany, there seem

to be additional factors that influence female employment. They may be the cause for the relatively low home production compared to the United States: Government transfers to families raise the irreversible labor market entry costs, while, at the same time, a shortage of child care facilities undermines efforts to raise female employment.



## Klaus F. Zimmermann Remains President of DIW Berlin

IZA Director *Klaus F. Zimmermann* has renewed his contract as President of DIW Berlin (German Institute for Economic Research) for another five years until 2009. Since 2000, Zimmermann has been head of Germany's largest economics think tank in addition to

his task as IZA Director. This dual job has provided a valuable stimulus for cooperative research and projects at IZA and DIW Berlin. "We are determined to further intensify our cooperation and to take advantage of our combined strengths in the competition

among research institutes," said Zimmermann. "This will enable IZA to maintain and improve its top position in national and international labor market research."



## IZA Director Joins Labor Market Working Group at the World Bank

The World Bank has supported the establishment of a Labor Market Working Group, under the auspices of the Bank's new European research network (Researchers Alliance for Development - RAD), that will be in dialogue with the Bank as it undergoes a revision of its labor market strategy. According to its mission statement, "the RAD is an action oriented and multidisciplinary network of re-

searchers from Europe and its bordering regions. Its objective is to contribute to innovative responses to poverty and development challenges by strengthening interaction between researchers, the World Bank and decision makers."

IZA Director *Klaus F. Zimmermann* has accepted the offer to join the Core Team of this

Working Group that will consist of 15-20 key individuals from the broader research community, policy makers and civil society representatives from the EU and the OECD.



## IZA Visiting Research Fellow: Frédéric Docquier



*Frédéric Docquier* (University of Lille 2) joined IZA as a Visiting Research Fellow in January 2004 and is spending part of his sabbatical in Bonn. Besides his tasks as Senior Lecturer in Economics at the University of Lille 2, he is also Economic Advisor at IWEPS (the economic department of the Regional Gov-

ernment of Wallonia). Previously, he was a Fellow at the Center for Operations Research and Econometrics in Louvain-la-Neuve, as well as part-time professor at the Free University of Brussels.

Frédéric Docquier holds a PhD in Economics from the University of Aix-Marseille 2. His research interests are in computable general equilibrium models, intergenerational transfers, international remittances, aging and international migration. Only recently he received the Milken Institute "Award for Distin-

guished Economic Research" for his joint work on the brain drain phenomenon and economic development.

He edited three books and published several articles in journals such as *Journal of Development Economics*, *Journal of Economic Dynamics and Control*, *Scandinavian Journal of Economics*, *Journal of Economic Behaviour and Organization*, *Economica*, *Public Choice*, *Journal of Population Economics*, *Regional Studies*.

# European Commission Sponsors IZA Summer School 2004 to 2007



Ian Walker

The next four IZA European Summer Schools in Labor Economics will be funded by the EU Commission under the 6th Framework Program “Marie Curie Conferences and Training Courses”. Marie Curie funding is available to help universities, research centers and businesses in the EU or associated states organize conferences and training courses and to allow early-stage and more experienced researchers to take part. With its generous financial support the EU Commission acknowledges the high quality of the annual IZA Summer School. The school’s new Advisory Committee is also

complete after *Ian Walker* (University of Warwick) has joined the group as representative of the European Economic Association (EEA). Now all leading European economic science organizations are represented in the committee: *Peter Jensen* (Aarhus School of Business) representing the European Society for Population Economics (ESPE), *Claudio Lucifora* (Università Cattolica del Sacro Cuore) for the European Association of Labour Economists (EALE), *Rudolf Winter-Ebmer* (University of Linz) for the Centre of Economic Policy Research (CEPR) and IZA Research Director *Armin Falk* (University of Bonn) as representative.



## IZA Workshop: “Search and Matching”

The question how buyers and sellers find each other in markets that are characterized by search frictions has initiated a growing literature in the field of economics. Many of the related issues have been investigated in the context of labor markets, where frictions are particularly strong and have direct implications on unemployment, unemployment duration and

their recent research, as well as what direction research in search and matching should take in the future. By providing a platform for discussion, the workshop also highlighted IZA’s role in fostering international academic exchange and creating international research networks. The workshop began with a presentation by *Kenneth Burdett* (University of Pennsylvania),

problem of flat tenure profiles of wages, *Burdett* proposed a model allowing for a general characterization of optimal wage-tenure contracts on frictional labor markets.

The main program of the workshop started with a presentation by *Melvyn Coles* (Institute for Economics Analysis, Barcelona), who investigated the correlation between the generosity of unemployment insurance and long-term unemployment. He showed that duration dependent unemployment insurance schemes tend to stabilize employment over the business cycle, since re-entitlement effects resemble the effects of net hiring subsidies in recessions.

*Susan Vroman* (Georgetown University, Washington D.C.) proposed a search model, where the individual searchers’ values of being unmatched may randomly decrease as time passes: buyers (or sellers) become desperate to match. The model, which was exemplified by an example of the housing market, has several possible equilibrium configurations, implying indiscriminate matching, i.e. everybody matches with everybody, opportunistic matching, where relaxed agents wait until they meet desperate counterparts, and desperate matching, where only desperate agents match with each other.

In the second session, *Jean-Marc Robin* (University Paris I) presented an empirical examination of the correspondence between the determinants of labor turnover, individual wage dynamics, and the determinants of wage dispersion using data from ten European countries and the U.S. The basic job search model fits the data surprisingly well. Moreover, the approach allows inferring differences in labor market frictions across countries.



wage distribution. Despite a considerable research effort, however, there are still unresolved issues. The IZA workshop on “Search and Matching on the Labor Market: Recent Developments and Avenues for Future Research” was intended to bring together some of the key contributors to the field in a relaxed atmosphere and to provide an opportunity to discuss

the author of several seminal contributions in the field, in the Research Seminar of the Economics Department of the University of Bonn. The talk addressed the problem that earlier search models implied wage distributions without tenure effects, while tenure effects on wages are well established empirically. After summarizing the literature, and pointing to the

*Pietro Garibaldi* (Bocconi University, Milan) addressed the problem of endogenous labor market participation as opposed to home production in a world of frictional labor markets. Labor market imperfections essentially act as entry costs to workers, driving a wedge between entry into and exit from labor markets. The model allows for deriving endogenous employment, unemployment and labor force participation rates, as well as measures of the sizes of the flows between these states.

The first day of the workshop ended with a presentation by *Simon Burgess* (University of Bristol) on labor reallocation in Britain. In the first part of the analysis, a model with matching frictions and continuous productivity shocks was laid out, which was subsequently calibrated to explore the relationship between labor reallocation and the tightness of the labor market. First, empirical results using a large British survey data set were presented, which confirmed the author's argument that a large fraction of reallocation does not occur via unemployment, but rather via direct job-to-job movements.

The second day of the workshop was ushered in by *James Albrecht* (Georgetown University, Washington D.C.) with a presentation on directed search with multiple applications. The model generalizes previous contributions by allowing workers to send an arbitrary number of applications, which may lie between one and the number of vacancies available, the two cases considered in the literature. The setting implies equilibrium wage dispersion, with those workers with just one job offer receiving lower wages than those workers with several job offers.

*Pieter Gautier* (Erasmus University Rotterdam and Tinbergen Institute) investigated the effects on wage dispersion and unemployment when the number of applications that workers send out when looking for a job and the wages that firms set are simultaneously and

endogenously determined. In this framework, the equilibrium exhibits wage dispersion only if workers apply for two or more but not to all jobs and there are more jobs than workers. The equilibrium results in one without unemployment if workers apply to as many jobs as workers are.

*Etienne Wasmer* (Free University of Brussels) presented a model, which was set out to explain differences between European and U.S. labor markets by endogenous differences in the accumulation of general and specific human capital. He argued that the returns to general human capital are higher and workers invest more in general skills when labor market frictions are lower as in the U.S., while the opposite is true in a frictional environment, such as in Europe.

In the second talk of the session, *Andreas Hornstein* (Federal Reserve Bank of Richmond) addressed the question how the way new technologies are adopted affects the equilibrium in frictional labor markets. Providing quantitative results using a matching model with vintage capital, he concluded that the equilibrium outcomes of unemployment, wage inequality and labor share are very similar, regardless whether firms make the technology adoption decision unilaterally giving rise to a hold-up problem, or whether the investment decision is made jointly by firms and workers.

*Barbara Petrongolo* (London School of Economics) provided an empirical analysis of aggregate matching patterns. In particular, she addressed the question whether matching outcomes are consistent with unemployment being mainly due to search frictions (giving rise to the random matching framework) or due to job queues (suggesting a 'stock-flow' matching approach as the right framework). According to her results, around half of all unemployed workers match quickly after entering unemployment, consistent with 'stock-

flow' matching, while the re-employment rates of the remaining workers depend statistically on the inflows of new vacancies rather than the stock, leading her to reject the random matching hypothesis.

*Klaus Kullti* (University of Helsinki) presented a model on "physical search", where buyers and sellers are assigned to locations and have to leave locations to find trading partners. The main result is that one-sided search is more efficient than two-sided search, and a one-sided search equilibrium, where the members of the larger pool search actively, is more efficient than if the members of the smaller group leave their location to search.

The last session of the workshop was opened by *Pierre Cahuc* (University of Paris I), who touched upon a hotly debated policy issue when presenting work on the role of employment protection legislation in a world with risk-neutral workers. He pointed out that efficient employment protection legislation implies a combination of layoff taxes paid by firms to the government, and job creation subsidies which are financed out of tax revenues. The efficient level of these taxes and subsidies increases with the expenditures on public goods, and can exceed the levels observed in countries with allegedly stringent employment protection legislation.

The workshop ended with a presentation by *Jan C. van Ours* (Tilburg University) on a cross-country analysis of different types of active labor market programs (ALMP) in the context of a search-matching model. The theoretical model was complemented by an empirical study on aggregate data from 20 OECD countries. The results indicated that expenditures on labor market training seem to be the most efficient ALMP, and have a larger impact on reducing unemployment than public employment services, while subsidized jobs seem to be not efficient.



## IZA Fellow Steve Pischke Succeeds Juan Dolado as CEPR Co-Director of the Labour Economics Programme

*Juan Dolado* (University Carlos III Madrid and IZA), co-organizer of the IZA/CEPR European Summer Symposium in Labour Economics (ESSLE) has stepped down from his post as Co-Director of CEPR's programme in Labour Economics. He has played a key role in bringing in many excellent young researchers who share his dedication to developing the highest quality empirical work in the field.

*Jörn-Steffen Pischke* (London School of Economics and IZA) has become the new Co-Di-



rector to *Gilles Saint-Paul* (University of Toulouse and IZA), who succeeded IZA Director *Klaus F. Zimmermann* as Director of CEPR's LE programme in 2001. Pischke has been an IZA Research Fellow since 1999. His move

from MIT to the London School of Economics a few years ago is widely regarded as a big plus for labor economics in Europe.

## IZA DISCUSSION PAPERS

From December 2003 until March 2004 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):

- 1030 Ingrid Woolard, Stephan Klasen**  
Determinants of Income Mobility and Household Poverty Dynamics in South Africa
- 1029 Maurice Schiff**  
Trade Policy and Labor Services: Final Status Options for the West Bank and Gaza
- 1028 Maurice Schiff, Yanling Wang**  
Education, Governance and Trade-Related Technology Diffusion in Latin America
- 1027 Maurice Schiff**  
Labor Mobility, Trade and Social Capital
- 1026 Nicolai Kristensen, Niels Westergård-Nielsen**  
Does Low Job Satisfaction Lead to Job Mobility?
- 1025 Guido Friebel, Sergei Guriev**  
Smuggling Humans: A Theory of Debt-Financed Migration
- 1024 Hartmut Egger, Volker Grossmann**  
Noncognitive Abilities and Within-Group Wage Inequality
- 1023 Gil S. Epstein, Shmuel Nitzan**  
Tournaments: There Is More Than Meets the Eye
- 1022 Philippe Cattoir, Frédéric Docquier**  
Population Prospects and the Determination of a Debt-Sharing Rule between Seceding Regions
- 1021 Horst Entorf, Nicoleta Minoiu**  
PISA Results: What a Difference Immigration Law Makes
- 1020 Erkki Koskela, Rune Stenbacka**  
Profit Sharing, Credit Market Imperfections and Equilibrium Unemployment
- 1019 Feng-Cheng Fu, Chu-Ping C. Vijverberg, Wim Vijverberg**  
Public Infrastructure as a Determinant of Intertemporal and Interregional Productive Performance in China
- 1018 T. H. Gindling, Katherine Terrell**  
Legal Minimum Wages and the Wages of Formal and Informal Sector Workers in Costa Rica
- 1017 Louis Jacobson, Robert LaLonde, Daniel G. Sullivan**  
Estimating the Returns to Community College Schooling for Displaced Workers
- 1016 Rainer Winkelmann**  
Subjective Well-Being and the Family: Results from an Ordered Probit Model with Multiple Random Effects
- 1015 Holger Bonin, Hilmar Schneider**  
Analytical Prediction of Transitions Probabilities in the Conditional Logit Model
- 1014 Erdal Tekin**  
Single Mothers Working at Night: Standard Work, Child Care Subsidies, and Implications for Welfare Reform
- 1013 Ernst Fehr, Jean-Robert Tyran**  
Money Illusion and Coordination Failure
- 1012 Charles Bellemare**  
A Life-Cycle Model of Outmigration and Economic Assimilation of Immigrants in Germany
- 1011 Astrid Kunze, Mette Ejrnæs**  
Wage Dips and Drops around First Birth
- 1010 Nuria Rodriguez-Planas**  
Re-Employment Bonuses in a Signalling Model of Temporary Layoffs
- 1009 Nuria Rodriguez-Planas**  
Signaling in the Labor Market: New Evidence on Layoffs and Plant Closings
- 1008 Luis Diaz-Serrano**  
Labour Income Uncertainty, Risk Aversion and Home Ownership
- 1007 Winfried Koeniger, Omar Licandro**  
Substitutability and Competition in the Dixit-Stiglitz Model
- 1006 John S. Earle, Andrew Spicer, Klara Sabirianova Peter**  
Community Norms and Organizational Practices: The Legitimization of Wage Arrears in Russia, 1992-1999
- 1005 Stephen Machin, Sandra McNally**  
The Literacy Hour
- 1004 Christina Gathmann**  
The Effects of Enforcement on Illegal Markets: Evidence from Migrant Smuggling along the Southwestern Border
- 1003 Christian Belzil, Michael Bognanno**  
The Promotion Dynamics of American Executives
- 1002 Ernst Fehr, Lorenz Götte**  
Do Workers Work More When Wages Are High?
- 1001 Klaus F. Zimmermann**  
Advising Policymakers Through the Media
- 1000 Jan Boone, Abdolkarim Sadrieh, Jan C. van Ours**  
Experiments on Unemployment Benefit Sanctions and Job Search Behavior
- 999 Thomas Bauer, Astrid Kunze**  
The Demand for High-Skilled Workers and Immigration Policy (forthcoming in: *Brussels Economic Review*)
- 998 David C. Ribar**  
What Do Social Scientists Know About the Benefits of Marriage? A Review of Quantitative Methodologies
- 997 Daniele Paserman**  
Job Search and Hyperbolic Discounting: Structural Estimation and Policy Evaluation
- 996 Daniele Paserman**  
Bayesian Inference for Duration Data with Unobserved and Unknown Heterogeneity: Monte Carlo Evidence and an Application
- 995 Giorgio Brunello, Massimo Giannini, Kenn Ariga**  
The Optimal Timing of School Tracking
- 994 Michael Fertig, Robert Wright**  
School Quality, Educational Attainment and Aggregation Bias
- 993 Angel Calderon-Madrid, Alexandru Voicu**  
Total Factor Productivity Growth and Job Turnover in Mexican Manufacturing Plants in the 1990s
- 992 Axel Heitmueller**  
Public-Private Sector Wage Differentials in Scotland: An Endogenous Switching Model
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Threshold Effects of Dismissal Protection Legislation in Germany
- 990 Holger Bonin, Concepción Patxot**  
Generational Accounting as a Tool to Assess Fiscal Sustainability: An Overview of the Methodology
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Are Young and Small Firms Hothouses for Nascent Entrepreneurs? Evidence from German Micro Data
- 988 Marcel Jansen**  
Can Job Competition Prevent Hold-Ups?
- 987 Andrea Ichino, Gerd Muehlheusser**  
How Often Should You Open the Door? Optimal Monitoring to Screen Heterogeneous Agents
- 986 Herbert Brücker, Parvati Trübswetter**  
Do the Best Go West? An Analysis of the Self-Selection of Employed East-West Migrants in Germany
- 985 Stepán Jurajda, Heike Harmgart**  
When Are 'Female' Occupations Paying More?
- 984 Wiji Arulampalam, Alison L. Booth, Mark L. Bryan**  
Are There Asymmetries in the Effects of Training on the Conditional Male Wage Distribution?

## IZA GUEST RESEARCHERS

From December 2003 until March 2004 the following renowned economists stayed at IZA to discuss issues of labor market research and policy:

- Sascha O. Becker**  
(University of Munich)
- Martin Biewen**  
(University of Mannheim)
- David M. Blau**  
(University of North Carolina, Chapel Hill)
- Atanas Christev**  
(Heriot-Watt University, Edinburgh)
- Matteo Cervellati**  
(Universitat Pompeu Fabra, Barcelona)
- Don J. DeVoretz**  
(Simon Fraser University, Burnaby)
- Juan José Dolado**  
(University Carlos III, Madrid)
- Pier-Giuseppe Fortunato**  
(University Paris I)
- Pietro Garibaldi**  
(Bocconi University, Milan)
- Lorenz Götte**  
(University of Zurich)
- Sherrie Kossoudji**  
(University of Michigan, Ann Arbor)
- Julián Messina**  
(European Central Bank, Frankfurt/Main)
- Panu Poutvaara**  
(CEBR, Copenhagen)
- Robert M. Sauer**  
(Hebrew University, Jerusalem)
- Helena Skyt Nielsen**  
(University of Aarhus)
- Leslie S. Stratton**  
(Virginia Commonwealth University, Richmond)
- Jan C. van Ours**  
(Tilburg University)
- Niels Westergård-Nielsen**  
(Aarhus School of Business)

# O P I N I O N

## Vocational Training Levy: Forced into Crisis



Germany's system of vocational training used to be a major showpiece of German competitiveness. It combines employer initiative with societal solidarity and provides young people with a practice-oriented introduction to professional life, thus saving them from the claws of youth unemployment. Starting a professional career without a job is a serious disadvantage. It usually brands the individual as a "lemon", an underachiever who will always be more prone to unemployment and earn less than others who are equally qualified. This is why Germany's dual system of vocational training has received much praise at home and abroad – though remarkably few countries have tried to emulate it.

Meanwhile, however, the luster has faded. The PISA Study has eroded public trust in Germany's educational and training standards. Vocational training has come to be seen as lengthy and too rigid to adjust to changing realities. More and more young people are unable to find a training slot. Critics are quick to attribute this fact to a lack of willingness on the part of employers. As a result, the government steps in: Last year every ninth of more than 560,000 new training slots was fully financed with public funds.

Once interventionism has taken hold, why not take it to the next level? A vocational training levy is often proposed as a means to force all employers to contribute their fair share. The idea is to reward employers who train, and to punish the evaders and freeloaders among them. While this may at first glance seem like an ingenious concept, it is in fact seriously flawed.

It is true that many firms are currently unwilling to provide sufficient, if any, training slots. This is due in large part to weak growth prospects. Germany is still caught up in a phase of stagnation that has lasted for years now. As none of the political parties have presented viable concepts, our social security systems and economic policy are still in dire need of reforms that would invigorate employer initiative. As a consequence, employers tend to postpone investment decisions on infrastructure and education. But there are also substantial shortcomings on the supply side: Teenagers tend to keep away from certain occupations, and they often lack motivation or basic skills. Training thus becomes a heavy burden on many firms, especially the smaller ones.

Under these circumstances, a vocational training levy would send a disastrous signal to employers and investors. It would be an ill-disguised placebo with the sole purpose to placate the political opponents of the reform process. We would create a new bureaucracy that would produce additional costs and swallow much of the revenue. Employers will always avoid hiring unqualified applicants – with or without a levy. Should the proposed levy be implemented, they would have an incentive to buy themselves out of their social responsibility to offer vocational training. Since providing high-quality training slots will certainly be more expensive than paying the levy, it would become worthwhile giving up training altogether. In view of the demographic decrease in the number of young people who will seek vocational training over the next years, the proposed levy is a misguided panic reaction that may well achieve the opposite of the desired effect.

The dual system of vocational training remains a useful, non-bureaucratic instrument.

Firms train because it pays off. Larger corporations even advertise their training efforts as an example of good corporate citizenship. Any forced action would destroy this motivation. A much more promising approach would be to cut the average duration of vocational training from three to two years, and to tighten the curriculum. Due to the decreasing half-life of knowledge and the accelerating rate of "creative destruction" of human capital, specialized skills taught in vocational training have become redundant in many professions. Instead, there is a growing demand for generalists who acquire special skills on the job. Therefore, it would also make sense to commit workers to undergo further training for an overall period of at least one year to be completed before the age of 50.

If schools fail at providing the proper education to prepare their students for vocational training, they should become the main focus of reform efforts. Businesses and schools need to cooperate more closely in providing internships or other professional experience in the form of job application and motivation training courses. Also, young people who choose to decline offered training slots should no longer receive financial support from the government.

There is no doubt that our system of vocational training needs some fresh ideas in order to become capable of adjusting to changing requirements. What it doesn't need is another levy.

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