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COMPACT

CONSIDERING THE FUTURE OF LABOR

Does Less Restrictive Dismissal Protection Increase Employment in Germany? New Study Analyzes Establishment-Level Adjustments

In 2004 Germany has enacted a number of new labor market regulations aimed at reducing the country's high rate of structural unemployment. A key element of the recent reforms is a change in the coverage of small establishments by the dismissal protection code. Specifically, the establishment-size threshold determining coverage has moved from five to ten employees in January 2004. Small establishments now may dismiss workers without having to prove grossly inefficient job performance, unacceptable personal conduct, or redundancy for operational reasons. The new law is basically a return to the legislation enacted under the center-right Kohl government in 1996, which the Social Democrats had originally rescinded after taking power in 1998.

The labor market effects of a liberalization of dismissal protection are still a controversial topic. While proponents of more liberal regulations expect a positive employment effect due to lower costs for employers, the unions and other critics are strictly opposed to any changes, arguing that unrestricted "hire and fire" would lead to unstable employment relationships and a net job loss. Both sides can draw on economic theory to support their views since the available literature does not offer any conclusive statement on the net employment effects of dismissal protection.

Uncertainty about the Effects of Dismissal Protection

From a theoretical perspective, legal protection against dismissal generates non-wage labor costs. Unless these costs are offset by lower wages, profits will fall for firms that have to keep unprofitable employees. This effect will be even stronger when employees protected against dismissal achieve excessive wage increases or reduce their work effort. The legal organization of dismissal protection in Germany is likely to generate additional costs. Since lawful dismissal is often difficult to substantiate, many cases are settled in court with severance payments. The direct cost of employment protection and uncertainty about legal positions make adjustment of labor more expensive, which tends to lower firms' willingness to hire.

On the other hand, effective legal protection of existing employment relationships lowers the number of layoffs. Firms can no longer react to temporary demand shocks by reducing their workforce. Enhanced productivity due to better job matches and additional investment in training programs for long-term employees could reinforce this positive effect. However, small establishments in industries with a labor shortage may find it more difficult to hire qualified personnel as poten-

tial employees might prefer large establishments that are subject to dismissal protection. The net impact of dismissal protection legislation is therefore unclear. It may increase or decrease employment – or none of the above.

Given this ambiguity of the theoretical effects of dismissal protection, there is a strong demand for empirical results. Most existing empirical studies focus on the aggregate effects of dismissal protection. They usually compare index values for the stringency of employment protection and the national employment or unemployment rates across countries. The only robust empirical finding in this literature seems to be that more stringent employment protection slightly reduces flows into and out of unemployment. However, since there is little within-country variation, it is difficult to gauge the impact of specific legislation and hardly possible to control for the interaction of employment protection legislation with other institutional features.

Two recent IZA studies (*Sher Verick, Threshold Effects of Dismissal Protection Legislation in Germany, IZA Discussion Paper No. 991*; *Thomas Bauer/Stefan Bender/Holger Bonin, Dismissal Protection and Worker Flows in Small Establishments, IZA Discussion Paper No. 1105*) take an entirely

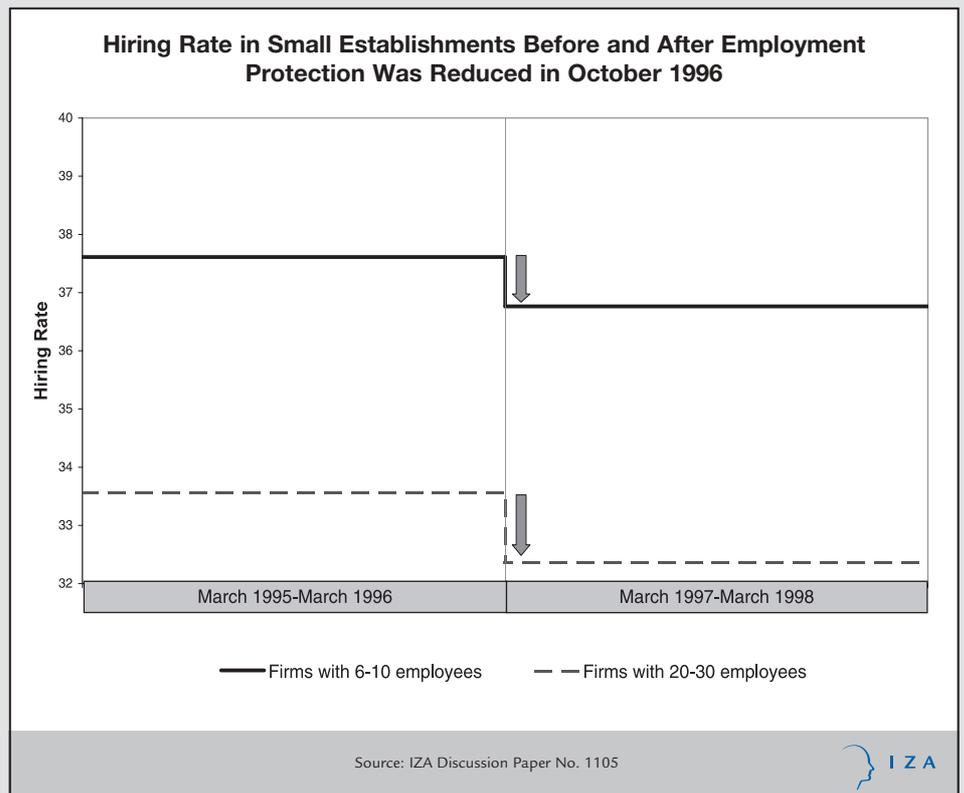
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different empirical approach by examining the effects of dismissal protection on the establishment level. The advantage of this approach is that changes in legislation can be accounted for in great detail. In order to find out whether the recent policy changes in Germany have had a statistically measurable effect on the hiring and firing behavior of employers, the authors of these studies use two different datasets.

On the basis of the IAB Establishment Panel for the period 1997-2001, *Sher Verick* (IZA and University of Bonn) examines whether the tightened dismissal protection legislation during the first years of the Social Democrat government under Chancellor Schröder had an impact on establishment size. Indeed, the study finds that establishments below the new threshold of five employees were less likely to grow in size than before the reform. The measured effect, however, is rather weak. This result is in line with evidence from previous studies on the effects of an exemption threshold in dismissal protection legislation on the distribution of firm sizes conducted in Italy.

If dismissal protection had a substantial effect on employment, one would expect a notable increase in the number of establishments operating precisely at the legally stipulated establishment-size threshold. The study finds no robust empirical evidence to support this theory. Instead Verick observes that changes in behavior mainly occur among establishments whose number of workers is clearly smaller than the exemption threshold. One possible explanation is that personnel managers in small establishments are not perfectly informed about the applicability of the law. There may also be too many interactions with other institutions and adjustment costs involved that are difficult to observe.



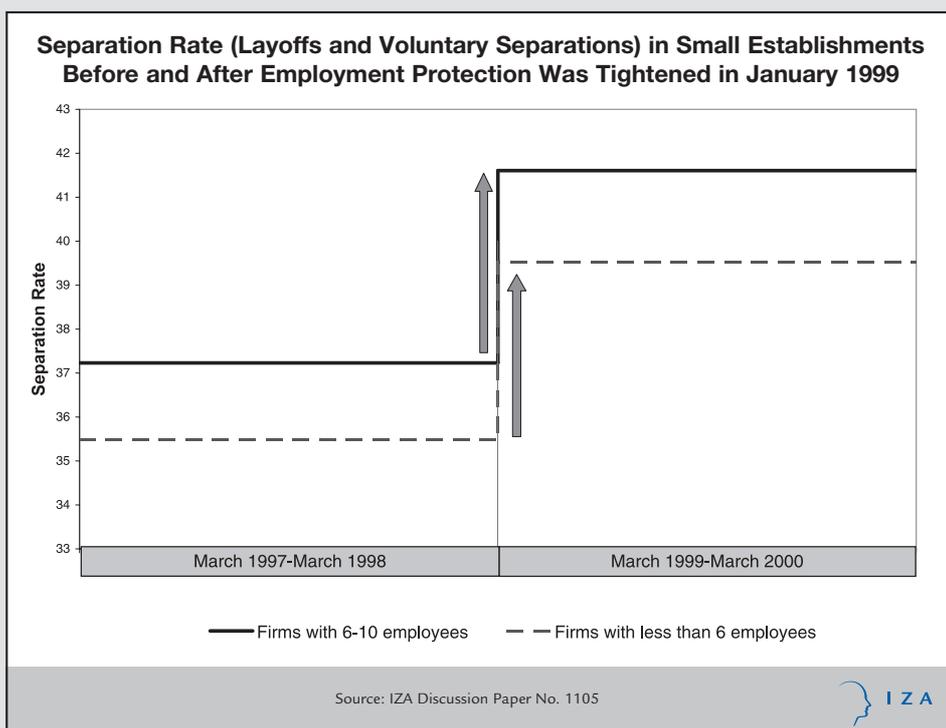
Thomas Bauer (RWI-Essen, Ruhr University of Bochum and IZA), *Stefan Bender* (IAB, Nuremberg) and *Holger Bonin* (IZA) ask whether establishments that are exempt from dismissal protection hire and fire more workers, and whether dismissal protection has a significant positive or negative net effect on employment. In order to find answers to these questions, the authors analyze worker flows in small establishments, in which employees have recently undergone periods of protection and non-protection as a consequence of the repeated changes in dismissal protection legislation. The analysis is based on a repre-

sentative sample of five percent of all German establishments with less than 30 employees. The sample, which was created specially for this study, includes more than 50,000 establishments with almost 300,000 workers.

The empirical analysis is concerned with several hypotheses that are often mentioned in the context of the current public debate in Germany on further increasing the establishment-size threshold for exemption from dismissal protection legislation. It is expected that small establishments below the threshold tend to show higher worker flows than larger establishments that are subject to dismissal protection. Moreover, establishments just below the threshold should exhibit lower hiring rates if they want to avoid growing in size so that they would cross the threshold. Vice versa, establishments just above the threshold may have an incentive to shrink so that the remaining employees will no longer be protected under the law. To test these hypotheses, the authors of the study analyze differences in worker flows between establishments that are subject to employment protection and establishments that are not. The empirical analysis shows whether there have been changes in the hiring and firing behavior of establishments whose status with regard to dismissal protection has changed.

Establishment-Level Employment Effects of the 1996 Legislative Changes

Figure 1 (▲) documents this approach for the effects of the policy change in 1996. A comparison of worker flows in small establishments affected by the reform (those with 6-10 employees) with unaffected small establishments (20-30 employees) over a longer period



shows that the hiring rate is generally higher for the former with 37.56%, as opposed to 33.61% for the latter. But the important question to be answered empirically is whether the liberalization of dismissal protection has widened this gap because it has eliminated hiring obstacles for newly exempted establishments.

Comparing the hiring rates before the reform (March 1995 – March 1996) and after the reform (March 1997 – March 1998), the authors find that hiring rates have decreased across all establishments due to changes in the macroeconomic environment. However, hiring rates have decreased slightly less in newly exempted establishments. For small establishments with six to ten employees, hiring rates decreased by 0.85 percentage points down to 36.76%. The decrease was more significant (1.19 percentage points down to a mere 32.37%) for establishments employing 20 to 30 workers (▼ table). Although this might be interpreted as evidence of a positive impact of more liberal dismissal protection in a negative macroeconomic environment, the observed change in the difference in hiring behavior is too small to be statistically significant.

What Happened When Dismissal Protection Was Tightened Again in 1999?

Figure 2 (▶ p. 2) illustrates the development of worker turnover due to layoffs and voluntary quits after dismissal protection was tightened again in January 1999. If dismissal protection indeed prevents layoffs, the separation rate should decrease in establishments with 6-10 employees, which are affected by the policy change. In reality, however, the separation rate turned out to be higher in the post-reform period (March 1999 – March 2000) than in the pre-reform period. It actually increased from 37.23% to 41.61%. This is certainly the result of higher occupational mobility during this period of economic recovery. The data show that both hiring and separation rates increased independent of establishment size. Since this increase was larger for hirings than for separations, the observed establishments overall grew in size.

It should be expected, nonetheless, that establishments coming under dismissal protection legislation through the reform would grow less than unaffected establishments. But figure 2 shows no significant deviation from the behavior of the control group of establishments with less than six employees. A

statistical comparison with the group of establishments with 20-30 employees yields the same result.

Study Found Only Small Impact on the Labor Market

The study thus does not support the hypothesis that worker turnover increases in establishments which are exempt from dismissal protection. Since the changes in the establishment-size threshold in German employment protection legislation during the second half of the 1990s had no statistically relevant effect on hiring and separation rates, the law had no significant impact on employment or unemployment either.

However, these findings should not lead to the conclusion that dismissal protection has no impact whatsoever on the labor market. First of all, the reforms may have been in effect for too short a period to reveal their full impact. Furthermore, the German institutional environment does not allow any empirical tests of how larger establishments would behave in the absence of dismissal protection. Finally, dismissal protection may change the structure of employment by promoting either the hiring of part-time employees or the creation of jobs for peripheral workers. It may also hurt the weaker labor market groups because employers tend to concentrate on highly productive, stable employment relationships in order to avoid separations. At the same time, employers may try to switch to more flexible working hours in order to adjust to temporary demand shocks. The investigation of possible structural effects of dismissal protection is the subject of a subsequent study currently undertaken by the authors.

Even if it is still too early for a conclusive evaluation of the labor market effects caused by the institutional reforms of dismissal protection laws, the latest findings hardly support the expectations of some political groups who hope to significantly revive the labor market with limited reforms in this area. A different conclusion is much more obvious: If reforms of details – either towards a restrictive or a more liberal legal position – have no apparent effect on employment, a general replacement of dismissal protection with statutory severance pay should be seriously considered. This would put an end to the current state of confusion about the precise legal positions concerning dismissal protection. The elimination of this inefficiency (including the psychological costs involved) could help to increase employers' willingness to hire without questioning the concept of employee protection as such.

Hiring and Separation Rates by Establishment Size							
		1995	1997	1999	1995	1997	1999
		1996	1998	2000	1996	1998	2000
Establishments with...		... 0-5 employees			... 6-10 employees		
hiring rate	mean	46.177	49.976	55.273	37.611	36.764	42.196
	standard deviation	(1.016)	(1.425)	(815)	(1.835)	(587)	(623)
	before - after		-3.799*	-5.297*		-847	-5.432*
separation rate	mean	34.623	35.496	39.520	39.182	37.231	41.606
	standard deviation	(427)	(435)	(432)	(478)	(427)	(461)
	before - after		-872	-4.025*		1.951*	-4.375*
job flow rate	average	11.553	14.480	15.752	-1.570	-467	590
	mean	(867)	(1.174)	(578)	(1.777)	(451)	(67)
	before - after		-2.926*	-1.272		-1.104	-1.057
Establishments with...		... 11-20 employees			... more than 20 employees		
hiring rate	mean	32.926	35.039	40.704	33.558	32.365	38.111
	standard deviation	(568)	(687)	(912)	(987)	(980)	(1,171)
	before - after		-2.112*	-5.665*		1.194	-5.746*
separation rate	mean	35.828	35.649	40.168	35.201	33.946	37.527
	standard deviation	(490)	(540)	(598)	(898)	(868)	(859)
	before - after		178	-4.520*		1.255	-3.581*
job flow rate	mean	-2.902	-610	535	-1.642	-1.581	584
	standard deviation	(416)	(440)	(562)	(721)	(685)	(842)
	before - after		-2.291*	-1.145		-61	-2.165*

Note: * indicates significance at the 95% confidence level; before/after comparison with previous period (average)

Source: IZA Discussion Paper No. 1105



IZA Prize in Labor Economics 2004 Awarded to U.S. Economist Edward Lazear – Official Ceremony in Berlin



Wolfgang Clement



Edward P. Lazear



Friedrich Merz

The IZA Prize in Labor Economics 2004 was awarded to the renowned U.S. economist *Edward P. Lazear* (Stanford University), honoring a prominent American economist for the third consecutive time after Jacob Mincer and Orley Ashenfelter received the prize in the previous years. Carrying a cash reward of 50,000 Euro, the IZA Prize is one of the largest international science awards in economics. A large number of distinguished guests from Germany and abroad followed IZA's invitation to Berlin, where IZA President *Klaus Zumwinkel* presented the award to Lazear on October 25, 2004 during a festive ceremony at the Museum of Communication.

According to the award statement, "Edward Lazear is an exceptionally creative thinker, whose input has profoundly shaped both economic research and policy debates." The IZA Prize Committee included Nobel Prize winners *George A. Akerlof* and *Gary S. Becker*, *Richard Portes*, President of the Centre for Economic Policy Research (CEPR), London, as well as IZA Director *Klaus F. Zimmermann* and IZA Research Director *Armin Falk*.

Lazear's analytical and empirical work has contributed largely to the understanding of today's labor markets. He has published path-breaking studies on employee incentive



K. Zimmermann, U. Backes-Gellner



Uschi Backes-Gellner

mechanisms such as piece rates, age earnings profiles, profit-sharing and career prospects. Lazear has also studied other important aspects of labor contracts including hiring and promotion strategies, teamwork and the organization of work processes. His work on employee participation and optimal severance pay has become ever more relevant in the current debate.

Furthermore, Edward P. Lazear is considered the founding father of personnel economics as a subdiscipline of labor economics. With his establishment of the *Journal of Labor Economics*, probably the world's most influential journal in the field, he has made a significant

contribution to the exchange and elaboration of ideas and insights in scientific labor market research.

At the beginning of the official award ceremony, Federal Minister of Economics and Labor *Wolfgang Clement* emphasized in his opening address the high quality of Lazear's research. He also praised IZA's successful efforts in providing valuable policy advice, which Clement considered an important contribution to the planned evaluation of the German labor market reform. In the subsequent panel discussion hosted by former State Minister and Chairman of the Board of the Federal Labor Agency *Florian Gerster*, the prospects and challenges of modernizing Germany's labor market structures were debated by Federal Minister Clement, IZA Prize-Winner Lazear, IZA Director *Zimmermann*, Vice Chairman of the CDU/CSU Parliamentary Faction *Friedrich Merz* and *Horst Neumann*, Board Member for Human Resources at AUDI AG.

The laudation for Edward Lazear was held by his co-author ("Personalökonomik") *Uschi Backes-Gellner* (University of Zurich), who praised Lazear as a driving force behind personnel economics and a "jack-of-all-trades" of labor economics. Lazear himself stressed in his acceptance speech the strong influence of personnel economics on entrepreneurial practices and strategies. He applauded IZA's decision to establish a new research program in this field and to appoint *Armin Falk*, an expert in behavioral and personnel economics, as IZA Research Director.



K. F. Zimmermann, E. Lazear, F. Merz, F. Gerster, W. Clement, H. Neumann



AWARD STATEMENT of the IZA Prize Committee

The IZA Prize in Labor Economics 2004 is awarded to *Edward P. Lazear* (Jack Steele Parker Professor of Human Resources Management and Economics at the Graduate School of Business and Morris A. Cox Senior Fellow at the Hoover Institution at the Stanford University), for his fundamental contributions to the field. Edward Lazear is an exceptional scholar, a path-breaking researcher and an eminent economist with a vision, who has shaped the research agenda in labor economics. His leadership and entrepreneurial spirit has boosted the recognition of the field. Lazear's research is both original and fundamental. He builds models that provide novel and often surprising insights. Combining such new and highly important theoretical insights with down-to-earth empirical work, his papers are exemplary in applied theory. Lazear has brought great rigor to the analysis of compensation schemes, incentives in labor relations and to the study of other human resource practices. His pioneering work in personnel economics has a decisive influence on modern labor economics.

His article "Why Is There Mandatory Retirement?" (*Journal of Political Economy*, 1979) marks the start of a sequence of studies that investigate the effects of various compensation schemes on productivity. In this paper, he argues that firms pay workers less than their marginal product early during the employment relationship and compensate them by paying higher wages at longer tenure in order to induce workers to provide efficient levels of effort throughout the employment relationship. Such compensation schemes make work around retirement age appear to be too attractive from the worker's point of view. Since workers would therefore not retire at the time when they optimally should withdraw from the labor market, firms make retirement mandatory. Lazear explains in "Agency, Earnings Profiles, Productivity, and Hours Restrictions" (*American Economic Review*, 1981) why efficient labor contracts with deferred compensation have hours requirements and restrictions. In "Incentives, Productivity, and Labor Contracts" (*Quarterly Journal of Economics*, 1984), a co-authored paper with Robert Moore, he argues that increasing age-earnings profiles largely result from contractual arrangements with back loaded wages that reflect the firms' desire to provide lifecycle incentives rather than human capital accumulation.

"Rank-Order Tournaments as Optimum Labor Contracts" (*Journal of Political Economy*, 1981), an article jointly written with Sherwin

Rosen, shows under which conditions rank-order tournaments, in which workers striving for promotions to better paying jobs on higher levels exert optimal levels of effort, can be superior incentive mechanisms compared to piece rate schemes. In "Salaries and Piece Rates" (*Journal of Business*, 1986) Lazear illuminates the question why some workers are paid piece rates based on output while others are paid salaries for their input. Lazear emphasizes that the choice between salaries and piece rates is affected by weighting quality and quantity of output, by sorting considerations, monitoring costs, and asymmetric information. Lazear's article "Performance Pay and Productivity" (*American Economic Review*, 2000) studies empirically the effect of the introduction of piece rates at a company that installs windshields and shows that productivity gains among workers on piece rates result as workers work harder and because more productive workers are attracted by the piece rate scheme.

Lazear has also shed light on other practices in employment relationships. In "Pay Equality and Industrial Politics" (*Journal of Political Economy*, 1989), he explains that some level of wage compression is efficient as it reduces uncooperative behavior that is detrimental to the firm. "Peer Pressure and Partnerships" (*Journal of Political Economy*, 1992), an article with Eugene Kandel, studies whether profit-sharing fosters peer pressure and how factors such as norms, shame, guilt, and empathy interact to create incentives in firms. Lazear's article "Job Security Provisions and Employment" (*Quarterly Journal of Economics*, 1990) makes the important point that government mandated severance pay can be offset by an optimal contract in a competitive labor market when payments by the firm are received by the worker, but that payments to third-party intermediaries necessarily distort incentives. He then analyzes the employment effects when the conditions under which severance payments are neutral are not met. Influential is also the paper with Sherwin Rosen entitled "Male-Female Wage Differentials in Job Ladders" (*Journal of Labor Economics*, 1990) in which they argue that observed male-female wage differentials reflect lower promotion probabilities of women, for whom promotion standards are higher.

Lazear's leadership and research has been an important impetus to the creation of the economics of personnel as a separate research field in economics, which finds expression in the fact that a new JEL code (M5) has been created for the discipline "Personnel Eco-

nomics". Starting with "The Job as a Concept", a contribution to the book *Performance Measurement, Evaluation, and Incentives* edited by William J. Bruns in 1992, and continuing with his Presidential Address to the Society of Labor Economists in 1998 entitled "Personnel Economics: Past Lessons and Future Directions" (*Journal of Labor Economics*, 1999), he has set the research agenda and inspired a large and growing literature. This field keeps attracting the interest of many scholars and researchers; and Lazear's intellectual influence on other scholars who will be producing in this area is just beginning. Lazear is more than a guiding force behind this literature. His work has shaped the way that modern labor economics studies actual work. Personnel economics has revolutionized the teaching of human resources in business schools worldwide, and is nowadays taught in many universities.

Lazear is responsible for much of its success. His textbooks make relatively complicated models and ideas accessible to undergraduates, MBA students and even the public. Lazear has founded the *Journal of Labor Economics*, which today is probably the world's top journal in the labor field. Thanks to Edward Lazear's entrepreneurial spirit, a forum was thus created that has improved the exchange of ideas among labor economists, stimulated scientific debate among scholars everywhere and enhanced the visibility and respect for the entire field.



The IZA Prize in Labor Economics 2004 honors the work of a brilliant scholar who greatly shaped and advanced the empirical and theoretical research in a new field of labor economics.

Friedrich Merz, MP at IZA Tower Talk: Warning against “Prosperity Illusion”

With *Friedrich Merz*, vice chair of the CDU/CSU parliamentary group in the German Bundestag, IZA was once again able to present a high-profile speaker at the IZA



Tower Talk on March 16, 2004. In his analysis of Germany's current economic and employment crisis, the tax and labor market expert of the conservative parliamentary opposition warned of a lingering “prosperity illusion” among the German population. According to Merz, the country is caught “much deeper in a structural growth and employment crisis than most people realize”. He added that this bubble is bound to burst unless rigorous and far-reaching reforms were implemented.

Merz focused on six major reform areas including a modern “labor market constitution” marked by modern wage-setting mechanisms to be achieved by “taking labor agreements back down to the firm level.” In addition, he stressed the crucial importance of a trend reversal in working hours.

He warned that not a single branch of the German social security system manages to maintain a balanced budget. With regard to health insurance, he favored a “flat fee” system with tax cuts for lower income groups. The mandatory public pension insurance,

however, would continue to be linked to wages but should guarantee, for demographic reasons, no more than a basic pension level in the near future. To prevent “welfare-recipient careers in the second and third generation,” the merging of unemployment and social welfare assistance would merely be a first step in the right direction.

The “increasingly fierce tax rate competition within the EU” and the “company and job flight” expected in the wake of EU eastward enlargement call for major tax cuts, according to Merz. He also demanded changes in Germany's education system with an unequivocal commitment to the creation of elites.

Merz did not mince his words either in the subsequent discussion with Hilmar Schneider, IZA Director of Labor Policy, when he addressed the role of the Federal Employment Agency (BA) in solving Germany's economic and social problems. He called the current structure of the agency “almost impossible to reform” and referred to its activities as “organized irresponsibility”.



Norbert Walter at IZA Tower Talk: Incentives for a Higher Labor Force Participation Rate

On June 23, 2004, IZA organized the fifth event in its regular “Tower Talk” series, which takes place at the corporate headquarters of



Deutsche Post World Net. Guest speaker was Prof. *Norbert Walter*, Chief Economist of Deutsche Bank and a frequent commentator

on economic questions in Germany. With a poignant plea for Germany's willingness to embark on reforms, he explained to more than 250 invited guests the radical measures and attitude changes he deems necessary for a successful reconstruction of Germany's economy and social security system.

To overcome the growing shortage of young workers, it would be worthwhile to promote a higher birthrate. However, the demographic effect of such a policy would only start to show in about 20 years. Immigration could also alleviate but not solve the problem. According to Walter, we must therefore “pull out all stops” to increase the labor force participation rate in Germany. He argued in favor of raising the retirement age and extending weekly working hours. At the same time, we should better integrate women in the labor market and improve the service sector in general. Those who fail to realize these necessities “are making a big mistake”.

The labor market needs younger, more innovative workers. According to Walter, this requires an extensive modernization of the entire educational sector, including earlier

school enrollment, more teaching of foreign languages, admission tests for secondary schools and universities, earlier graduation from the school system, and an incentive structure for university education based on tuition fees.

A higher participation rate can also be achieved through the abolition of the minimum wage and further reforms of the tax and transfer system. In this context, Walter argued for a strictly performance-based remuneration scheme to replace the principle of seniority that Germany still adheres to.

In the ensuing discussion with *Hilmar Schneider*, IZA Director of Labor Policy, Norbert Walter pointed out that the window of opportunity for change will close in five to ten years. This is why the elites should set a good example. They should exert a positive influence on policymakers and, in contrast to many business leaders, base their ideas and actions on long-term considerations. Walter did not deny that this process is uncomfortable and difficult to get across to the people: “When communication is poor, nobody will listen.”

The Probability of Entrepreneurship – Evidence from Germany

Germany needs innovation, new ideas and new businesses. As politicians like to emphasize these days, the people's inventions and innovations are Germany's greatest capital. In order to give the German economy a much needed boost, it is important to help new business ideas to develop. In this context, it is a well known fact that young people are more innovative and more willing to establish a new business on their own than older people because they are less risk averse. Given the demographic change in Germany, the question arises if there will be less innovation and less foundations of new enterprises in the future. To answer this questions, we must examine how important previous occupations are for a nascent entrepreneur to start up a business and, moreover, what differences in risk aversion exist between men and women.

Two recent IZA discussion papers try to resolve the question where and under what circumstances new companies are established, and what businesses young entrepreneurs in Germany previously worked in. Another subject of the study is the relationship between gender and self-employment (*Joachim Wagner, Are Young and Small Firms Hothouses for Nascent Entrepreneurs? Evidence from German Micro Data, IZA Discussion Paper No. 989; Joachim Wagner, What a Difference a Y Makes – Female and Male Nascent Entrepreneurs in Germany, IZA Discussion Paper No. 1134*).

Start-Ups Related to Firm Size and Age

A fact emerging from a vast number of empirical studies on new firm formation is that the start-up rate in a region tends to be positively related to the share of employees working in small firms, or the proportion of small firms among all firms in the region. A theoretical explanation for this empirical regularity argues that working in a small firm tends to provide employees with more relevant experience for starting a new business than working in a large firm. Employees in small firms often have close contact with customers and with the owner of the firm, who thus provides a role model for the employees to follow.

A similar argument can be made for those who work(ed) in young firms compared to those in old firms: Through close contact with a successful entrepreneur, people in a young firm have the opportunity to gather information about the transition from paid employment to self employment with all its problems and possible solutions. The "employer-as-a-role-model" argument put forward in the context of the small firm should be even more relevant here because, while not all small firms are young, many young firms are small.

There is only scarce evidence on how the size and age of the firm a person is or has been working for affects the decision to start a new business. Existing studies find that the probability to step into self-employment decreases with firm size. Furthermore, those who completed their vocational training in a small firm are more likely to become self-employed than those trained in large firms.

Nascent Entrepreneurs Come from Small and Young Firms

The data used for the study on the relevance of the firm age and size are taken from a representative survey of the population aged 18 to 64 in 11 "planning regions" in Germany. The questionnaire asked for socio-demographic characteristics (among others sex, age, employment status, education, fields of professional experience) and if the interviewee is currently engaged in starting an own business. Those who answered in the affirmative are considered to be nascent entrepreneurs.

Both firm size and firm age are at the core of the investigation. A young firm is defined to be at most 10 years old. Firms with up to 20 employees are considered to be small firms. In this case, the focus is on the group of firms that are both young and small. Nascent entrepreneurs are or have been more often employed in younger and smaller firms. Both the mean firm age and firm size is much smaller for the group of nascents, and the shares of nascents which are from a low firm age and a low firm size are much higher than these firms' respective shares of overall employees. Nearly every third nascent entrepreneur comes from a firm of this type.

Furthermore, fear of failure is a significant impediment to starting a business. If the interviewee answered this question in the affirmative, he must be regarded as a person with a high degree of risk aversion, and a negative impact on the probability of becoming a nascent entrepreneur is expected. Moreover, the probability to step into self-employment will depend on the individual's age, financial basis and risk preparedness. On the one hand, a certain age could result in work experience and a certain amount of wealth, which would in principle facilitate taking the risk of entrepreneurship; on the other hand, risk aversion will rise, aggravated by the fact that the shorter the expected life span of the new business, the shorter the period over which typical start-up sunk costs can be earned back. Hence, the interviewee's age must be observed closely.

Finally, the role model aspect is quite important. If there has been at least one self-employed in the interviewee's family, a positive

impact of contact with such a role model is expected. A recent proposition is the jack-of-all-trades view of entrepreneurship. Based on a coherent model of the choice between self-employment and paid employment, it can be shown that having a background in a large number of different roles increases the probability of becoming an entrepreneur.

Entrepreneurs must have sufficient knowledge in a variety of areas to put together the many ingredients needed for survival and success in a business. The variety of professional experience of an interviewee is measured by two variables: The number of different professional fields the interviewee has been active in the past and information about professional degrees completed after school, i.e. passed apprenticeship, qualification as a master craftsman, or university degree.

Overall, among the nascent entrepreneurs we find more males, less people with a high degree of risk aversion, and more individuals with at least one self-employed family member. Furthermore, nascents on average tend to be younger, have more fields of experience, and a slightly higher number of professional degrees. Yet starting a new business is a rare event; only 3.6 % of all persons included in the sample are nascent entrepreneurs.

More Male than Female Entrepreneurs

In western industrialized countries the share of men in total self-employment is much higher than the share of women. The probability of preferring to be self-employed is also higher for males. Men are on average more than twice as active in entrepreneurship as women. In 2002, the female share in total entrepreneurial activity in 29 countries ranged from 44.3% in South Africa to 17.5% in Japan. The figures for male and female entrepreneurs in European countries are presented in charts 1 and 2 (▶ p. 8). Chart 3 also shows that the entrepreneurial activity of women varies across industrial sectors.

Germany is a case in point. Official statistics reveal that women's self-employment rate as a percentage of all working women is only about half the men's rate (6.3 % vs. 12.9 % in 2002). According to a representative survey among Germans aged 18 to 64 in 2001, the share of men who were actively involved in starting a new business was 4.9 % compared to 2.3 % of all females. Another survey showed that in Germany 15.9 % of all men, but only 7.4 % of all women, wished to become self-employed.

In the sample used for this study, the percentage of nascent entrepreneurs is about twice as high for men (4.7%) than for

women (2.4%). However, large (in an economic sense) differences between men and women are especially found for risk aversion – the proportion of those who consider fear of failure to be a reason not to start an own business is 12% higher for women than for men – and for work in small firms, young firms, and in small as well as young firms. The shares of women who are working in these “hothouses” for nascent entrepreneurs are higher than the respective shares of men. But on average male nascents are younger than females, and they tend to have one additional field of experience.

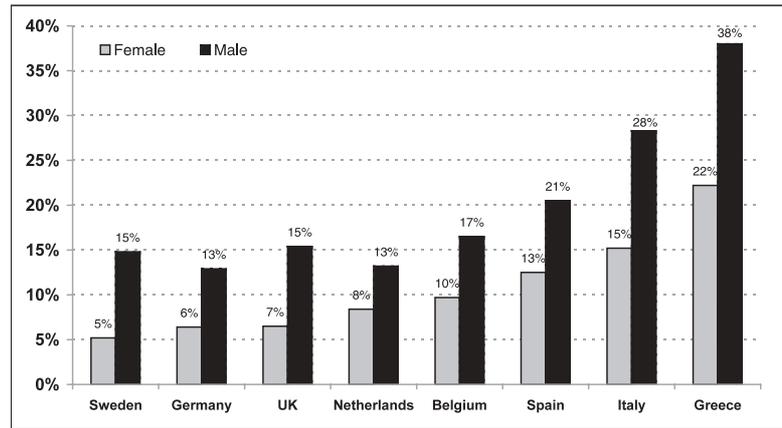
The gender-specific difference in risk aversion is also important: Only 44% of all men, but 56% of all women, in the sample consider fear of failure a reason not to become self-employed. Studies have found women more likely to perceive a situation as risky. Women also exhibit greater risk aversion in their choice behavior and lower valuations of risky prospects. In the context of entrepreneurship, female founders are more risk averse and less likely to expect debt financing to capitalize their businesses. The part of the gender differential in nascent entrepreneurship is an important topic for future research that has to be resolved before sound policy measures aimed at fostering entrepreneurial activities by women can be implemented. The recently started initiative of the German federal government to support women who are in the process of starting their own business (three federal ministries are financing a service agency in 2004-2007 in an attempt to increase the share of start-ups by women) should be evaluated thoroughly in order to observe and further influence possible changes in the performance of women who are starting a business of their own, and who are willing to take the risks associated with becoming an entrepreneur.

Conclusions

Using a large recent representative sample of the German population, the hypothesis that young and small firms are hothouses for nascent entrepreneurs was empirically tested. Controlling for various individual characteristics and attitudes, it can be demonstrated that work experience in a firm that is both young and small is not only statistically significant but also economically important for entrepreneurship decisions.

An important implication of this result is, given that entrepreneurs tend to found their new business in the region they live in, regions with more young and small firms today will have more young and small firms tomorrow. By then, today’s successful young and small firms will be old, and many of them will be large. Vice versa, regions with few hothouses for nascent entrepreneurs will have few in the future. This is, in a sense, micro-econometric evidence for the thesis that entrepreneurship breeds entrepreneurship both at the individual and at the regional level.

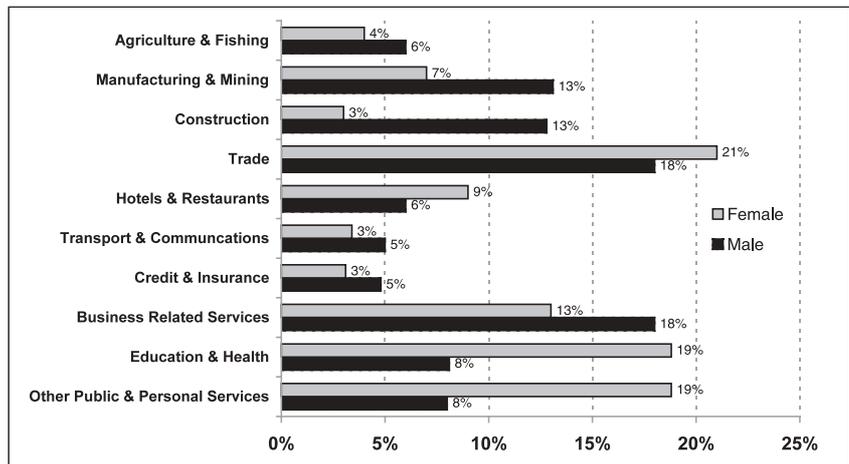
Self-Employed Persons in % of Workforce by Gender in Selected EU Countries 2002



Source: Eurostat (LFS), calculations ifm University of Mannheim



Distribution of Start-ups by Industrial Sector* and Gender in Germany

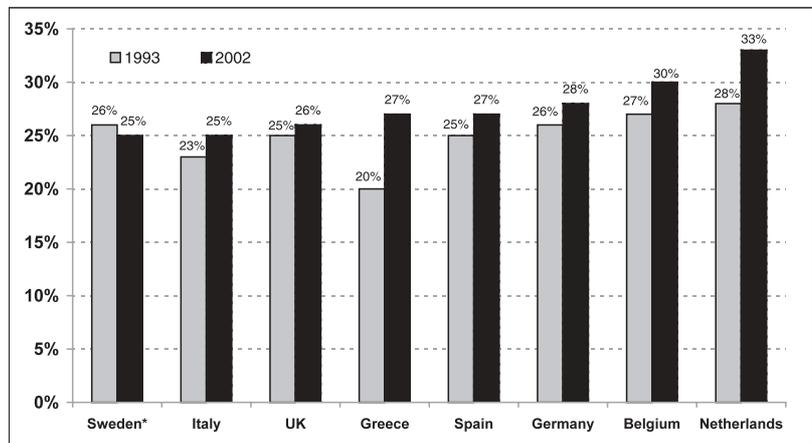


*) Energy and Water; Public Administration: Sample size too small for reliable estimation

Source: Federal Statistical Office Germany (LFS 1998, 70%-subsample), ifm University of Mannheim



Self-Employed Women in % of all Self-Employed in Selected EU Countries 1993/2002



*) Data available since 1995

Source: Eurostat (LFS), calculations ifm University of Mannheim



PISA Results – What a Difference Immigration Law Makes

Germany's educational system used to be respected throughout the world. German students were happily accepted at international schools or universities, given their strong reputation of achievement. The only drawback of Germany's educational system seemed to be that German students are on average older than most other nation's after finishing high school and university. In the first part of the Program for International Student Assessment (PISA) survey in 2000, a total of 265,000 students were tested in reading literacy. The poor performance of German students triggered a

public debate on educational reforms in Germany. Meanwhile, the results of the second PISA study published in 2004 have shown that Germany's performance has hardly improved. Can this be attributed, at least in part, to deficits in immigration and integration policy?

Out of 32 countries participating in the PISA 2000 survey, three traditional immigration countries (Australia, Canada and New Zealand) performed a lot better than the others. France, Germany and other European countries, as well as the United States, per-

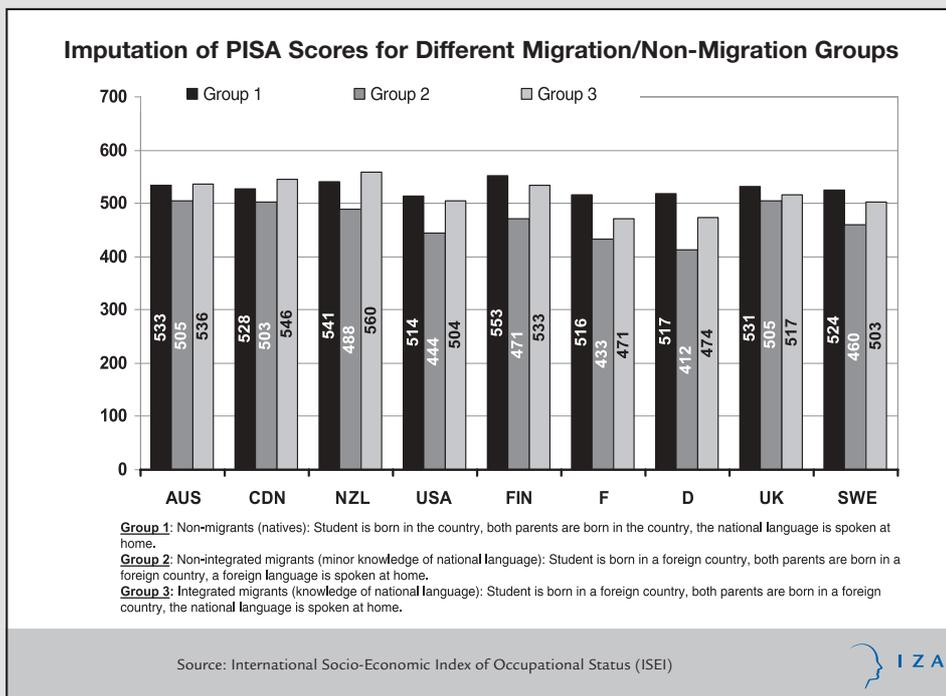
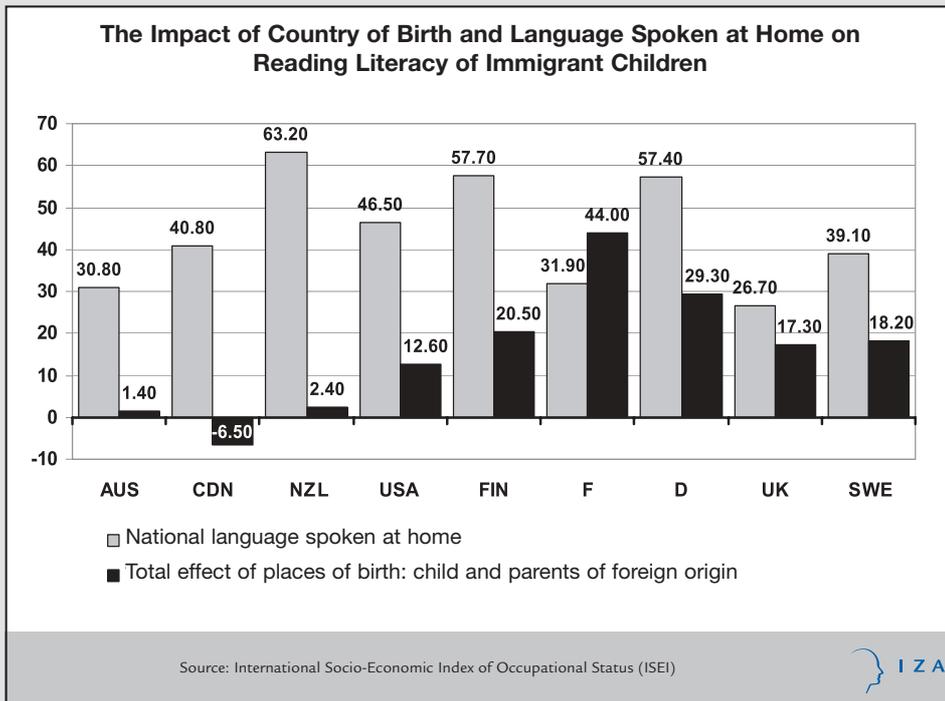
formed significantly worse than Canada, ranking second in the test, New Zealand (third) and Australia (fourth). The importance of social class and migration background for the PISA school performance of teenagers is an interesting fact yet to be examined. To analyze the impact of migration background on school performance, it is necessary to gather information on the performance of immigrants. A recent IZA discussion paper sheds light on the ongoing debate about different countries' performances in the PISA 2000 survey (*Horst Entorf/Nicoleta Minoiu, PISA Results: What a Difference Immigration Law Makes, IZA Discussion Paper No. 1021*). The paper draws on the 'International Socio-Economic Index of Occupational Status' (ISEI) of parents (average of both parents). ISEI is mainly based on education, occupation, income and age of parents.

Social and Ethnic Background

Part of the problem for students seems to derive from the social and ethnic background of the students and their families. In Germany the social and ethnic background relations apparently have a strong impact on student achievement. Early division by skill level into different secondary school systems does not seem to give immigrant children enough time and chance to integrate well enough to learn basic skills. Therefore, poor test results of insufficiently integrated children contribute to the problem of Germany's PISA test scores. The immigrant children in question mostly stem from socially less advantaged families. In many European countries, and especially in Germany, socially less privileged children often come from families with a labor migration background. Other typical "immigration countries" select immigrants in different ways, for example by skill or by education. It is symptomatic of such a policy approach that in traditional immigration countries the socioeconomic status of migrants even exceeds the national average. Migrants to other countries stem from various nations with various backgrounds and immigrate for different kinds of work.

Economic Background

The impact of the socioeconomic status of parents ('socioeconomic gradient') on the school performance of their children differs strongly across nations. Its highest influence is found for Germany, the UK and United States. In Scandinavian countries and Canada social mobility is more likely. Educational inequalities between social classes can be very strong. OECD researchers found the spoken language at home to be a similarly important variable as socioeconomic status. If the national language is spoken at home, integration is much easier. The majority of immigrants in Germany have neither a German-speaking nor Germanic background, nor do they originate from Western countries; the situation in Germany thus differs strongly from that in France and the UK. A special situation also occurs in New Zealand, where the Maori natives have their own language.



In terms of source countries, native languages and socioeconomic background, the situation in the United States and the UK is actually the reverse of the expected. In the UK the ISEI of students from foreign-born parents is higher than ISEI from students born in the country. Migrants from EU countries and from India account for a large share of the foreign workforce in the UK. This is unusual since the UK is not a traditional immigration country, and many European countries tend to have immigrants with a labor migration background from less industrialized non-Western countries. The United States, on the other hand, despite selective U.S. Visa and Green Card policies, is experiencing problems typically associated with labor migration, e.g. with illegal migrants from Mexico, which is uncommon for a traditional immigration country (chart ▼).

Social Capital

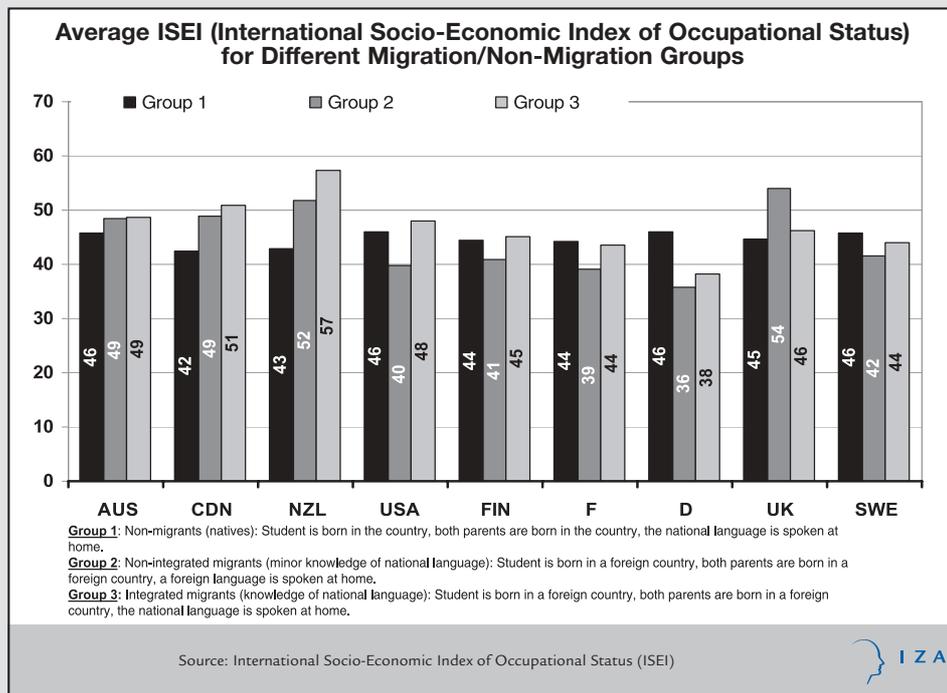
One of the factors determining the school performance of immigrant students is the social capital of migrant families, which is lower than that of natives. Other factors include life in disadvantaged urban areas and schooling systems that fail to cater to the needs of children from foreign cultural backgrounds. Students from all countries benefit from the fact that they were born and brought up in the receiving country. Thus factors associated with the student's place of birth also play a role, as does their parents' place of birth. A major difference between the traditional immigration countries and European countries is that in immigration countries students whose parents are born abroad perform better in the test than native students, while in Europe the opposite is true (▲ chart p. 9). Finland and traditional immi-

gration countries (with the exception of the United States) are among the top performers in the PISA 2000 survey. Germany, France and the United States, but also New Zealand, would all have improved by 10 points if only native speakers or students who speak the national language at home would have taken part in the test (▲ chart p. 9). While assimilation of labor immigrants in Germany and France (in terms of practicing the national language) would lead to a significant improvement of reading achievements, school performance of immigrants would still clearly lag behind that of natives due to other factors that cannot be ignored.

PISA Results for Scientific Literacy

Calculations and estimation procedures for preliminary results on scientific literacy (focus of a forthcoming PISA study) strongly confirm the findings based on reading literacy. In particular for Germany and France school problems in either discipline are reinforced by language problems. A high socioeconomic gradient is confirmed for Germany, but both the UK and the United States, too, are characterized by a high degree of social immobility. For the U.S. this result challenges the popular notion "from rags to riches". In general, large differences in educational achievement can be explained by the presence or absence of migration backgrounds, combined with socioeconomic background and potential language problems of immigrants.

This conclusion strongly emphasizes the need of an improved integration policy for immigrants, which also has to focus on parents' language acquisition to improve the prospects of the young generation. But reforms must go beyond immigration and integration policy. Germany's school system also needs to be restructured and improved to ensure a better assimilation of immigrant children. Early division into different school systems is not conducive to realizing the full intellectual potential of either native or immigrant children.



Seventh IZA European Summer School in Labor Economics Funded by European Union

IZA hosted the 7th European Summer School in Labor Economics, which took place April 19-25, 2004, at the conference center of Deutsche Post at the Lake of Ammersee (near Munich) in Bavaria, Germany. The objective of the Summer School is to bring together a large number of PhD students and senior lecturers to study new areas in labor economics. 37 students attended the event. Sixteen nationalities were represented, creating a very colorful and productive international environment.

Lecturers for the 7th European Summer School were *Armin Falk* (IZA and University of Bonn) and *Christian Belzil* (Centre National de Recherche Scientifique/GATE, IZA and Concordia University). Falk's lectures concentrated on "Behavioral Economics", whereas Belzil taught on "Empirical Labor Market Models with Dynamic Self-Selection: Applications to

Wage Regression Functions, Human Capital Accumulation Models and Personnel Economics". A wide range of topics in labor economics were covered in student presentations, such as personnel economics and the psychological foundations of incentives, labor markets in transition economies, gender issues, migration, returns to education and training, unemployment and evaluation of labor market policies. A final session on "How to improve presentations: video-based feedback" provided the participants with practical advice.

The European Summer School is supported by the Centre for Economic Policy Research (CEPR), the European Economic Association (EEA), the European Association of Labor Economists (EALE), and the European Society for Population Economics (ESPE). *Peter Jensen*, member of the IZA Summer School Advisory

Committee representing ESPE, participated in the event. The Summer School is funded by the European Union, under the Sixth Framework Programme "Marie Curie Conferences and Training Courses".

The next IZA European Summer School in Labor Economics will take place April 18-24, 2005. **Frank Vella** (European University Institute) will lecture on "Semiparametric Estimation of Micro Econometric Models" and **Patricia Apps** (Professor of Public Economics, Faculty of Law, University of Sydney) will give a lecture on "Modeling the Labor Supply of Multiperson Households". The application deadline is February 4, 2005. For further information, please visit www.iza.org.

The Nature of Discrimination – IZA Workshop Discussed Crucial Labor Market Topic



On June 1, 2004, under the auspices of its research program on the “Future of Labor”, IZA held a workshop on the “Nature of Discrimination”. Solicitations for papers relating to this topic were sent to all fellows and associates of the Institute. The general theme was research that considers why apparently discriminatory earnings and other labor-market differentials arise; and whether in fact such differentials merely represent the returns to productive characteristics.

Roland Fryer (Harvard University) and *Matthew Jackson* (California Institute of Technology) ask the questions that should underlie all research on discrimination: What is the nature of human cognition that underlies the formation of groups in people’s minds? Is there an economic theory of how groups are contemplated that might help to explain apparently discriminatory outcomes? Fryer and Jackson assume that forming categories in one’s mind is costly – it takes time, and with more categories in mind classifying individuals and their behavior takes longer. This cost leads people to economize on categories, creating them only for those bundles of characteristics that they expect to encounter sufficiently frequently to justify their creation.

The research by *Tuomas Pekkarinen* (Oxford University) and *Juhana Vartiainen* (FIEF-Stockholm) deals with issues of gender discrimination in promotion. Using a massive data set covering workers and firms in the Finnish metalworking industry from 1990 to 2000, they asked whether there were gender differences in job assignments and promotion rates, and how these related to supervisors’ evaluations of workers. The authors conclude that much apparent gender discrimination arises because the standards for promotion to more complex, higher-paying jobs are set higher for women than for men.

Michael Ransom (Brigham Young University) and *Ronald Oaxaca* (University of Arizona, Tucson) offer a model of monopsony – the power of individual employers to “exploit” workers who have few alternative jobs in their locales. Their mathematical model indicates that we can measure the extent of monopsony, and whether it differs by gender, by examining gender differences in the responsiveness of the rate at which workers leave a company to shocks to their wages at the company. Workers who are “stuck” at the company – who are unlikely to leave even in response to better wages elsewhere – are ripe for exploitation, while those

who are more responsive to alternative wages cannot be so readily exploited. According to the authors’ findings women’s relative unresponsiveness to wage differences between their current jobs and outside alternatives does make them liable to exploitation, so that one possible explanation for gender wage differentials may be greater employer monopsony over female workers.

Sandra Black (University of California, Los Angeles), *Astrid Kunze* and *Kjell Salvanes* (both Norwegian School of Economics and Business Administration, Bergen) examine possible sources of gender pay differentials. Apparently the differential sorting of women and men into narrow occupations and industries is a major cause of the gender wage gap. Examining the causes of the substantial amount of sorting that appears to exist, Black and her coauthors focus on the role of differences in employers’ characteristics. Adjusting for many plant characteristics, they find that otherwise identical women are disproportionately likely to be working in plants where the variation in profitability is lower. They conclude that women may be choosing to work in places where there is less risk of bankruptcy, and also less chance of sharing in unusually high profits, and that this apparent aversion to this type of risk may explain part of the different sorting of men and women that in turn appears to affect wages.

Rafael Lalive and *Alois Stutzer* (both University of Zurich) use a large cross-section data set describing Swiss individuals to examine gender wage differences and their determinants. They initially establish the existence of a gap between women’s and men’s pay and then move to examine causation. One candidate for such a cause is differences in attitudes toward women’s roles outside the home. Lalive and Stutzer take this approach, using inter-community (over 3000 communities) differences in the outcomes of an earlier Swiss referendum that asked voters to approve an amendment to the Swiss constitution that recognized women’s rights to equal pay for equal-value work. They find that the gender wage gap is narrower in communities that had had higher approval rates on this referendum. They also demonstrate that women in those areas, despite their wages lagging behind men’s by less than those of their sisters elsewhere in Switzerland, are less satisfied with life, an outcome that Lalive and Stutzer infer argues against pure discrimination.

Almost all research on gender differences in labor-market outcomes has focused on differ-

ences in wages and labor-force participation. *Ghazala Azmat* and *Alan Manning* (both London School of Economics), and *Maia Güell* (University Pompeu Fabra, Barcelona) study the determinants of gender differences in unemployment rates and how these differences vary across industrialized countries. Using data on individuals they show that there is little or no gender gap in unemployment rates in “Anglo-Saxon” countries, but that women’s unemployment rates are substantially higher than men’s in Mediterranean countries. Where the gap exists it arises both because women’s probabilities of moving from employment to unemployment, and from unemployment to employment, differ from those of men.

Derek Neal (University of Chicago) presents a comprehensive discussion of differences in skill levels and economic outcomes between American blacks and whites. From a large variety of sources he documents that black-white skill differentials – test scores, educational attainment, and others – narrowed between the 1960s and 1980s. Since the early 1980s there has been little narrowing and perhaps even a slight widening. Neal examines the incentives that blacks face to invest in education – the returns to education – and finds that the returns are at least as great for blacks as for whites. While economists typically assume that the costs of education do not differ between blacks and whites, Neal argues that the results of past discrimination, in terms of school quality and parental resources, make it costly for blacks to acquire the education that would break this vicious cycle.

Kate Antonovics (University of California-San Diego) and *Brian Knight* (Brown University) examine whether racial discrimination in the United States is a two-way street: Do African-Americans and Hispanics discriminate against whites and in favor of people in their racial/ethnic groups at the same time that whites discriminate against minorities and in favor of whites? They study this issue using data describing every stop and search of a car by a member of the Boston, Massachusetts, police department during a recent year, a particular problem referred to in the U.S. as “racial profiling.” The evidence is absolutely clear that minority police stop minority drivers less, and majority drivers more, while white police stop African-Americans and Hispanics more than they do white drivers. The authors infer that this behavior stems from a taste for discrimination against outsiders that exists in each racial/ethnic group of officers.

If nothing else, the Workshop demonstrated that interesting research that goes beyond the mere measurement of possibly discriminatory wage and employment differences by gender, race or ethnicity is being done in many countries around the world. Taking all the studies that were discussed, one cannot pick out any one or even several explanations for apparent labor-market discrimination. Attitudes are clearly important, as is access to education; but it seems that experiences and causes differ greatly among countries, and between men/women compared to between majorities/minorities. These findings show the relevance of the “economics of discrimination” as an important research field within labor economics.

New IZA Books on Migration and the Labor Market in Denmark and Germany

Despite some progress in recent years, the integration of immigrants from non-western countries in the EU labor markets still causes significant problems. This is one of the findings from a comparative research project on labor market integration of foreigners in Germany and Denmark based on representative surveys among immigrants in both countries. Headed by IZA Director *Klaus F. Zimmermann* and *Torben Tranæs* (Research Director, The Rockwool Foundation Research Unit, Copenhagen), a

group of researchers analyzed questions of education, training, employment and income prospects as well as the probability of self-employment among migrants. The economists also calculate the "socio-economic balance" of tax revenue generated by and transfer payments awarded to immigrants.

The results have been published in two books. While the English version provides a complete account of the research findings, the German



version offers a more policy-oriented perspective. In its next edition IZA Compact will present the key findings of this important research project.



Successful Third IZA/SOLE Transatlantic Meeting Financial Support by the German Science Foundation

The third IZA/SOLE Transatlantic Meetings took place on June 3-6, 2004 at the Management Center of Deutsche Post World Net in Buch on Lake Ammersee, Bavaria. The Meetings are organized every year jointly by IZA and the Society of Labor Economists (SOLE). IZA Program Director *Daniel S. Hamermesh* (University of Texas at Austin) organized the event and acknowledged the financial support from the German Science Foundation/Deutsche Forschungsgemeinschaft (DFG). The Meetings proved to be motivating also for the scholars

and research projects covered under the DFG program area "Flexibility Potentials in Heterogeneous Labor Markets."

The annual Transatlantic Meetings aim to promote high quality research in all areas of labor economics by providing an annual forum that fosters scientific exchange of ideas among scholars from around the world. At the end of 2003, IZA Fellows and Affiliates as well as members of the SOLE were invited to submit papers. Over 100 submissions were received

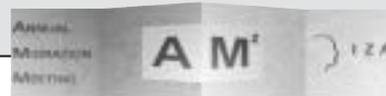
and 19 papers were selected for presentation. During the three days of Meetings, internationally renowned experts in the field of labor economics presented their latest work in seven separate sessions. The program covered a variety of issues, e.g. Labor Supply, Human Capital, Search and Unemployment, Internal Labor Markets, Transitional Labor Markets, Effects of Childcare and Health. A complete program and the papers presented can be found at the IZA homepage.



IZA/Urban Institute Workshop on Migration Topics in Germany and the U.S.



As part of the institute's research agenda on migration issues, IZA further intensifies its international collaboration in the field. Jointly with the renowned Urban Institute, IZA conducted a workshop on hot migration topics in Germany and the United States, which was held in Washington, D.C. on May 21. Organized by *Amelie Constant* (IZA) and *Michael Fix* (Urban Institute), the workshop presented new research findings of contributing researchers from IZA, DIW Berlin, and the Urban Institute. IZA Director *Klaus F. Zimmermann* and Program Director (Migration) *Barry R. Chiswick* also attended the workshop and took the chance to discuss a professional cooperation of both institutes. This initiative and the newly established Annual Migration Meeting (▶) underscore the significance of migration studies in IZA research.



IZA Annual Migration Meeting (AM²): A Successful Premiere



The first IZA Annual Migration Meeting (AM²) took place on June 25-26, 2004 in Bonn. Organizers were IZA Director *Klaus F. Zimmermann* and *Amelie Constant*, Deputy Program Director of the IZA research area on migration. The individual sessions dealt with Return / Repeat Migration, Immigrants' Geographic Location and Homeownership, Impact on Natives, International Migration, Net Inflows and Trends, Migration and Smuggling, and Human Capital and New Frontiers in Surveys. Topics discussed on the first day were the skill level of migrants versus non-migrants, self-selection and performance of return migrants from the perspective of the source country, locational choices of legal immigrants across different admission categories as well as the homeownership gap between immigrants and natives. Also featured were a study of the short-run and long-run effects of immigration from the Former Soviet

Union to Israel on natives' wages and employment and a talk on "Immigration and Crime across Seven Nations." The second day of the meeting started with a panel data analysis of the economic and non-economic determinants of international migration. A highlight of the meeting was the newly introduced Julian Simon Lecture on "Immigration Policy: Methods of Economic Assessment", delivered by IZA Research Fellow *Don DeVoretz* in honor of the late American migration expert Julian Simon. Topics of the remaining sessions were smuggling of humans, differences between natives and second-generation immigrants in the intergenerational transmission of educational attainment, and the New Immigrant Survey (NIS). The IZA Annual Migration Meeting 2004 was an impressive start of this new IZA initiative to stimulate international migration research.

Gerard van den Berg and Pierre Cahuc New IZA Program Directors



Since July 2004 IZA Research Fellow *Gerard J. van den Berg* (Free University of Amsterdam) has been IZA Program Director for "Evaluation of Labor Market Programs". Van den Berg is Full Professor in Labor Economics and has worked at Northwestern University, New York University, Stockholm School of Economics, Tilburg University, Groningen University, and INSEE-CREST before joining the faculty of the Free University of Amsterdam. He is Joint Managing Editor of *The Economic Journal* and has published in *Econometrica*, *Review of Economic Studies*, *International Economic Review* and other journals. While keeping close contacts to IZA since early 1999, van den Berg is also affiliated with IFAU (Uppsala), CREST-INSEE (Paris), and CEPR (London).



Pierre Cahuc, who joined IZA as a Research Fellow in October 1999, has succeeded Dennis Snower as IZA Program Director for "Labor Markets and Institutions" as of April 2004. Cahuc is Professor of Economics at the University of Paris 1-Panthéon Sorbonne. He is also a researcher at CREST-INSEE and a research fellow of CEPR. His main fields of research are the micro foundations of macroeconomics with a special concern for labor market. His papers have been published in *The Economic Journal*, *European Economic Review*, *Journal of Public Economics*, *Economics Letters*, *Scandinavian Journal of Economics*, *Journal of Labor Economics*, *Labour Economics*, *Review of International Economics*, *Journal of Economic Behavior and Organization* and other journals.



IZA President Klaus Zumwinkel Receives John J. McCloy Award 2004



Klaus Zumwinkel, President of IZA and CEO of Deutsche Post World Net, received this year's "John J. McCloy Award" on November 29, 2004. The American Council on Germany honored Zumwinkel's contributions to German-American business relations through the

growing presence of the German postal service in the United States. In his almost 15 years as CEO, Zumwinkel managed to transform the former government agency into a highly profitable multinational corporation. As the President of IZA, he also heads an international research institute with close ties to American partners. The "John J. McCloy Award" was established as a tribute to the former High Commissioner in Germany (1949-1952) and initiator of U.S. President John F. Kennedy's famous Berlin visit (1963).



Florian Gerster Becomes IZA Director for Policy Fellows



Former State Minister *Florian Gerster*, who also headed the Federal Labor Agency from 2002 until 2004, has accepted the invitation to become the new IZA Director for Policy Fellows.

He will establish and coordinate a network of influential members

from politics, business, academic science and the media. This group will not only provide IZA with additional input and advice, but its members will also profit from the institute's research findings. "The goal of this initiative is to promote the exchange of ideas on labor market issues between academic science, policy-making and economic practice. We are convinced that this is an essential undertaking if we want to meet the economic policy challenges facing us here in Germany", said IZA Director *Klaus F. Zimmermann*.

Klaus F. Zimmermann Awards Kuznets Prize to Olympia Bover and Manuel Arellano



During the Annual Conference of the European Society for Population Economics (ESPE) in Bergen, Norway, *Klaus F. Zimmermann*, IZA Director and Editor-in-Chief of the *Journal of*

Population Economics, announced the third Kuznets Prize Winner of the Journal. This prize is awarded for the best article published in the



Journal during a three-year period. At a formal ceremony on June 10, *Olympia Bover* (Bank of Spain) and *Manuel Arellano* (CEMFI) received the Prize for their article "Learning about migration

decisions from the migrants: Using complementary datasets to model intra-regional migrations in Spain" (*Journal of Population Economics* (2002) 15:357-380)



Prize-Winning Paper by IZA Research Director Armin Falk



In May 2004, IZA Research Director *Armin Falk*, Professor of Economics at the University of Bonn and Director of the Bonn Laboratory for Experimental Economics, received the "CESifo Prize in Public Economics 2004 – Distinguished CESifo Affiliate". This prize is

awarded annually by the Center for Economic Studies at the University of Munich, jointly with the ifo Institute, to honor academically outstanding and policy-relevant work by a CESifo affiliate in the field of Public Sector Economics. The award-winning paper entitled "Charitable Giving as a Gift Exchange: Evidence from a Field Experiment" was published as IZA Discussion Paper No. 1148 and is downloadable at www.iza.org.

Alain Jousten New IZA Visiting Research Fellow



In October 2004, *Alain Jousten* (University of Liège, Belgium) came to IZA for a three-month stay as a Visiting Research Fellow. He has been professor of macroeconomics at Liège since 1999 and studies, among other things, the viability of our pension systems. He succeeds *Frederic Docquier* (University of Lille 2), who previously spent three months at IZA. *David Jaeger* (College of William and Mary) had been at IZA for twelve months and returned to the U.S. in July. The Visiting Fellow Program, which is targeted at members of the worldwide IZA network, has by now been firmly established as an attractive form of research cooperation.



IZA Research Fellow Felix Büchel Passed Away



It is with deep regret that we received notice that IZA Research Fellow *Felix Büchel* has passed away on July 12, 2004. Felix Büchel was a tenured Senior Research Scientist (C3 position) at the Max Planck Institute for Human Development (Max-Planck-Institut für Bildungsforschung) in Berlin. He was affiliated as a Professor of Economics (Adjunct Professorship) at the Technical University Berlin, as a Professor of Sociology (Honorary Professorship) at the Free University of Berlin, and as a Research Professor with the German Socio-Economic Panel Study (SOEP) at the DIW Berlin. As one of IZA's most active Research Fellows, he participated in several IZA workshops and published a total of 10 IZA Discussion Papers. IZA will cherish his great contributions in memory.



IZA Alumni

In 2004 IZA Research Associate *Gulcin Gumus* and IZA Resident Research Affiliate *Sher Verick* left the institute to take over new tasks abroad. While Gumus moved as an Assistant Scientist to the Health Economics Research Group at the University of Miami in July, Verick joined the Melbourne Institute of Applied Economic and Social Research as a Research Fellow in October. IZA will keep close contacts with both Alumni.

Christian Belzil Received DFG Funding for Stay at IZA



IZA Research Fellow and Associate *Christian Belzil*, who joined the IZA staff on a part-time basis in June 2003, has received funding under the Mercator Program of the DFG (German Science Foundation) in 2004. He has taught doctoral courses in applied microeconomics at the Bonn Graduate School of Economics and was involved in the lecture program of the 2004 IZA European Summer School in Labor Economics. Belzil is one of only two economics professors sup-

ported by the Mercator Program in 2004. The program enables Germany's research universities to invite highly qualified scientists and academics working abroad to complete a DFG-funded stay at their institutes. The visit should focus on joint cooperative projects by the guest and host. By assuming teaching duties, visiting professors will contribute to providing a clear international dimension to the research-oriented training of young researchers in the host departments.

IZA Establishes Own Scholarship Program

IZA continually expands its activities in supporting and promoting young labor economists. In addition to integrating junior researchers as IZA Research Associates and IZA Research Affiliates, IZA is also actively involved in the graduate studies program of the Bonn Graduate School of Economics. Highly qualified students at the Graduate School have the opportunity to conduct their research at IZA as Residential Affiliates.

To complement these efforts, IZA has established its own Scholarship Program offering a number of doctoral scholarships in different fields of labor economics, preferably in one of IZA's research program areas on (1) Labor Market Policy (2) Migration and (3) Behavioral Economics.

To qualify for a scholarship, the applicant must demonstrate above-average academic achievement and/or receive an offer by IZA due to special aptitude for a specific project. Moreover, the doctorate regulations of the respective university apply. In principle, the IZA Scholarship Program is open to all qualified applicants regardless of their nationality.

The doctoral thesis must be supervised by a professor of a German or foreign university or by an IZA staff member with the required qualifications. Each doctoral student will be tutored by an IZA researcher. A well-equipped office space is usually provided by IZA. The student will also have access to IZA's entire information infrastructure including internal service and the external academic network.

The student will be directly integrated in IZA research activities. This applies to the choice of topic as well as to the participation in ongoing research project or other activities. Each student will be assigned to an IZA research program area.

The scholarship is normally awarded for a period of one year. It may be renewed twice, thus resulting in a maximum duration of three years.

The complete terms and conditions are downloadable from the IZA website (www.iza.org) under "People/Scholarships".

New IZA Research Staff Members



In September 2004 two young labor economists joined the IZA Research Team. *Olivier Bargain* received his Ph.D. from DELTA, Paris. Previously, he had worked as a business analyst for TotalFina-Elf and had received an M.A. in "Economic Analysis and Policies" at DELTA and a French "Grandes Ecoles" diploma in business administration at ESCP-EAP. His main research interests focus on the impact of tax policies on labor supply and welfare, optimal taxation, microeconomic methods and models of household behavior.



Lutz Kaiser received his Ph.D. in Social Science at the Ruhr University of Bochum, where he also obtained his Master's in Social Science in 1997 (Dipl.-Sozialwissenschaftler). From 1995-1996 he studied "Contemporary European Integration" at Trinity College Dublin. His research interests include labor supply, job satisfaction, unemployment, and labor policy.

IZA DISCUSSION PAPERS

Until November 2004 IZA Discussion Papers included the following titles
(a complete list is available on our homepage at www.iza.org - all papers are downloadable):

- 1400 James Albrecht, Aico van Vuuren, Susan Vroman**
Decomposing the Gender Wage Gap in the Netherlands with Sample Selection Adjustments
- 1399 Alicia Adsera**
Marital Fertility and Religion: Recent Changes in Spain
- 1398 Sylke V. Schnepf**
How Different Are Immigrants? A Cross-Country and Cross-Survey Analysis of Educational Achievement
- 1397 Stanley A. Sedo, Sherrie Kossoudji**
Rooms of One's Own: Gender, Race and Home Ownership as Wealth Accumulation in the United States
- 1396 Luis Diaz-Serrano**
Income Volatility and Residential Mortgage Delinquency: Evidence from 12 EU Countries
- 1395 Don J. DeVoretz, Sergiy Pivnenko**
The Economic Causes and Consequences of Canadian Citizenship
- 1394 Ingo Lückgen, Dirk Oberschachtsiek, Rolf Sternberg, Joachim Wagner**
Nascent Entrepreneurs in German Regions: Evidence from the Regional Entrepreneurship Monitor (REM)
- 1393 Daniel Münich, Jan Svejnar, Katherine Terrell**
Do Markets Favor Women's Human Capital More than Planners?
- 1392 Anne Flipo, Denis Fougère, Lucile Olier**
Is the Household Demand for In-Home Services Sensitive to Tax Reductions? The French Case
- 1391 Philippe Mahler, Rainer Winkelmann**
Single Motherhood and (Un)Equal Educational Opportunities: Evidence for Germany
- 1390 Evelyn L. Lehrer**
Religion as a Determinant of Economic and Demographic Behavior in the United States
- 1389 Shelly Lundberg, Richard Startz**
Information and Racial Exclusion
- 1388 Pedro S. Martins**
Do Foreign Firms Really Pay Higher Wages? Evidence from Different Estimators
- 1387 Eduardo Melero**
Sex Differences in Managerial Style: From Individual Leadership to Organisational Labour Relationships
- 1386 Amelie Constant, Klaus F. Zimmermann**
Self-Employment Dynamics Across the Business Cycle: Migrants Versus Natives
- 1385 Daniele Checchi, Laura Pagani**
The Effects of Unions on Wage Inequality: The Italian Case in the 1990s
- 1384 Maurice Schiff, Yanling Wang**
North-South Technology Diffusion, Regional Integration, and the Dynamics of the "Natural Trading Partners" Hypothesis
- 1383 Mirko Cardinale, Michael Orszag**
Severance Pay and Corporate Finance: Empirical Evidence from a Panel of Austrian and Italian Firms
- 1382 Pedro S. Martins**
Firm-Level Social Returns to Education
- 1381 Armin Falk, Urs Fischbacher, Simon Gächter**
Living in Two Neighborhoods: Social Interactions in the Lab
- 1380 Deborah Cobb-Clark**
Selection Policy and the Labour Market Outcomes of New Immigrants
- 1379 Richard Akresh**
Adjusting Household Structure: School Enrollment Impacts of Child Fostering in Burkina Faso
- 1378 John T. Addison, Christopher J. Surfield**
The Use of Alternative Work Arrangements by the Jobless: Evidence from the CAEAS/CPS
- 1377 Eduardo Melero**
Evidence on Training and Career Paths: Human Capital, Information and Incentives
- 1376 Pedro S. Martins**
Rent Sharing Before and After the Wage Bill
- 1375 Simon Gächter, Arno Riedl**
Dividing Justly in Bargaining Problems with Claims: Normative Judgments and Actual Negotiations
- 1374 Eric Bartelsmann, John C. Haltiwanger, Stefano Scarpetta**
Microeconomic Evidence of Creative Destruction in Industrial and Developing Countries
- 1373 Wiji Arulampalam, Alison L. Booth, Mark L. Bryan**
Is There a Glass Ceiling over Europe? Exploring the Gender Pay Gap across the Wages Distribution
- 1372 Holger Görg, Aoife Hanley**
Does Outsourcing Increase Profitability?
- 1371 Tito Boeri, J. Ignacio Conde-Ruiz, Vincenzo Galasso**
Cross-Skill Redistribution and the Tradeoff between Unemployment Benefits and Employment Protection
- 1370 Swati Basu, Saul Estrin, Jan Svejnar**
Employment Determination in Enterprises under Communism and in Transition: Evidence from Central Europe

IZA GUEST RESEARCHERS

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

- Alain Jousten** (CREPP, Univ. de Liège), **Jonas Agell** (Stockholm Univ.), **Arne Uhlenhorff** (DIW Berlin), **Nuria Rodriguez-Planas** (Univ. Autònoma de Barcelona), **Bruce A. Weinberg** (Ohio State Univ.), **Saul Schwartz** (Carleton Univ.), **Miguel Portela** (Tinbergen Institute), **Bernd Fitzenberger** (Univ. of Frankfurt), **Kenneth L. Sokoloff** (Univ. of California, Los Angeles), **Theo Eicher** (Univ. of Washington), **Tapio K. Palokangas** (Univ. of Helsinki), **Xiaodong Gong** (Australian National Univ.), **Miles Corak** (Statistics Canada), **Marcus Hagedorn** (Univ. of Pennsylvania), **Marco Leonardini** (Univ. of Milan), **Leif Danziger** (Bar-Ilan Univ.), **Don J. DeVoretz** (Simon Fraser Univ.), **Guillermina Jasso** (New York Univ.), **Francine D. Blau** (Cornell Univ.), **Lawrence M. Kahn** (Cornell Univ.), **Mark Gradstein** (Ben Gurion Univ. of the Negev), **Shoshana Neuman** (Bar-Ilan Univ.), **Michael C. Burda** (Humboldt Univ.), **Sebastian Kessing** (Wissenschaftszentrum Berlin für Sozialforschung (WZB)), **Giorgio Brunello** (Univ. of Padova), **Laszlo Goerke** (Univ. of Mainz), **Michael Sattinger** (State Univ. of New York, Albany), **Gil S. Epstein** (Bar-Ilan Univ.), **Antje Mertens** (Max Planck Institute for Human Development), **Myeong-Su Yun** (Tulane Univ.), **Ira N. Gang** (Rutgers Univ.), **Yoram Weiss** (Tel Aviv Univ.), **Till von Wachter** (Columbia Univ.), **Eytan Sheshinski** (Hebrew Univ., Jerusalem), **Astrid Kunze** (Norwegian School of Econ. and Business Administr.), **Øivind Anti Nilsen** (Univ. of Bergen), **Kenneth Troske** (Univ. of Missouri), **Audrey Light** (Ohio State Univ.), **Axel Heitmueller** (Department for Work and Pensions, UK), **Kostas G. Mavromaras** (Univ. of Aberdeen), **Chinhui Juhn** (Univ. of Houston), **Deborah Cobb-Clark** (Australian National Univ.), **Marek Góra** (Warsaw School of Econ.), **Charles Bellemare** (Univ. Laval), **Sherrie Kossoudji** (Univ. of Michigan), **Josef Zweimüller** (Univ. of Zurich), **Holger Stichnoth** (Univ. of Bonn), **Simon Gächter** (Univ. of St. Gallen), **Barry R. Chiswick** (Univ. of Illinois, Chicago), **Jörgen Hansen** (Concordia Univ.), **Fabien Postel-Vinay** (CREST-INSEE), **Robert M. Sauer** (Hebrew Univ., Jerusalem), **Michael Bognanno** (Temple Univ.), **Miguel Portela** (Tinbergen Institute), **José V. Rodriguez Mora** (Univ. Pompeu Fabra), **Urs Fischbacher** (Univ. of Zurich), **Lorenz Götte** (Univ. of Zurich), **Olivier Deschenes** (Univ. of California, Santa Barbara), **Hartmut Lehmann** (Univ. of Bologna), **Bas van der Klaauw** (Free Univ. of Amsterdam), **Mark R. Rosenzweig** (Harvard Univ.), **Marco Francesconi** (Univ. of Essex), **Jan C. van Ours** (Tilburg Univ.), **Wendelin Schnedler** (Univ. of Bristol), **Martin Biewen** (Univ. of Frankfurt), **Richard Akresh** (Yale Univ.), **Helena Skyt Nielsen** (University of Aarhus and IZA), **Alfonso Rosolia** (Bank of Italy), **Hillel Rapoport** (Bar-Ilan University), **Sascha O. Becker** (Univ. of Munich)

O P I N I O N

Turnaround in the German Labor Market?



The New Year brings cause for cautious optimism. The German economy has left the path of stagnation in 2004. In the tradition of previous upswings in Germany, a thriving global economy and strong exports have eventually energized our economy. Real economic growth reached an after all remarkable 1.7% last year. And the conditions in 2005 seem favorable for a continuing expansion as positive domestic factors coincide with a substantially improved global economic environment. We expect growth to accelerate slightly to 1.8% this year and 2% in 2006. Compared to the three lean years between 2001 and 2003, this would mark a significant improvement.

The labor market, however, has not yet profited from the economic upturn. Employment in Germany is expected to rise from 38.4 million in 2004 to a mere 38.6 million in 2005 and 38.9 million in 2006. From a macroeconomic perspective, the unemployment figures will not drop con-

siderably until 2006, when the number of unemployed could decrease by 400,000. Since the potentially strong effects of the recent labor market reforms cannot yet be evaluated due to their microeconomic nature, they are not included in this estimate.

While the boom of the global economy is beginning to fade, it remains on a high level. This applies not only to the United States, but particularly to Asia and Eastern Europe. Neither the high oil price nor the weak dollar poses a serious threat. The economic situation in Germany's important export destinations will further stabilize. But domestic demand will nonetheless need to be revived in order to create a self-sustaining upswing. In view of the massive budget deficits at all levels of government, this much-needed increase in domestic demand will depend on private investment and consumption. The signs are good for private investment to pick up soon due to postponed replacement investment decisions, the rise in global demand, and the growing confidence in the reform efforts of the German government.

The most important component of the German labor market reform went into effect in January. The program referred to as "Hartz IV" abolishes parts of the unemployment benefit system that originated in times of full employment. Benefits for the long-term unemployed are no longer based on previous wage income. In most cases they are reduced to a level close to social welfare. The goal of the initiative running under the motto *Fördern und Fordern* ("supporting and demanding") is to improve counseling services for the unemployed while at the same time increasing their willingness to accept lower-paid jobs. This may help to stimulate the underdeveloped low-wage sector in Germany, which offers viable job prospects particularly to low-skilled workers who suffer most from unemploy-

ment. In fact, Hartz IV is nothing short of a small revolution as it has eradicated a practice that was no longer financially sustainable and offered too little employment incentives.

Policymakers are therefore well advised to maintain course. Germany is now sailing moderate macroeconomic seas. Fiscal policy is slowly stabilizing, and the European Commission is likely to implement reforms this year that would add credibility to the Stability and Growth Pact. This must be applauded because it is a precondition for a steady and solid restructuring process of our economy. However, it is an open secret that economic success will ultimately depend on effective incentive mechanisms and an efficiently organized economic and social system. We cannot do without further reforms in the fields of federalism, healthcare, pension funding, education and research. We still need more competition in most of these areas. If our policymakers muster the courage to undertake additional steps in this direction, confidence in Germany as a business and investment environment will rebound. If this does not happen, a sustainable upswing with a lasting labor market effect will be difficult to achieve.

K. F. Zimmermann



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