



IZA COMPACT

Considering the Future of Labor

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Germany – What Next? New Book Presents Concepts for Economic and Social Reforms

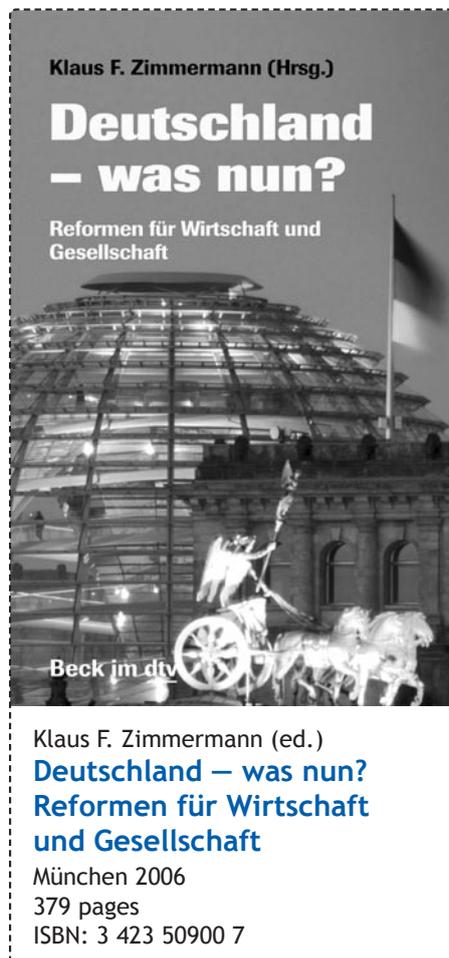
At the end of 2005, Germany is wavering between “reform-willingness” and “reform-weariness”. The first steps at modernizing the country’s economy and welfare state are only slowly taking effect. Given the widespread misgivings about a strict continuation of the chosen path, policymakers and society are faced with enormous challenges in the fields of federalism, the labor market, budget balancing and taxation, health-care, pensions and intergenerational fairness, education and research, and family policy.

Renowned Authors Give Recommendations

In view of the huge tasks ahead of the new Grand Coalition of Christian Democrats and Social Democrats, IZA Director *Klaus F. Zimmermann* has gathered a team of leading economists, who comment on these issues in a provocative but constructive manner. The authors have contributed twenty articles on the most important challenges that will shape Germany’s future. The result is a multi-faceted volume, which critically addresses the crucial economic and social issues of our time.

Among the authors are *Bert Rürup* (Chairman of the German Council of Economic Experts), *Wolfgang Wiegard* (Member of the German Council of Economic Experts), *Thomas Straubhaar* (President, HWWI Hamburg), *Michael Hüther* (Director, IW Cologne Institute for Business Research), *Rüdiger Pohl* (University of Halle-Wittenberg), *Friedrich Breyer* (University of Konstanz), *Claudia Kemfert* (DIW Berlin), *Charles B. Blankart* (Humboldt University, Berlin), *Hilmar Schneider* (IZA), *Gebhard Kirchgässner* (University of St. Gallen),

Gert G. Wagner (Research Professor, DIW Berlin), *Bernd Raffelhüschen* (University of Freiburg), *David B. Audretsch* (Max Planck Institute of Economics, Jena), *Georg Meran* (Vice President, DIW Berlin), *Friedrich Schneider* (University of Linz), *Hans-Georg Petersen* (University of Heidelberg), *Alfred Steinherr* (Head of Department for Macro Analysis and Forecasting, DIW Berlin), and *Christian von Hirschhausen* (DIW Berlin).



>> In This Issue

NEW BOOK ON THE PROCESS OF ECONOMIC AND SOCIAL REFORMS IN GERMANY

On the initiative of IZA Director Klaus F. Zimmermann, a number of renowned German economists have contributed to a book that explains the most important reform tasks faced by the new German government and proposes possible measures.

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LABOR MARKET REFORMS IN EUROPE

A new IZA Discussion Paper describes and analyzes the recent reform efforts in selected European welfare states (Denmark, Sweden, United Kingdom, Switzerland, Netherlands, Spain and Germany) in the areas of employment protection, unemployment benefits and active labor market policy.

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IZA TOWER TALK

As the invited speaker at the 11th IZA Tower Talk, Bundesbank President Axel Weber talked about the opportunities and risks of globalization.

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IZA ANNUAL MIGRATION MEETING CALL FOR PAPERS

Papers or abstracts for presentation at the 3rd IZA Annual Migration Meeting can be submitted until February 15, 2006.

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IZA YOUNG LABOR ECONOMIST AWARD

To reward outstanding labor market research by young academics, IZA has established the Young Labor Economist Award, which will be presented for the first time in 2006.

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Published in German language under the title "Deutschland - was nun? Reformen für Wirtschaft und Gesellschaft" (*Germany - What Next? Reforms for Economy and Society*), this scientifically well-founded yet easy-to-read book explains how Germany got into its current predicament - and what can be done to get the country back on track. As the synthesis of the various articles shows, there is no more room for a wait-and-see approach to the problems that need to be tackled by our policymakers over the next years. This is why the volume wants to encourage the political reformers to stay on course and imple-

ment effective reforms for a lasting modernization of the country.

Strong Political Leadership Needed

The outcome of the federal elections in September 2005 is a good basis for a socially symmetric reform policy. A Grand Coalition can speed up reforms that were previously slowed down by partisan bickering. But this raises expectations and the pressure to succeed, which - in the interest of the country - no political player should try to evade. The necessary reform spirit in society, however, can only be

generated if policymakers muster the courage and strength to undertake painful steps that might well upset their constituency. Most importantly, they must convince the people that only an effective reform policy can guarantee long-term prosperity and prevent economic exclusion. Politicians too often find themselves caught between the realization that courageous action can no longer be postponed and the temptation to keep procrastinating in order not to "overburden" their voters.

The new book "Deutschland - was nun?" demands from policymakers that they

AUTHORS AND TOPICS



Klaus F. Zimmermann
Germany 2015



Bernd Raffelhüschen
Intergenerational Fairness



Gebhard Kirchgässner
Reform of Federalism



Michael Hüther
Family and Population Policy



Hilmar Schneider
Labor Market



Thomas Straubhaar
Immigration



Bert Rürup
Pension Reform



Klaus F. Zimmermann
Educational Policy



Friedrich Breyer
Healthcare Reform



Gert G. Wagner
Reform of Higher Education

focus on long-term needs rather than relying on cosmetic short-term effects. The contributing economists share the hope that Germany will eventually succeed in embarking on the necessary reforms. It must be kept in mind, however, that most of the modernization measures will not have an observable impact any time soon. Even in the best-case scenario, no one can promise a substantial improvement of the labor market situation over the short term. The inevitable reorganization of our welfare state to provide stronger incentives and more intergenerational fairness will require substantial sacrifices

from the German people, which cannot be offset - but merely alleviated over time - by lower taxes. A massive reduction of subsidies will not only rely on a competitiveness assessment for entire industries but also on a reorientation among interest groups towards the collective good. The necessary reform of the German educational system is a vital investment in our future, but it is not a magic wand that can immediately eliminate the human capital deficits which impede our economic performance. The same is true for family policy or climate control. Progress in all these areas will largely depend on

a liberating move towards a new federalist structure, which cannot itself be achieved in the short run.

This is why a strong political leadership in the new Grand Coalition is all the more important. Its historical precedent in the years between 1966 and 1969 is not remembered for political inertia, but much rather for its remarkable progress particularly in the field of economic policy. Germany's second Grand Coalition must hold itself to the highest expectations and is literally "doomed to success". The book proposes ways to achieve this success.



Hans-Georg Petersen
Tax Reform



Georg Meran
Industrial Policy



Wolfgang Wiegand
Corporate Taxation



Friedrich Schneider
Shadow Economy



David B. Audretsch
Innovation



Claudia Kemfert
Climate Control



Rüdiger Pohl
Reforms in Eastern Germany



Alfred Steinherr
Macroeconomic Conditions



Christian von Hirschhausen
Infrastructure



Charles B. Blankart
European Constitution

The Interaction of Labor Market Regulation and Policies in European Welfare State Reforms

Employment protection legislation, unemployment benefits and active labor market policy are Janus-faced institutions. On the one hand, they are devices of insurance against labor market risks that provide income and employment security. On the other hand, they influence the capacities of labor markets to adapt to changing economic conditions since institutional features of the welfare state also affect actors' economic adaptation strategies. In view of these institutional complementarities, reforms to increase the dynamics of (European) labor markets had to address more than one area.

A recent IZA Discussion Paper by *Werner Eichhorst* (IZA) and *Regina Konle-Seidl* (IAB, Institute for Employment Research) describes recent reform sequences affecting employment protection, unemployment benefits and active labor market policies in a number of European welfare states: Denmark, Sweden, the United Kingdom, Switzerland, the Netherlands, Spain, and Germany. It thereby shows whether and to what extent national policy patterns actually converge in the direction of a higher level of adaptability with employment protection being eased and labor market policies being activated through a combination of "carrots and sticks". Regarding the politics of reforms, the paper tries to answer the question whether consistent reforms of the three insurance devices are more likely in political systems characterized by strong government and/or social partnership since such institutional prerequisites may favor reform packages (↪ *W. Eichhorst / R. Konle-Seidl, The Interaction of Labor Market Regulation and Labor Market Policies in Welfare State Reform, IZA Discussion Paper No. 1718*).

The Adaptability of National Labor Markets

Differentials in national labor market performance can to a significant extent be explained by the capacity of economic actors to adapt to structural shifts or business cycle variations. This capacity is determined by institutional factors. The higher the labor market adaptability, the less severe will be the problem of persistent unemployment. Employment protection legislation, passive labor market policies (unemployment benefits), and the system of active labor market policies have two

meanings in this context: first, they are important features of national welfare states which provide insurance against labor market risks; second, they influence structures and dynamics of labor markets.

In the European countries combinations of employment protection legislation as well as active and passive labor market policies differ over time and space. With reasonable simplification it can be argued that "liberal" welfare states like the UK not only provide low employment protection legislation but also lower levels of out-of-work benefits and less active labor market policies, while Switzerland is "hybrid" since it provides low employment protection but more generous benefits and active labor market policies. The same holds for Denmark, which is usually joined by Sweden in the "Scandinavian" cluster since both are big spenders on active and passive labor market policies, although there is no clear pattern in employment protection. In "conservative" welfare states in continental Europe, e.g. in Germany and the Netherlands, employment protection legislation is rather strict while considerable resources are spent on active and passive labor market policies. Finally, "southern" welfare states such as Spain can roughly be described by strict employment protection and lower levels of benefits as well as less intense active labor market policy.

The Effects of Labor Market Regulation and Policies

As regards the effects of the diverse security mechanisms, we can identify positive and negative effects of interference with markets:

Strict [employment protection legislation](#) can stabilize employment and income, strengthen commitment of workers to their firm, and induce more investment of employers and employees in firm-specific human capital; but restrictive regulation reduces labor market adaptability by inhibiting labor market transitions, i.e. job-to-job mobility. Once people are made redundant, this can result in longer unemployment spells and lead to higher long-term unemployment. Easing restrictions on fixed-term contracts and temporary agency work increases flexibility at the margin and might, therefore, contribute to stronger employment growth at least in flexible

jobs which provide entry opportunities for labor market entrants. This, however, may result in a persistent "dualization" of the labor market with a strict divide between the core and the marginal segment.

A generous "passive" benefit system - regarding [unemployment benefits](#) - can increase the duration of individual unemployment spells since the pressure to search for a new job is lower the longer and more generous awarded unemployment benefits are. On the other hand, unemployment insurance can contribute to more stable and productive matches on the labor market as it works as a search subsidy so that jobseekers can wait and choose a job offer that matches their profile better than an offer accepted because of financial need.

The negative employment effects of a relatively generous benefit system might be offset by a suitable [active labor market policy](#) that raises effective labor supply by making the unemployed more willing to accept jobs or by making them more attractive to prospective employers. But participation in active labor market programs can also lead to lock-in effects that reduce job search efforts. That may be ineffective and may go along with high dead-weight and substitution effects on the macroeconomic level.

Contingent on the interaction of employment protection and active and passive labor market policies, the dynamics of labor markets are supposed to differ. Nevertheless, higher levels of unemployment benefits can be compatible with good labor market performance if benefit receipt is made conditional upon individual job search and acceptance of job offers or training measures. Therefore, in order to reduce unemployment persistence, reforms have to aim at increasing overall labor market adaptability by easing employment protection, making active labor market policies more effective, and strengthening work incentives of benefit recipients by activation strategies. The concrete design of reforms, however, can differ according to the properties of the system in place.

The Role of Complementarities in Labor Market Reforms

Since high labor market adaptability depends on an effective institutional

arrangement of several related policy areas, reforms have to tackle more than only one policy field to create an institutional setting conducive to high employment growth and low unemployment. There are positive complementarities between reforms in a double meaning: Positive economic complementarities can make reforms more effective because coordinated changes in related policy areas cause mutually reinforcing effects on labor market dynamics. On the other hand, political complementarities can facilitate reforms since coordinated changes across policy areas may be more practicable in political terms as package deals can take into account resistance from actors fearing short-term losses.

Process and outcome of labor market reforms, therefore, depend on the capacity of national political systems to implement complementary reforms. Government capacities are weaker if veto points such as second chambers in federal systems,

the necessity of social partner negotiations, constitutional autonomy in wage setting, or self-administration in social security exist. In addition, if control of some areas of economic policy is shared with the social partners, policy complementarities can only be mobilized if government can coordinate reforms with employers' associations and trade unions. This is a feasible option if government can establish a "shadow of hierarchy", i.e. if it has the power and the determination to formulate a reform agenda and to induce the social partners to enter bargaining processes, which is furthered by government's credible threat of unilateral action or intervention. Apart from this, reforms are easier to implement if there is a general consensus on societal problems and objectives which can be generated by political leadership. If no broad consensus exists, reforms depend upon support of pivotal groups. Hence, we can expect that reforms to increase labor market adaptability are more prob-

able if groups that might benefit from them have ample size.

Different Reform Paths in European States

European governments follow different paths of labor market reforms ([Figures, ▼ / p.6](#)). On the one hand, there are those welfare states with a low initial level of labor market regulation which was not reduced further. These countries concentrated on implementing stricter activation policies with active elements, appearing rather late in the UK with the shift to New Labor and in Switzerland where active programs were designed according to OECD blueprints. In contrast, Denmark activated its full-blown system of active labor market policy in the early 1990s. However, whereas in the United Kingdom modest benefits were cut, they were kept intact in Denmark and in Switzerland.

All countries belonging to this cluster now combine liberal labor market regulation with intense activation - but in contrast to "liberal" UK, the "hybrid" countries Denmark and Switzerland still provide a generous level of unemployment benefits if the unemployed comply with the requirements imposed upon them. As regards the resulting labor market performance, this setting turns out to be a favorable one in terms of achieving and maintaining low unemployment and long-term unemployment. The specific lesson we can draw from the Danish and Swiss example is that if a liberal regime of employment protection is combined with institutions that support income and reemployment security, but ensure activation, one can obtain a well-functioning employment system without dismantling the welfare state.

The countries in continental and Southern Europe (the Netherlands, Germany and Spain) but also Sweden had a high level of employment protection at the outset. Initial reforms in this policy field increased flexibility at the margin in order to create additional flexible jobs and increase overall labor market flexibility. However, at that point in time, individual dismissal protection applicable to regular jobs was left untouched. As a reaction to strong growth of the flexible segment and increasingly dual character of labor markets, the next wave of reforms raised the level of job protection for workers in flexible jobs while moderately reducing the level of individual dismissal protection.

With respect to labor market policy, these countries followed similar paths. The common policy shift from costly but

Changes in EPL, ALMP and Unemployment Benefits

	Denmark	Sweden	United Kingdom	Switzerland	Netherlands	Spain	Germany
Employment Protection Legislation (Aggregated Indicator, OECD)							
Fixed-Term Contracts							
Late 1980s	2,3	2,7	0,0	1,3	1,5	2,0	3,5
Late 1990s	2,3	1,8	0,0	1,3	0,8	2,5	1,8
2003	2,3	1,8	0,3	1,3	0,8	3,0	1,8
Temporary Work Agencies							
Late 1980s	4,0	5,5	0,5	1,0	3,3	5,5	4,0
Late 1990s	0,5	1,5	0,5	1,0	1,6	4,0	2,8
2003	0,5	1,5	0,5	1,0	1,6	4,0	1,8
Dismissal Protection							
Late 1980s	1,5	2,9	0,9	1,2	3,1	3,9	2,6
Late 1990s	1,5	2,9	0,9	1,2	3,1	2,6	2,7
2003	1,5	2,9	1,1	1,2	3,1	2,6	2,7
Overall Strictness of Regulation							
Late 1980s	2,3	3,5	0,6	1,1	2,7	3,8	3,2
Late 1990s	1,4	2,2	0,6	1,1	2,1	2,9	2,5
2003	1,4	2,2	0,6	1,1	2,1	3,1	2,2
Expenditure on Active Labor Market Policy in % of GDP							
1993	1,97	2,98	0,57	0,39	1,24	0,53	1,62
1998	1,89	2,01	0,34	0,70	1,76	0,72	1,27
2003	1,74	1,29	0,53	0,77	1,83	0,72	1,14
Change in PP	-0,23	-1,69	-0,04	0,38	0,59	0,19	-0,48
Expenditure on Passive Labor Market Policy in % of GDP							
1993	5,49	2,77	1,60	1,64	2,87	3,59	2,59
1998	3,74	1,91	0,63	1,07	3,14	1,64	2,29
2003	2,68	1,22	0,37	1,02	1,86	1,48	2,31
Change in PP	-2,81	-1,55	-1,23	-0,63	-1,01	-2,11	-0,28
Unemployment Benefit Generosity (Gross Replacement Rates for Different Earnings)							
1993	51	28	19	30	53	32	28
1997	62	27	18	34	52	31	26
2001	51	24	17	38	53	31	28
Net Replacement Rates of Unemployment Benefits, Average Production Worker, Single, First Month of Unemployment							
1997	62	72	50	73	75	76	60
1999	63	71	46	81	82	74	60
2002	59	81	45	72	71	70	61
Net Replacement Rates of Unemployment Benefits, Average Production Worker, Single, 60th Month of Unemployment							
1997	48	58	50	61	60	25	54
1999	60	54	46	54	60	23	54
2002	50	51	45	51	58	27	61

Source: IZA Discussion Paper No. 1718 (OECD Employment Outlook, OECD Benefit Systems and Work Incentives, OECD Benefits and Wages)

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Mapping Labor Market Reforms and Outcomes

Country	Labor Market Policies			Employment Protection	Labor Market Outcomes		
	Active	Passive	Activation		Unemployment	Employment	Long-Term Unemployment
Denmark	▶	▶	▲▲	▶	▼	▶	▼
Sweden	▲ → ▼	▶	▲	NE ▼	▼	▼	▲
United Kingdom	▲	▼	▲▲	▶▲	▼	▶	▼
Switzerland	▲	▲	▲▲	▶	▶	▶	▲
Netherlands	▲	▶	▲▲	NE ▼ → NE ▲ + SE ▼	▼	▲	▼
Spain	▲	▼	▲	NE ▼ → NE ▲ + SE ▼	▼	▲	▼
Germany	▲ → ▼	▶	▲(▲)	NE ▼	▲	▶	▲

▲▲ Strong Increase ▲ Increase NE Non-Standard Employment Relationship (Temporary Work, Flexible Employment)
 ▶ Constant ▼ Decrease SE Standard Employment Relationship
 → Changes in Labor Market Policy

Source: IZA Discussion Paper No. 1718 (compilation by authors)

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fairly passive labor market policies to stricter activation was first implemented in the Netherlands and later in Germany and Sweden. Despite these activation policies with stricter monitoring of job search, more frequent sanctions and more restrictive availability criteria, there are no significant reductions of benefit levels. Since less permissive benefit systems make receipt of income out of work less convenient, jobseekers tend to make concessions regarding the wage level of jobs offered. However, even though employment protection legislation was eased at the margin over the last decade, flexibility of the labor market is still insufficient in these countries so that the potential for the creation of additional jobs available for activated jobseekers is limited.

As regards the complementarities between labor market regulation and labor market policies, one can see that in the long term countries with strong social partner institutions benefit from their capacity to identify needs for reform and to agree on appropriate remedies. With hindsight it can be argued that those countries were more successful in creating a more adaptable labor market that could rely on effective capacities to manage policy complementarities: during the decisive years under scrutiny, in Denmark and the Netherlands, there was a strong political

leadership that could mobilize societal support and rely on cooperative social partner relations and influential policy advice. This does not mean, however, that all reforms were implemented smoothly. Switzerland, in this context, profits from a strong consociational system.

These "successful" models, however, rely on preconditions which are not easily transferable. A system with low employment protection in combination with high benefit levels is easier to achieve if countries never introduced strict employment protection, which is hard to abolish later on. In contrast, acceptance of a more flexible regime of labor market regulation and a strict activation strategy accompanied by benefit cuts remains a delicate issue in continental and southern European countries. Here the demand for capacities to manage policy complementarities is most pronounced since labor market insiders benefit from the status quo and can oppose policies that imply short-term losses for them. Thus, policy makers have to design packages that are feasible in political terms.

Needs for Reform in Continental and Southern Europe

Labor market adaptability benefits from both relaxing employment protection

legislation and introducing activating elements in labor market policies, whereas maintaining a high benefit level does not seem to be incompatible with lowering unemployment. The challenges countries faced, however, were uneven as they departed from different starting points and embarked on diverging paths of reform although all of them tried to ease employment protection and to introduce activating elements into labor market policy. While the UK, Denmark, and Switzerland increased labor market adaptability and lowered standardized unemployment, continental and southern European countries still face a considerable need for reform. In these countries, the transition to a more adaptable labor market seems difficult, given the discrepancy between the extent of reforms needed and strong path dependence reinforced by insider opposition. Therefore, it might be viable to combine strict activation with maintaining higher benefit levels in order to make deregulation more acceptable to insiders. This requires strong political leadership, a general understanding of societal objectives and a certain level of trust between social partners (and/or political actors) which allows for employment protection to be reduced while other security mechanisms are recalibrated.

Bundesbank President Axel Weber at IZA Tower Talk: It Takes a Whole Pillbox to Cure Germany's Self-Inflicted Problems

Axel Weber, President of the German Bundesbank, was the invited guest speaker at the IZA Tower Talk on November 24, 2005. In his speech on the opportunities and risks of globalization, he emphasized the urgent need for reforms of the German labor market. The former economics professor at the universities of Bonn, Frankfurt/Main and Cologne warned not to make the globalization phenomenon a "scapegoat for self-inflicted problems". Based on a number of economic facts, he concluded that Germany is clearly among the beneficiaries of international economic integration. Since the actual victims are much rather found in Africa, which has been largely excluded from the benefits of globalization, Weber called for a comprehensive removal of trade barriers for these countries.

For Germany, in contrast, globalization is like a vitamin treatment for the ailing welfare state and the labor market, Weber explained. "We need a whole pillbox to cure these patients", he said. While the right prescriptions are readily available,

policymakers are still reluctant to administer the much-needed medicine. In order to solve the structural problems of the welfare state, health insurance and long-term care insurance should be disconnected from labor costs, collective bargaining regulations and layoff protection should become more flexible, and public subsidies should be shifted from declining to aspiring industries, particularly the service sector. The time for reforms is running out, Weber warned, as demographic change would severely aggravate the problems from 2010 on.

Hilmar Schneider, IZA Director of Labor Policy, agreed with Weber that it must be doubted whether the new federal government will have the strength to implement effective reforms against the expected public opposition. While the Grand Coalition offers an opportunity to overcome the political standstill, the diverging ideologies and interests of the involved parties could just as well stand in the way of a far-reaching reform strategy.



Axel Weber is President of the German Bundesbank (since 2004). He previously taught as an economics professor at the universities of Bonn, Frankfurt/Main and Cologne. He was also a member of the German Council of Economic Experts (2002-2004).

Third IZA Annual Migration Meeting (AM²) and IZA Topic Week on Immigration and Integration

Call for Papers: February 15, 2006

The 3rd IZA Annual Migration Meeting (AM²), organized by IZA Program Director Barry R. Chiswick (University of Illinois, Chicago) and IZA Senior Research Associate Amelie Constant, will take place in Bonn on May 20-21, 2006. During the meeting, new research findings on central questions in the economics of migration will be presented and discussed. The highlight of the event is the third Julian Simon Keynote Lecture in honor of the great pioneer of migration research. For

the first time, the meeting will be part of an "IZA Topic Week" on migration, which takes place from May 13-21, 2006 and offers an attractive program covering various issues of migration research. All participants of the Annual Meeting are invited to attend other events of the Topic Week as well. Further details will be announced soon.

Authors who are willing to participate may submit current papers or

an abstract of ongoing research for presentation at the IZA Annual Migration Meeting until February 15, 2006. We particularly encourage submissions by junior researchers. A convenient online application form is available on the IZA website. Decisions of acceptance will be announced by March 1, 2006.

<http://www.iza.org/AMSquared>

New IZA Initiative: Young Labor Economist Award

The "IZA Prize in Labor Economics", awarded annually since 2002, has become one of the most distinguished international awards in economics. Starting in 2006, IZA will additionally establish the "IZA Young Labor Economist Award" to honor an outstanding published paper in labor economics written by young researchers. To qualify for the award, all authors of the paper must be younger than 40 years of age at the time of pub-

lication. The prize money of 5,000 Euros is shared between the authors.

The selection process will start with nominations sent in by IZA Research Fellows. The nominated papers will then be screened by the IZA Program Directors, who will propose three papers each. On the basis of these proposals, the prize-winner(s) will be selected.

The first IZA Young Labor Economist Award for a paper published in 2004 will be awarded at the IZA/SOLE Transatlantic Meeting of Labor Economists in May 2006. "The establishment of this award reflects IZA's strong ambition to support young and aspiring academics. It is meant to provide an additional incentive for this group to conduct high-quality research in labor economics," explained IZA Research Director Armin Falk.

Employment through Innovation

High and persistent unemployment is the key problem of Germany's economy and society. Contributing to the weakness of economic growth, it has become a millstone around the neck of our social security systems. As a result of the structural change triggered by globalization, it is particularly the low-skilled workers who are falling through the cracks of the labor market. This is why we must place a high priority on providing under-achieving youths with vocational training as a ticket to the working world. Of course, trainability is limited and the globalized environment will further aggravate the international competition for skills. Does this mean our society will be split into job owners and job losers - with growing numbers forever on the losing end?



Klaus F. Zimmermann

Germany's opportunity lies in the strong innovative capabilities of our economy. Much will depend on our ability to produce lasting innovations even under changing production and market conditions. Innovation leads to economic growth, which in turn creates employment - for all skill levels. High performers profit directly from an innovative economy while low performers profit indirectly from overall economic prosperity by taking up support jobs.

Germany has never experienced a lack of inventions, which are the natural prerequisite for innovation. The German problem is much rather rooted in the marketability of inventions. Product innovations must be tailored to the needs of the consumer, and process innovations must quickly lead to cost-efficient changes in the production structure. In Germany this is often viewed as a purely technocratic issue. But curiosity and risk-taking are factors as important as the technical aspects of innovativeness. Are we really eager enough to capture new trends in consumption and production?

On behalf of the Deutsche Telekom Foundation and the Federation of German Industries (BDI), the German Institute for Economic Research (DIW Berlin) has recently developed a

new innovation indicator, according to which Germany achieves only a middle rank among other competing industrial countries. The indicator is based on the following most important factors: education, research and development, financing and innovation, integration of the innovating agents, implementability, regulation and competition, and the "innovation-friendliness" of demand. The findings show that many nations with strongly differing models of society, such as the United States and the Scandinavian countries, have a much higher level of innovativeness than Germany. But the indicator also shows that German businesses are indeed successful, largely due to a close integration of customers, suppliers, and research, as well as a still powerful infrastructure in the areas of transportation, energy, information technology, and communications.

The weaknesses of the German system of innovation are mainly found in the educational system, which needs more funding, quality improvements, and competition. Germans are also too risk-averse and lack an entrepreneurial spirit. Risk capital for start-ups is not easily available, and the general interest in science and technology is underdeveloped. Moreover, women in Germany are excluded from the innovation process to a much larger extent than in other countries.

Therefore, issues in labor economics play a key role in improving Germany's innovativeness. Strengthening education and training remains the core task in the fight against unemployment. But the goal should not simply be to teach specific knowledge that helps understand and foster technological advances. What we need is a culture of accepting changes and risks. We need people who are open to new things and able to deal with temporary failure. This is another goal to be achieved by the educational system. After all, the human being is the most important factor in our knowledge society. It is the ultimate resource able to cope with the challenges our society is facing.




Institute for the Study of Labor



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