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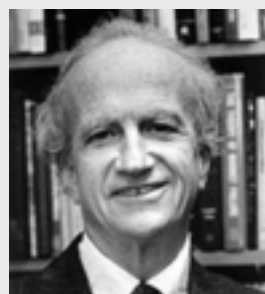
CONSIDERING THE FUTURE OF LABOR

IZA Prize in Labor Economics

New Initiative to Stimulate Labor Market Research



George A. Akerlof



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A sound understanding of labor economics has proven ever more important in coping with the adjustment processes currently taking place in the international labor markets. In light of this trend, the Institute for the Study of Labor (IZA) has created the "IZA Prize in Labor Economics". This prize will be awarded annually in recognition of outstanding academic achievements in the field of labor economics. The goal of this initiative is to stimulate fundamental research as well as concrete proposals for labor market policy reforms. Thanks to the generous support of the Deutsche Post Foundation, the prize carries a cash award of €50,000 and a research visit to IZA.

The IZA Prize will be awarded by IZA President *Klaus Zumwinkel* (CEO, Deutsche Post World Net) for the first time in November 2002. At the award ceremony in Berlin, the laureate will present his or her work to a number of invited guests from academia, business, politics, and the media.

Only IZA Research Fellows are entitled to nominate candidates for the IZA Prize in Labor Economics. For this purpose, the IZA website provides an online nomination form until May 31, 2002. The final decision on the prize-winner is made by the IZA Prize Committee, which includes *George A. Akerlof* (University of California, Berkeley), *Gary S. Becker* (University of Chicago) and *James J. Heckman* (University of Chicago) – all of them Nobel laureates in Economics. The selection process will be coordinated by IZA Director *Klaus F. Zimmermann* and IZA Research Director *Gerard A. Pfann*.

With the establishment of the IZA Prize in Labor Economics, IZA wishes to underscore the crucial importance of labor market research in shaping a promising "Future of Labor". Additional information, such as guidelines for the nomination process and details on the award ceremony, can be found on the IZA homepage or at www.iza-prize.org.



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New IZA Study: Employment Potential of a Dual Subsidizing Strategy in the Low-Wage Sector

Job seekers who may only achieve low wages in the labor market increasingly face difficulties in becoming integrated in the labor market. This mainly affects low-skilled and older workers. Unemployment rates for these groups are already above average. Although the labor market dilemma of low-skilled workers is common to many countries, Germany in particular has failed to adopt appropriate remedial policies. A potential approach considered by policymakers is the subsidization of the low-wage sector to generate jobs and earned income for these problem groups.

The cost of low-skilled labor is too high because union wage rates tend to be downward inflexible, and because technological change and increased international competition have further exacerbated the situation. This not only leads to a decrease in the demand for easily substitutable labor but also inhibits the development and consolidation of service sector segments that provide work and income to low-skilled workers. Unions and employers seem unable to respond flexibly to this challenge. Demand subsidies by the government could help buying time to allow the necessary adjustment processes to take place. After a transition period, a low-wage sector could develop that would be profitable and independent of government support in the long term.

Another important obstacle to the employability of low-skilled and older workers is the German welfare system. Workers whose market wages barely exceed unemployment benefits or welfare entitlements have few incentives to take up employment. Their available income does not increase substantially with employment because earned income is almost completely deducted from transfer entitlements. Wage subsidies are regarded as a way to modify the strict deduction rules of the transfer system and to create significant income improvements through employment, i.e. to help people escape from the "welfare trap". This method would also reduce incentives to work in the shadow economy.

Proposed Model

In its latest research report IZA analyzed a policy proposal by the government of the federal state of Northrhine-Westphalia that seeks to stimulate both the supply and the demand side of the labor market (*H. Schneider/K. F. Zimmermann/H. Bonin/K. Brenke/J. Haisken-DeNew/W. Kempe, Beschäftigungspotenziale einer dualen Förderstrategie im Niedriglohnbereich, IZA Research Report No. 5, only available in German*). The proposal differs from the so-called "combination wage" models that are currently being discussed or tested in Germany. On the one hand, the concept aims at boosting labor supply and demand by lower-

ing non-wage labor costs through subsidized social security contributions. On the other hand, tax breaks are supposed to make household-related services more affordable. Although the primary objective is to create jobs for low-paid workers, the proposal is not explicitly tied to one particular target group. Therefore, any form of employment in certain low-income sectors could qualify for subsidies under this program.

Specifically, the wage subsidy provides a degressive subsidization of social security contributions for monthly gross incomes above €325. Corresponding to the equal share of employer and employee contributions, subsidies are paid to both the supply and the demand side of the market. There are four different versions of the proposed model. Version A consists of a linear-degressive subsidy of social security contributions up to an income of €920. In Version B, social security contributions are waived completely for incomes between €325 and €510, followed by a linear reduction of subsidies on social security contributions up to an income of €920. Version C is the most extensive model. Up to an income of €510 social security contributions are waived as well. Then, however, the reduction of transfer payments is slower and extends up to a gross earned income of €1,280. Version D gives no subsidy to the employer and thus departs from the principle of equal division of contributions between employer and employee. In addition, employers have to make a 22% contribution to social security benefits for incomes between €325 and €920. In return, the government reduces its maximum contribution to the subsidy on the employee side from about 20.45% of gross income to 18.9%. The subsidy decreases in a linear-degressive manner up to an income of €920.

However, the incentive effect of the proposals not only depends on the extent of the subsidy, but also on the deduction practice. If the subsidy is paid or refunded, it would actually have to be deducted from transfer en-

titlements on the employee side. However, the available income would not increase significantly in this case, and the incentive effect would be rather small.

With regard to the expansion of household-related services, the proposal contains subsidies for activities described in the regulation for vocational training in home economics. A high demand potential can be expected in this sector as there are large discrepancies between official statistical data and household surveys on the utilization of these services. This observation suggests that the shadow economy plays a large role here.

The Potential of a Supply-Side Subsidy on Social Security Contributions

Estimates of supply-side responses to the policy proposals described above are based on an empirically estimated labor supply model which takes into account the income effects of the proposals by applying a tax and transfer module in the household context.

The improvement of labor income certainly increases the personal motivation of unemployed workers with a low productivity to take up employment. Nonetheless, very few workers will reenter the labor market as a result of wage subsidies. If the subsidy in the amount of the social security contributions is not deducted from other social transfers, expected net participation is about 37,300 in Version A, 50,600 in Version B and 104,000 in Version C, the highest outcome (see table ▼). It is interesting to note that couple households show substitution effects: Non-subsidized partners (mostly men) give up their jobs so that their spouses, who qualify for the subsidy (mostly women), can take up employment. Women with children (particularly single mothers) show above-average positive reactions to the work incentives. Labor supply increases mainly for workers with hourly wages below €10. Within this group, there is also a positive effect for men in couple households. In eastern Germany,

Supply and demand effect in individuals

Policy Version	Labor Demand		Labor Supply			
	325 - 1,280 €	Total	Version	Women	Men	Total
Version A	64,300	87,300	without deduction	42,100	-4,800	37,300
			with deduction	22,200	8,700	30,900
Version B	90,500	122,900	without deduction	57,200	-6,600	50,600
			with deduction	29,300	11,700	41,000
Version C	239,200	135,100	without deduction	111,500	-7,500	104,000
			with deduction	59,600	21,200	80,800
Version D	-17,300	-23,500	with deduction	23,100	8,700	31,800

Source: IZA Research Report No. 5

the reaction is somewhat stronger than in the western part.

If the additional income achieved through the subsidy is deducted from tax payments and transfer entitlements, the monetary advantage decreases. At the same time, however, the substitution effect disappears. The resulting participation effect is therefore only slightly smaller than without deduction: For Version A it amounts to 30,900 individuals, for Version B, 41,000, for C 80,800 and for Version D 31,800.

In addition to the participation effect, the proposals create a strong part-time incentive for current full-time employees, which even leads to an overall decrease in hours worked. A major consequence is a loss in payroll tax revenues and social security contributions.

Since the additional labor supply is small, the subsidization of all individuals in the low-wage sector places a large fiscal burden on the subsidy provider. Workers who already earn income in this sector, or reduce their labor supply in response to the part-time incentive, receive the largest funding. Although this could be justified as a general relief of low-wage earners from the burden of taxes and insurance contributions, it creates very high per capita costs with regard to every potential additional employee. IZA therefore analyzed modified versions of the original proposal that reduce the undesired side effects or lower their costs. It becomes apparent that there is a trade-off between the specificity of the subsidy and its potential employment effect.

Expected total costs of the different versions range from €0.5 billion in Version D (which, however, is co-financed by employers and thus causes contractionary effects on the demand side) to €4.1 billion in Version C without deduction. In addition to direct expenditures for the subsidy, the costs include the immediate effects on social security and tax payments as well as other welfare transfers. The criterion for fiscal efficiency is the calculated expenditure for each additional worker brought into employment. This amounts to between €40,000 and 45,000 annually without deduction and about €20,000 to €22,000 with deduction.

The Potential of a Demand-Side Subsidy on Social Security Contributions

The simplified assumption that different income categories represent different types of qualification leads to the observation that a subsidy of labor costs in certain income categories implies a change in factor prices relative to other qualification types or labor cost categories. Linking the policy-induced changes in factor prices with the empirically determined elasticities of labor demand according to labor costs yields the changed demand for total hours worked (or, approximately, the demand for workers) in each labor cost category.

Each version of the proposal – with the exception of Version D, which does not include a demand subsidy – results in a demand increase that exceeds the effect of the supply side subsidization. While the demand for workers is substantially higher in the directly subsidized income categories, negative cross-price effects lead to a lower demand in sectors with relatively higher factor prices. This effect is most pronounced in Version C, with a calculated additional demand for 240,000 individuals. Due to the substitution effect, however, net demand only amounts to about 135,000 individuals. Versions A and B generate somewhat lower increases in demand.

The direct demand-side costs of the different models can be determined directly from wage subsidies on certain types of labor. Government expenditure increases analogous to the extent of the reduction in labor costs. In absolute terms, Version A costs only €0.8 billion and Version B about €1.1 billion, while Version C requires about €3.3 billion in funds. Due to varying demand effects, the costs of the different versions are set against the newly created demand for workers. Versions A and B remain the most cost-effective with €9,100 and €9,300, respectively, per additional worker. Due to stronger substitution effects between subsidized and non-subsidized labor cost categories, the subsidies in Version C amount to as much as €24,500 annually.

Not Recommended: Subsidization for Both Sides of the Market Without Limiting the Target Group

The evaluation of the costs and effects of subsidizing both sides of the market depends on various factors. It is unclear whether additional supply and demand are absorbed by the market. The worst case will be a mismatch if supply and demand evolve in different market segments. In the best-case scenario, the effects add up because the newly created supply is met by an already latent demand restrained by the supply side. This could also apply vice versa to the newly created demand in another labor market segment.

In cases where subsidized labor supply and demand meet, Version C would presumably lead to additional employment of 100,000 individuals. The total annual cost of the subsidy on both sides of the market would then amount to €7.3 billion. This breaks down to an annual cost of €73,000 for every newly created job. Although, strictly speaking, this calculation would have to include positive aggregate effects of the additional employment, the costs of the policy programs remain extremely high. From an economic point of view, therefore, a subsidization of wages and labor costs without limiting the target group cannot be recommended.

Subsidization of Household-Related Services is Useful

Private households in Germany are still a largely untapped source of legal employment.

The number of existing jobs in this sector can only be estimated with great uncertainty. While official statistics record only several hundred thousand workers, household surveys suggest that the actual number is much larger. The following analysis is based on the German Socio-Economic Panel (SOEP) 2000, which determines that a projected 3.3 million households demand household-related services on an occasional or regular basis.

This database also provides the basis for an empirically estimated behavioral model which projects the demand for household-related services as dependent on the presumed costs. The changed household demand for private services is determined for a subsidy of 10% and 20%, respectively, of present market wages. Based on the assumption that an average household demands services worth €325 per month, a cost reduction by 10% causes an additional 745,540 households to demand services – or 351,703 for a 20% reduction (see table ▶). Higher subsidies result in a more than proportional increase. At the same time, the intensity of the demanded services increases.

This approach, however, requires a new political and institutional framework. From a conceptual point of view, it would make sense to implement the subsidies through service agencies. These could either be sub-agencies of the *Bundesanstalt für Arbeit* (Federal Employment Service), publicly funded agencies or private temporary help firms. The new institution would be responsible for assessment, registration and placement of household service positions. Registration provides a way to record and organize the market, making it easier to manage changes in demand, fluctuations, vacation and sick leave periods. A crucial advantage of a service agency is the fact that it can transform several small jobs into full-time employment for an individual worker.

The demand for subsidization and the potential fiscal relief can be quantified under several assumptions. Model (I) assumes that all newly created employment opportunities are €325 jobs, and all workers are recruited from the “silent reserve”. Given a labor cost reduction of 10%, the subsidy requires annual funds of €1.4 billion (20%: €3.1 billion), or €3,989 (20%: €4,172) for each additional household demanding services. This includes windfall gains for those households that are already demanding services in the status quo. These costs can be regarded as the costs for legalizing the sector.

In Model (II), additional demand is transformed by the agencies into nearly 90,000 (10% subsidy) or 190,000 (20% subsidy) new full-time positions. This channeling process requires that the agencies pay employer contributions to social security, which increases the demand for subsidies to €1.7 billion (20%: €3.7 billion) per year. But since there is no information on individuals taking up full-time employment, it is difficult to determine how much fiscal relief this program

would actually bring. It would mean a substantial relief if the agency manages to get unemployed individuals into full-time employment. No longer necessary unemployment benefit and the payment of taxes and social security contributions, will presumably result in a financial relief of €1.4 billion (10% subsidy) or €3.0 billion (20% subsidy). This amount would almost cover the funds needed for the subsidy. With regard to the subsidization of household-related services, the overall evaluation is more favorable than the evaluation of the subsidies on social security contributions. Substantial employment effects can be reached. If the agency succeeds in creating full-time employment from additional low-wage jobs and fills these jobs with unemployed workers, the program practically requires no subsidies. It can thus be considered a useful tool to legalize employment that is still taking place largely in the shadow economy.

Subsidy Costs and Potential Fiscal Relief Through New Employment

	Subsidy	
	10%	20%
Model (I)		
Newly created positions	351,703	745,540
Subsidies to private households, billion € p.a.	1.4	3.1
Subsidy per new job, € p.a.	3,989	4,172
Model (II)		
Full-time positions	87,956	186,385
Subsidies incl. employer contributions of the agency, billion € p.a.	1.7	3.7
Fiscal relief effects of employment, billion € p.a.		
- Unemployment benefits	0.7	1.5
- Taxes	0.2	0.4
- Social security contributions	0.5	1.1

Source: IZA Research Report No. 5



Taxes and Unemployment

The lack of jobs in many European countries has been alleviated only moderately in recent years. Against this background, numerous ideas of how to reduce unemployment have been developed. Among the proposals which have been put forward are subsidies for low-paid jobs or a reform of the tax system. A new study by IZA Research Fellow *Laszlo Goerke* (University of Konstanz and University of Regensburg) looks at the theoretical foundations for such policy proposals. In particular, it investigates the labor market effects of variations in tax rates and of tax reforms (*Laszlo Goerke, Taxes and Unemployment: Collective Bargaining and Efficiency Wage Models, Boston/Dordrecht/London 2002*).

The analysis is based on the hypothesis that excessive labor costs are the cause of unemployment. In such a situation, unemployment can basically be lowered by reducing taxes or social security contributions. The investigation employs two principal mechanisms of wage determination. First, it is assumed that wages are the outcome of a collective bargaining process. Hence, employees bear the "responsibility" for the lack of jobs. Second, it is hypothesized that firms drive up wages to increase the productivity of their employees. In such an efficiency wage setting, firms are "liable" for unemployment.

The employment effects of income taxes, taxes on labor costs, respectively social security contributions, and a sales tax are investigated on the basis of the two approaches of wage determination. It can be shown that both employees and firms have incentives to raise wages in response to lower tax rates. This is due to the fact that the negative

impact of higher wages in terms of a decline in employment or a rise in costs is mitigated by lower taxes.

Accordingly, the study also looks in depth at the impact of reforms which alter the structure of the tax system but retain the level of the tax burden. Three types of reforms are discussed.

First, and following the discussion in recent years, the impact of changes in tax progression is investigated. For a number of different settings, the analysis confirms the – perhaps surprising – result that higher tax progression raises employment. The reason for this outcome is the following. A rise in tax progression implies that a given wage increase raises the net income of employees by less than before the tax reform. However, the costs of higher wages remain unaffected. Therefore, the employees' or firms' gain from a higher wage declines relative to the situation before the tax reform, and greater tax progression induces a fall in wages.

Second, a shift in the tax burden from labor to consumption is investigated. Such a shift broadens the tax base since a sales tax also applies to consumption financed by non-labor income. Thus, the tax burden on labor can be lowered disproportionately. Moreover, a sales tax affects non-labor income. Taken together, the broadening of the tax base and the reduction in the real income from not working induce a fall in labor costs and increase the incentives to work at the going wage.

Third, a shift in the tax burden from employers to employees is considered. Traditionally, it is

argued that the legal incidence of a tax is without impact on its economic consequences. However, this is not necessarily true in imperfectly competitive labor markets. The present study derives the requirements for a shift in the tax burden to alter employment. Such employment effects will arise in particular if tax progression is altered, or if the tax reform also takes the income of the unemployed into account.

Overall, the study demonstrates that lower taxes or social security contributions can cause substantial budget deficits, but that an adjustment in wage behavior by firms and employees may prevent the positive employment consequences commonly attributed to such policy measures. Hence, a simple reduction of taxes, does not solve the unemployment problem. Instead, the conditions for employment-enhancing tax reforms have to be met. The most important prerequisite is that the incentives to raise wages for firms or employees are reduced. This will occur, for example, if the difference between the net real wage and wage replacements for the jobless, such as unemployment benefits or social assistance, is increased.

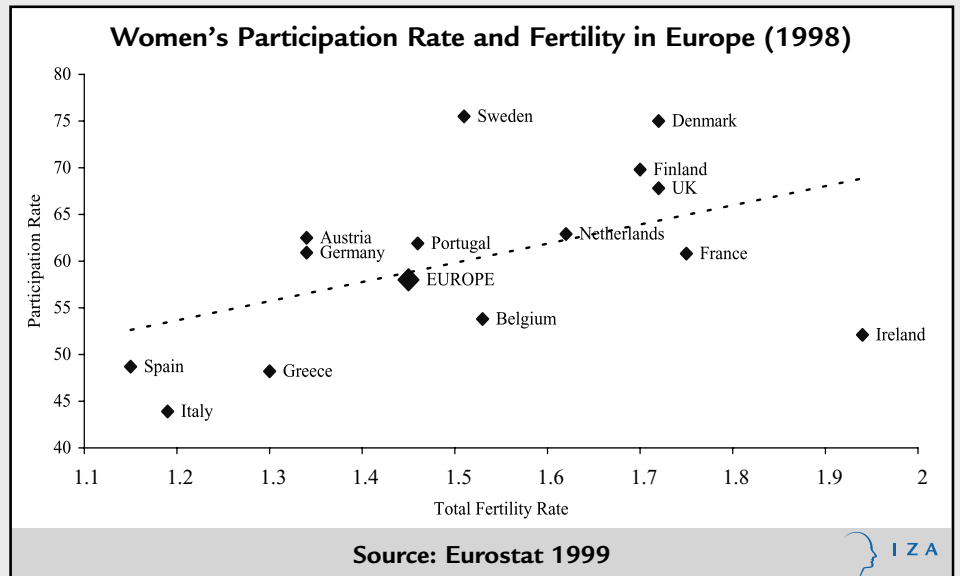
However, even if such requirements are met, lower tax rates or tax reforms alone will not cure the employment crisis, but they need to be integrated into a more comprehensive reform not only of labor market institutions. The investigation by IZA Research Fellow *Laszlo Goerke* illuminates the contribution that tax policy can make.

The Effect of Child Care and Part Time Opportunities on Participation and Fertility Decisions

In almost all industrialized countries a rise in female participation and a decline in fertility rates have been observed in the last few decades. In Italy, however, fertility has declined dramatically while increases in labor market participation rates have been modest. The figure shows that in Italy (as in Spain and Greece) fertility and participation rates are substantially lower than in the non-Mediterranean EU countries.

A recent IZA Discussion Paper proposes explanations for this apparent anomaly, which involve the characteristics of the Italian institutional environment, most importantly the particular rigidities and imperfections that are pervasive in the labor market and peculiar features of the publicly-funded child care system (Daniela Del Boca: *The Effect of Child Care and Part Time Opportunities on Participation and Fertility Decisions in Italy*, IZA Discussion Paper No. 427).

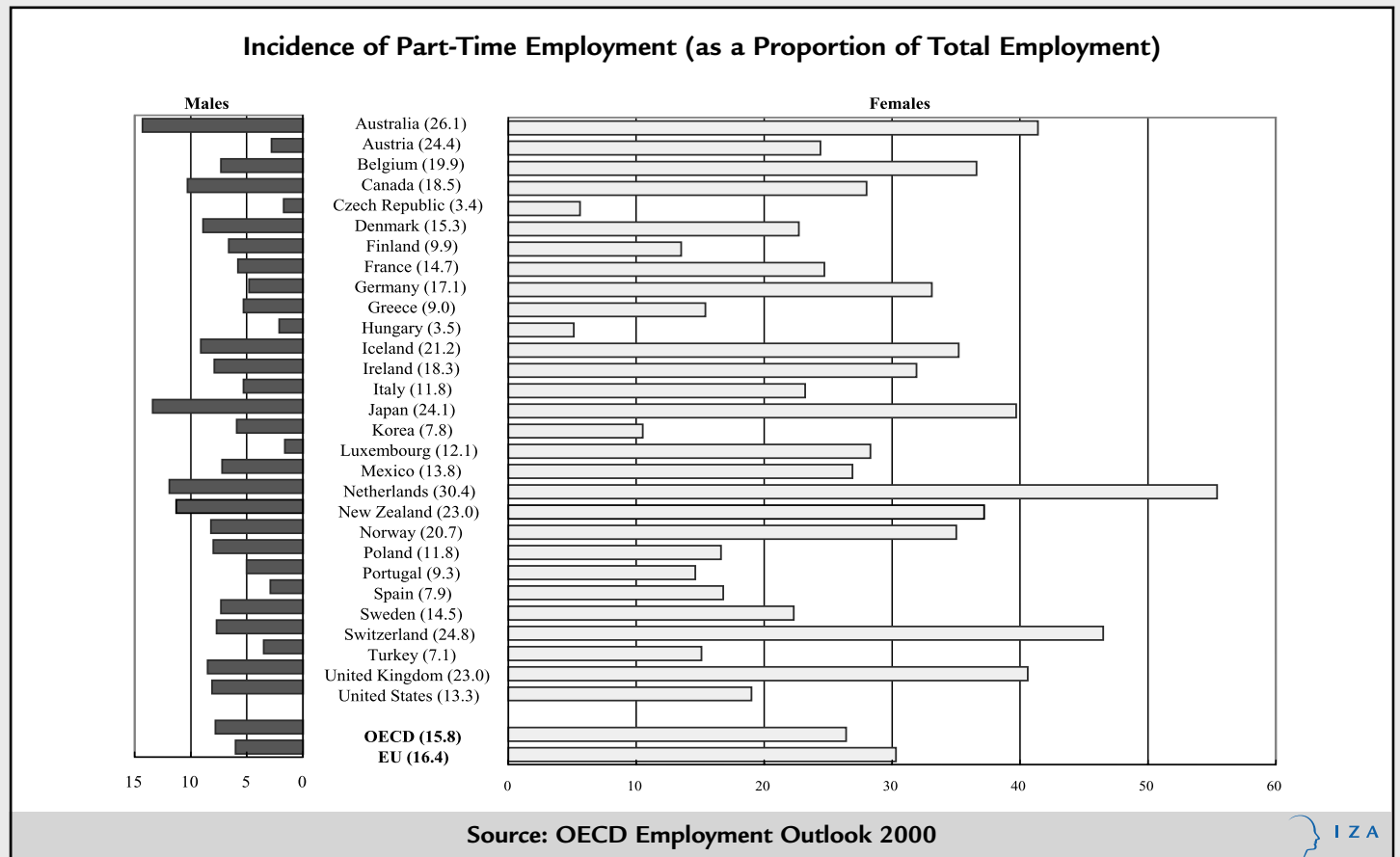
With regard to the labor market, the work rules and wage policies implemented during the 1970s and 1980s have served to increase job security for full-time labor market participants, but this benefit for some has come at the cost of lower probabilities to find work for new entrants and/or individuals looking for part-time employment. Part-time employ-



ment is very rare in Italy. This is an important factor in accounting for the low employment rates of married women, particularly those with children.

As a consequence, married women are forced to choose between no work or full-time work,

neither of which is necessarily their preferred option. Married women who choose to work are mostly full-time employed, which is not conducive for having large numbers of children. Moreover, even married women who do not work tend to limit their family size, which is at least partly due to the characteristics of



the labor market. Since entry level positions are so hard to find, many children live at home until they find their first “stable” employment.

Thus the labor market indirectly imposes large fertility costs on families even when the mother does not work. Hence, the structure of the Italian labor market both directly and indirectly discourages fertility.

In addition to the labor market, the public child care system does not provide services which are of much assistance to married women in terms of reducing the direct costs of labor market participation. In particular, while the quality of publicly-provided child care services is very high in many regions in Italy, there is only a limited number of slots available, and the hours of child care are typically incompatible with full-time job hours.

In light of these considerations, the study by IZA Research Fellow *Daniela Del Boca* (University of Torino) considers other factors in the determination of labor participation and fertility besides traditional individual-specific determinants of prices and income. The analysis focuses on the effect of several aspects of institutional characteristics using panel data from the “Survey on Household Income and Wealth of the Bank of Italy (1991-1995)”.

Institutional Rigidities

Despite recent institutional changes, the Italian labor market still remains highly regulated. Labor market regulations have been largely responsible for the high unemployment rates of women and young individuals. The unemployment rate of women is twice as high as the male rate (16.8% versus 9.5%, while the long-term unemployment rates are 11.5% and 6.5 %, respectively). Due to this high unemployment rate, women may find it difficult to take breaks in their working life during childbearing years and then reenter the labor market.

An important aspect of the rigidity of the labor market is the limited menu of available employment arrangements. Progression towards a more flexible working hours system has started later in Italy than in other countries and has been much slower. In Italy the incidence of part-time employment for women as a proportion of employment is well below the EU average (see figure 4). Compared to other EU countries like the Netherlands, which ranks first with more than 55% of all employed women working part-time, Italy's part-time employment rate of women seems dramatically low at only 23%. Moreover, the service sector, where part-time work is traditionally more widespread, has not developed as quickly in Italy as in other countries.

The Italian child-care sector is another source of rigidity. Child-care services are typically inexpensive, relative to private-sector alternatives, though their capacity in terms of number of children and hours per child is extremely limited. The system is highly subsidized but characterized by extreme rigidity in the number of weekly hours available. This makes the service compatible with part-time work but not with full-time activities. Having school-age children does not necessarily increase the attractiveness of full-time employment since school days often end in the mid-afternoon, thus making child care necessary for the late afternoon and early evening. For children under six the supply is particularly limited in comparison to other countries. These shortcomings in the child-care sector also result in a negative effect on mothers' labor market participation (see figure 5). The

ipitation and fertility decisions are both affected by similar forces. The decisions to work and to have a child are positively influenced by the available supply of public child-care as well as the availability of part-time jobs. The empirical results also indicate that the availability of family support, both in the form of transfers by and presence of parents, increases the probability of market work and having children. Furthermore, the results point out that increasing the flexibility of employment relationships would induce more women to enter the labor market.

Conclusions

The findings show that a more flexible labor market and a better child-care infrastructure would increase female participation rates. This result does not only apply to Italy but to other European countries as well. Most Euro-

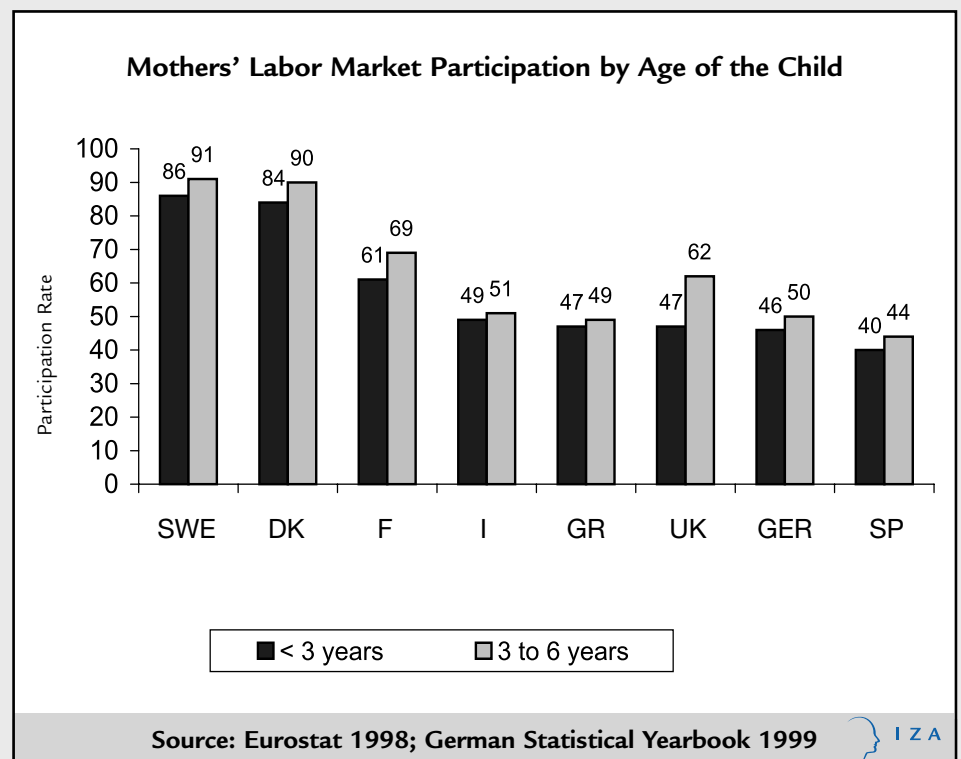


figure shows that mothers' participation is particularly high in countries with an extensive child-care sector.

A simple model of labor supply and fertility in which rationing and market imperfections is used to capture the impact of “environmental” variables on household behavior. In estimating the model, the study includes several variables reflecting levels of potential and actual family support as well as institutional characteristics of the regional child-care system and local labor market in order to explicitly take into account relevant constraints that Italian households face when making their labor market and fertility decisions.

Even if some elasticities are not large, the results seem to indicate that labor force partic-

pean economies still do not offer sufficient possibilities for women to participate in the labor market. This is a deficit that must be eliminated in order to counteract the impending shortage of skilled workers on European labor markets.

SHORT REPORTS

+++ First IZA/SOLE TransAtlantic Meeting of Labor Economists in June 2002 +++

The First IZA/SOLE TransAtlantic Meeting of Labor Economists is a joint initiative of the Director and the Research Director of IZA and the 2001 and 2002 Presidents of the Society of Labor Economists (SOLE). The TransAtlantic Meeting will provide an annual forum for labor economists worldwide, where different aspects of problems currently faced by modern labor markets will be discussed. The aim is to enhance our knowledge of basic labor market parameters and to improve our ability to predict the effects of changes in labor market policies. The meeting will be held at the conference center of the Deutsche Post World Net in Buch on Lake Ammersee, Germany on June 6-9, 2002. In October 2001 IZA Research Fellows and SOLE members were asked to submit abstracts of papers for possible presentation. Out of 110 submissions worldwide 22 have been selected for presentation. IZA's web page provides further information on this new IZA initiative.

+++ IZA Pre-Conference of the International Research Consortium in the Economics of Time Use +++

Data on time use have been underutilized by researchers in general and economists in particular. The central purpose of this IZA conference on May 19-20 was to demonstrate to policymakers and the research community that these data can be exploited to generate intellectually interesting and socially fruitful analyses if one uses the proper economic analysis and econometric tools. The Pre-Conference included preliminary versions of 10 original research studies by authors using data from 9 different countries to analyze issues such as: the determinants of routine behavior, time use by unemployed workers, time use in informal education, the effect of changing retail opening hours legislation, the coordination of economic activities, the effect of mothers' market work on their children's development, gender wage gaps, and the relation of time use and household savings. Several studies aimed at improving methods of collecting and analyzing time use data. A detailed program of this conference initiated by IZA Program Director *Daniel S. Hamermesh* (University of Texas at Austin) is available at www.iza.org.

+++ IZA Workshop on "The Future of Family and Work: Evaluating Family Friendly Policies" +++

Family friendly policies have recently attracted a lot of interest among politicians in order to improve the conditions for families with children. For example, parental leave policies governed by law have reached great importance, mainly in continental European countries. It is striking that differences in the policy design of family friendly policies across countries coincide with differences in labor market outcomes. In Scandinavian countries, for example, parental leave is granted for 6 to

15 months, and high replacement rates are paid by the state. At the same time, female labor force participation rates are high. In Germany by contrast, law guarantees parental leave for up to three years, and the replacement rate is very low. Furthermore, labor force participation rates of young women with children are relatively low. Research in European countries so far has mainly focused on the female labor force participation rate and reduced form model frameworks. An IZA-CIM workshop on "The Future of Family and Work" took place at IZA on May 10-11, 2002 and collected research results going beyond this analysis. Organized by *Astrid Kunze* (IZA), *Mette Ejrnaes* (University of Copenhagen; CIM), *Nina Smith* (Aarhus School of Business; CIM; IZA) and *Mette Verner* (CIM) the workshop included a special policy session. All papers presented are available at www.iza.org.

+++ Second IZA-WDI Conference on Labor Markets in Emerging Economies +++

The second IZA-WDI Conference on Labor Markets in Emerging Economies, organized by IZA Program Director *Hartmut Lehmann* (Heriot-Watt University, Edinburgh) and *Katherine Terrell* (University of Michigan; WDI), took place in Costa Rica from April 1-6, 2002. The conference consisted of two self-contained workshops. The first workshop compared the interaction of restructuring policies and the experience of workers in the labor market in Latin America and Eastern Europe during the 1990s. Even though the initial conditions were very different in the two regions, some similar trends in the development of labor market outcomes can be observed. A significant increase in labor market flexibility and the opening-up of economies to world trade have often had negative consequences for the labor market experience of the average worker in the short and medium run. At the same time, highly skilled workers have thrived in the new environment. Older and unskilled workers have been hit particularly hard by restructuring. There are, however, striking differences that can be observed across the two regions. Informal employment provides a larger buffer of adjustment in Latin America than in Eastern Europe, and the labor market experience of Latin American and Eastern European women could hardly have been more different.

In the second workshop, new research on job gross flows in the transition countries of Eastern Europe was presented. The productivity-enhancing role of job destruction (Schumpeterian "creative destruction"), the effect of trade regimes on job creation, the impact of human capital on job flows as well as the role of wage determination in restructuring were some of the topics discussed in the workshop. The transition from a socialist planned economy to a market economy implies large job flows that can be thought of as the outcome of a natural experiment.

+++ IZA Workshop on "European Integration and Labor Market Performance" +++

This workshop hosted by IZA on April 5-6, 2002, focused on a topic that has been subject of an extensive political and academic debate in recent years. The participants discussed the impact of economic integration on wages, employment, capital flows and the production structure. In particular, the workshop addressed the role of labor market institutions and their effect on economic performance in the process of economic integration. Moreover, challenges for fiscal policy and changes in unions' bargaining structure in the aftermath of economic integration were analyzed. Finally, research was presented on interactions between international mergers and trade liberalization and their implications for unionized labor. The workshop was organized by IZA Program Director *Torben M. Andersen* (University of Aarhus).

+++ Job Stability and Security in European Labor Markets +++

On March 8-9, an IZA workshop organized by *Thomas Bauer* (IZA) and *David Jaeger* (College of William and Mary, Williamsburg; IZA) brought together a selection of economists to discuss and investigate the issue of job stability in Europe. The conference focused on several political economy aspects and especially tried to find an answer as to why the levels of employment protection laws differ so widely between countries, or more general between the Anglo-Saxon countries and mainland Europe in particular. One possible explanation could be that employment protection laws and geographical mobility are two competing insurance mechanisms against job loss. The former makes it less likely to lose a job to begin with, while the latter makes it much easier to find new employment after having experienced job loss. Similar to this trade-off it was also suggested that unemployment benefits and employment protection laws are competing insurance mechanisms.

Furthermore, the workshop focused on the empirical aspects and tried to obtain an insight into job instability over time. Time series evidence for France, for instance showed that job instability could be linked to institutional changes and the introduction of new technologies, where the latter appears to be the driving force. Closing remarks by *David Neumark* (Michigan State University) put the workshop into perspective and discussed the findings from a US angle. The majority of research in the US had focused on the actual measurement and development over time of job stability. A key point was that job instability is voluntary in some cases. According to Neumark, it is crucial to make a distinction between quits and lay-offs – a distinction that European datasets often do not allow for.

NEW IZA STAFF MEMBERS



Wolfram Kempe

Wolfram Kempe received his degree as Diplom-Volkswirt in August 1995 from Humboldt University, Berlin. From 1995 to 1997 he worked as research assistant at the chair of statistics at the universities of Potsdam and Zurich. In 1997, he became staff economist in the labor market department of the Halle Institute for Economic Research (IWH). In January 2002, Wolfram Kempe joined IZA as Research Associate. His current research interests concern labor supply and wage subsidies.

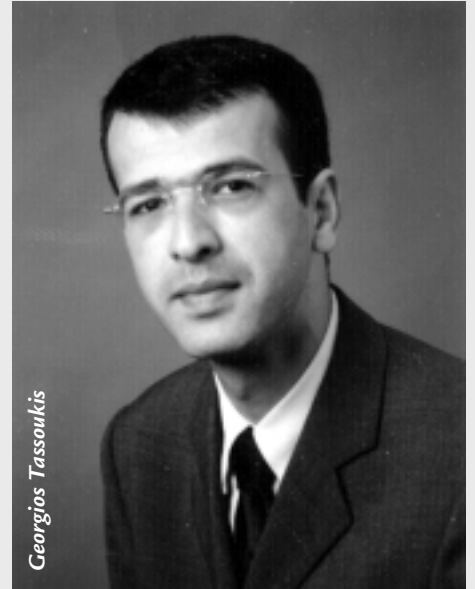
later as team member and project director for IT applications. In 1994 he became director of the Competence Center TQM (Total Quality Management). In 1996 he was promoted to department manager at Thyssen Krupp Stahl AG and was responsible for different systems in distribution. Since October 2000 he directed the system coordination for finances and accounting at Karstadt Quelle AG. Stephan Hennig joined IZA as Head of IT in January 2002.



Martin Schellhorn

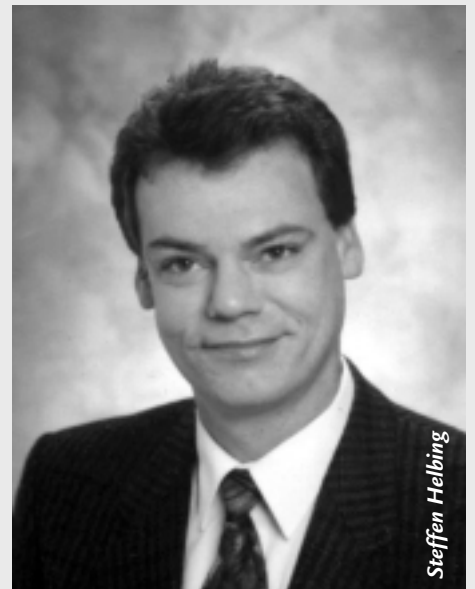
Martin Schellhorn studied economics at University of Konstanz and graduated in 1994. He obtained his doctoral degree from University of Bern in August 2001 with a dissertation on "The Demand for Health Care: Swiss Evidence". In 2001 he visited McMaster University in Hamilton, Canada, with a fellowship of the Swiss National Science foundation. In March 2002 he joined IZA as a Research Associate. His research interests include health economics, the interaction between health, labor and retirement, and the econometric modelling of count data. He has published articles in journals such as *Empirical Economics*, *Journal of Health Economics* and *Health Economics*.

Georgios Tassoukis studied Sociology, Economic History and East European History at the Universities of Cologne and Bonn and finished his studies with an M.A. in Sociology in 1996. Then, he was responsible for the data service and analysis departments of several market research institutes in Nuremberg. Further, he managed the implementation of strategic key figures and segmentations for the data center of the Deutsche Lufthansa AG as an external service provider. In December 2001, Georgios Tassoukis joined IZA. Here, he is responsible for the institute's database service center.



Georgios Tassoukis

Steffen Helbing has started to work as a web developer at IZA. He studied Physics at University of Heidelberg. After receiving his diploma in 1991, he worked at the Institute of Plasma Physics at the Research Center Jülich for several years. In 2000, he took a position as senior developer for an advertising agency. He joined IZA in April 2002.



Steffen Helbing



Stephan Hennig

Stephan Hennig studied economics at the University of Duisburg after completing his banking apprenticeship. After receiving his degree in economics, he enrolled in a traineeship at Thyssen Stahl AG, where he first worked in the field of organizational development and

New IZA Alumni

Melanie Ward (European Central Bank, Frankfurt), Rainer Winkelmann (University of Zurich), Xiadong Gong (Australian National University), and Rob Euwals (CPB Netherlands Bureau for Economic Policy Analysis) completed their work at IZA in order to accept new positions in the field of politics and research in Germany and abroad. We would like to thank them for their outstanding achievements at IZA, looking forward to maintain a close connection with them as IZA Alumni.

NEW IZA DISCUSSION PAPERS

A complete list of IZA Discussion Papers is available on our homepage at www.iza.org.
Most papers are downloadable.

- 442 Mikael Lindahl**
Estimating the Effect of Income on Health and Mortality Using Lottery Prizes as Exogenous of Variation in Income
- 441 Christopher W. Sibley, Patrick P. Walsh**
Earnings Inequality and Transition: A Regional Analysis of Poland
- 440 Guiseppe Bertola, Stefan Hochguertel, Winfried Koeniger**
Dealer Pricing of Consumer Credit
- 439 Giulio Fella, Paola Manzini, Marco Mariotti**
Does Divorce Law Matter?
- 438 Alexandru Voicu**
Employment Dynamics in the Romanian Labor Market: A Markov Chain Monte Carlo Approach
- 437 Michael Fertig**
Evaluating Immigration Policy Potentials and Limitations
- 436 Astrid Kunze**
The Evolution of the Early Career Gender Wage Gap
- 435 Gil Epstein, Melanie Ward**
Perceived Income, Promotion and Incentive Effects
- 434 Adriana Kugler**
From Severance Pay to Self-Insurance: Effects of Severance Payments Savings Accounts in Colombia
- 433 Joshua Angrist, Adriana Kugler**
Protective or Counter-Productive? Labor Market Institutions and the Effect Immigration on EU Natives
- 432 Erdal Tekin**
Employment, Wages, and Alcohol Consumption in Russia: Evidence from Panel Data
- 431 Michael Fertig, Christoph M. Schmidt**
The Perception of Foreigners and Jews in Germany - A Structural Analysis of a Large Opinion Survey
- 430 Johannes Schwarze, Marco Härpfer**
Are People Inequality Averse, and Do They Prefer Redistribution by the State? Evidence From German Longitudinal Data on Life Satisfaction
- 429 Silke Anger, Johannes Schwarze**
Does Future PC Use Determine Our Wages Today? Evidence from German Panel Data
- 428 Daniela Del Boca**
Mothers, Fathers and Children after Divorce: The Role of Institutions
- 427 Daniela Del Boca**
The Effect of Child Care and Part Time Opportunities on Participation and Fertility Decisions in Italy
- 426 Joop Hartog, Wim Vijverberg**
Do Wages Really Compensate for Risk Aversion and Skewness Affection?
- 425 Felix Büchel**
Successful Apprenticeship-to-Work Transitions: On the Long-Term Change in Significance of the German School-Leaving Certificate
- 424 Felix Büchel, Maarten van Ham**
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- 422 John T. Addison, Lutz Bellmann, Claus Schnabel, Joachim Wagner**
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- 421 Paola Manzini**
Divide et Impera: Negotiating with a Stakeholder
- 420 Åsa Rosén, Etienne Wasmer**
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- 419 Paul Frijters, John Haisken-DeNew, Michael A. Shields**
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- 418 Markus Frölich, Patrick A. Puhani**
Immigration and Heterogeneous Labor in Western Germany
- 417 Joachim Wagner**
Taking a Second Chance: Entrepreneurial Restarters in Germany
- 416 Bruno Crépon, Francis Kramarz**
Employed 40 Hours or Not-Employed 39: Lessons from the 1982 Mandatory Reduction of the Workweek
- 415 Marianne Bertrand, Francis Kramarz**
Does Entry Regulation Hinder Job Creation? Evidence from the French Retail Industry
- 414 Anders Frederiksen, Niels Westergård-Nielsen**
Where Did They Go?
- 413 Holger Bonin, Rob Euwals**
Participation Behavior of East German Women after German Unification
- 412 Martin Barbie, Marcus Hagedorn, Ashok Kaul**
Government Debt as Insurance against Macroeconomic Risk
- 411 Steven Stillman**
The Response of Consumption in Russian Households to Economic Shocks
- 410 Hartmut Lehmann, Jonathan Wadsworth**
Wage Arrears and the Distribution of Earnings in Russia
- 409 Patricia Apps, Ray Rees**
Fertility, Female Labor Supply and Public Policy
- 408 H. Naci Mocan, Erdal Tekin**
Nonprofit Sector and Part-Time Work: An Analysis of Employer-Employee Matched Data of Child Care Workers



IZA GUEST RESEARCHERS

From December 2001 until April 2002 a number of renowned economists stayed at IZA to discuss issues of labor market research and policy:

- Jaap Abbring**
(Free University of Amsterdam, Netherlands)
- Syed Ahsan**
(Concordia University, Montreal, Canada)
- Uschi Backes-Gellner**
(University of Cologne, Germany)
- Stefan Bender**
(IAB, Nürnberg, Germany)
- Eli Berman**
(Boston University, USA)
- Dilip Bhattacharyya**
(University of Leicester, UK)
- Lex Borghans**
(University of Maastricht, Netherlands)
- Thorsten Braun**
(University of Aarhus, Denmark)
- Karl Brenke**
(DIW Berlin, Germany)
- Herbert Brücker**
(DIW Berlin, Germany)
- Monika Bütler**
(University of Lausanne, Switzerland)
- Jeff Campbell**
(University of Chicago, USA)
- Paul Chen**
(Australian National University, Canberra)
- Thomas F. Crossley**
(York University, Toronto, Canada)
- Don J. DeVoretz**
(Simon Fraser University, Burnaby, Canada)
- Galina Didukh**
(RIIM, Vancouver, Canada)
- Pieter A. Gautier**
(Tinbergen Institute, Netherlands)
- John Haisken-DeNew**
(DIW Berlin, Germany)
- David Jaeger**
(College of William and Mary, Williamsburg, USA)
- Alain Joustien**
(CREPP, University of Liege, Belgium)
- Hartmut Lehmann**
(Heriot-Watt University, Edinburgh, UK)
- Øivind Anti Nilsen**
(University of Bergen, Norway)
- Demetrios Papademetriou**
(Migration Policy Institute, Washington, USA)
- Mark Regets**
(National Science Foundation, Vancouver, Canada)
- Sarah Senesky**
(University of California, Irvine, USA)
- Margaret Stevens**
(Oxford University, UK)
- Bas ter Weel**
(University of Maastricht, Netherlands)
- Kenneth Troske**
(University of Missouri, Columbia, USA)
- Kjell Vaage**
(University of Bergen, Norway)
- Jan C. van Ours**
(Tilburg University, Netherlands)
- Kang Qing Zhang**
(RIIM, Vancouver, Canada)

O P I N I O N

Demand-Side Incentives: New Opportunities in the Low-Wage Sector



Labor market opportunities in the low-wage sector have declined worldwide. While countries with flexible labor markets are experiencing falling wages, European welfare states are witnessing a substantial and persistent unemployment increase in this market segment. The need for reform is becoming ever more evident. For reforms to be effective, however, they must go beyond breaking up rigid labor market structures. They must also focus on deregulating and vitalizing product and service markets, which create new jobs and income in this area. Only then will adequate wages no longer conflict with job security. Supporting measures to develop markets and to gain time for improved solutions have been debated in Germany for quite some time.

The debate about feasible concepts breaks down into two approaches. The first approach bases on the assumption that the current tax and transfer system creates disincentives to accept jobs in the low-wage sector, thus effectively destroying income opportuni-

ties. Financial incentives for employees in this sector are supposed to encourage employment and create a more performance-oriented tax and transfer scheme. The second approach assumes that global competition, improved production technologies, trade, and collective bargaining have rendered low-skilled work redundant or too expensive. As businesses are downsizing, they offer fewer jobs in the low-wage bracket.

Both approaches do not fundamentally oppose each other. It seems plausible that changes in the wake of globalization forced an adjustment in relative wages, on which labor markets were unable to react due to institutional rigidities imposed by the welfare state and the collective bargaining system. The question is whether to address these problems from the supply or the demand side. Is the job shortage due to the fact that businesses have no demand for labor, or is it because a non-existent labor supply keeps them from offering jobs? There are currently two million unemployed in the German low-wage sector. Given this enormous scope, any remedial policy program will only have a limited impact. It is therefore necessary to analyze the employment effects as well as the costs of a policy that aims at both the supply and the demand side. In Germany, these considerations primarily center around the subsidization of social security contributions in the low-wage sector.

Studies show that such programs bring about radical changes on the labor market. On the supply side, more people are willing to work. But there are also those among the already employed workers who want to switch to the subsidized low-wage sector. In the end, part-time work will be encouraged, but the total number of hours worked will actually decline. This kind of policy is extremely costly because it supports several different groups: newly employed workers, households that are already active in the low-wage sector, and

those who cut their working hours in order to qualify for subsidies. The latter group will be responsible for a further drop in tax revenues and social security contributions. On the demand side, the subsidization leads to a significant increase in the demand for hours worked and for additional employees in the low-wage bracket. This effect is partly offset by a falling demand in the non-subsidized areas. Given the currently rather strong demand for high-paid workers, however, this drop in demand will have only minor consequences. Since the financial burden on the demand side remains reasonable, a demand-side oriented policy seems to be a promising approach.

If the job shortage is the key problem, subsidizing only the employer side could yield a lasting effect. The subsidy would be worth the cost if it succeeds in getting unemployed workers and welfare recipients into work. This desired effect could be reinforced through stricter requirements for these target groups to accept a job. Subsidizing older and low-skilled workers for a limited time could also be worthwhile. If disadvantaged labor market groups were provided with reintegration support at an early stage, long-term unemployment could in many cases be prevented.

K. F. Zimmermann



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