



# DIW DCynopsis

Real, Clear Economics: A Newsletter from DIW DC

www.diwdc.org

September - December 2009

## CONTENTS

Successful Trip to China

German Day on Development

DIW DC Joins Partner Institute to Celebrate the 2009 IZA Prize in Labor Economics, Policy Forum and Award Ceremony

It Pays to Be Happy  
Dr. Richard Easterlin takes away the 2009 IZA Prize for ground breaking happiness analysis

The Economics of Well-being and Happiness

From Germany to Georgetown

Trans-Atlantic Infraday

Pioneers in Econometric Analysis of Internet Data in Labor Market Research

Selected Economic Indicators

Time for Financial Supervision.  
By Whom?

The European Year in combating poverty and social exclusion

Professor Jan Svejnar - A profile

DIW DC in Journals

Brainy Africans in Fortress Europe: For Money or Colonial Vestiges?

Abandoning Sickcare or creating Healthcare?  
An analysis of healthcare reform and impacts on the labor market

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Bienvenue Tien

## Successful Trip to the Emerging Giant...

### China

*Cutting edge research in cooperation with Renmin University of China and other prominent universities and institutes*

Early this Fall (12 – 26 September 2009), Professor Amelie F. Constant, Executive Director of DIW DC was part of a high profile Delegation of Scholars from DIW DC and IZA in an academic explorative trip to China. The trip's goal was to meet with scholars in China, participate in a joint conference and give presentations and talks in several cities. As a network organization, IZA had already many connections in China. This trip was successful in rekindling old professional relationships and forging new ones as well as in promoting the institutes in this emerging giant. On October 1st, 2009 China celebrated its 60th anniversary as the People's Republic of China. The country's large social and economic transformation as well as its scientific and academic progressive stance was transparent.

With Beijing being the first stop, the journey started with a panel discussion on "Global Green Recovery – Will the Next Recovery be Green?" at the German Embassy in Beijing. In an effort to strengthen existing cooperation between IZA, as well as DIW DC and various Chinese institutes and universities, the delegation met with scholars, faculty and administrators at the China Institute of Industrial Relations (CIIR) - where they discussed and exchanged information about the global financial crisis, the health care system and the education system; and at the China Center for Economic Research (CCER) at Beijing University - where they discussed the migration flows in China with regard to the financial crisis and to the government's regulation of migration flows. The delegation was pleased to find many common areas for further collaboration at the academic level.

At Beijing Normal University (BNU), and in an amphitheater well-attended by high-ranking representatives, faculty and students, Professor Dr. Klaus F. Zimmerman, Chairman of DIW DC's Board and IZA Director presented his book "EU Labor Markets after the Post-Enlargement Migration." Professor Amelie Constant presented the DIW Berlin Graduate School. The delegation also met with the labor group at BNU's Business School and discussed future collaboration, especially with respect to migration. Future plans for exchange of students and faculty were also discussed.



A visit to Tsinghua University in Beijing and a meeting with members of the Economics Faculty was informative; both parties expressed the desire to explore future avenues of cooperation. The delegation had another fruitful meeting with two high-ranking representatives of the National Bureau of Statistics of China about the current data infrastructure situation in China and future prospects for labor market research.

Next, the delegation participated in the 1st Annual CIER/IZA Workshop on Research in Labor Economics that took place at Renmin University of China on September 18th – September 20th. The meeting started with welcoming speeches by high-ranking officials from the Chinese Ministry for Human Resources and Social Security, Mr. Faming Yu, and Professor Zimmermann. Fifteen papers were presented during the meeting. In a large conference room, scholars from Europe, China and Australia discussed and debated labor market issues, from the financial crisis to education, to the mental health of immigrants, etc. Constant presented her co-authored paper on “What Do New U.S. Immigrants Know about the Labor Markets in the U.S. and their Home Countries? Perceptions of Earnings in Selected Occupations.”

Shanghai, the financial capital of China, was the next stop of the delegation. At the Shanghai School of Finance and Economics, the most distinguished University in the city, the delegation gave talks on intra-EU migration and the DIW Berlin Graduate Center. Both parties were happy to explore prospective areas of cooperation.

In Xiamen and at the Wang Yanan Institute for Studies in Economics (WISE) of Xiamen University, Professors Zimmermann and Constant gave talks in a room overflowing with attendees. Zimmermann presented and answered numerous questions posed by the audience on his latest book on EU enlargement. Constant in her capacity as the vice-dean of the DIW Berlin Graduate Center presented the program, gave brochures and urged students to consider applying to the Graduate Center. The delegation had talks with members of the Economics Faculty in Xiamen to strengthen the current cooperation.



Hong-Kong and the Chinese University of Hong-Kong (CUHK) was the last stop of the delegation's trip. The delegation had a presentation on developments in the German labor markets and the financial crisis as well as the on the Graduate Center. The presence of Nobel laureate Robert A. Mundell, a CUHK professor at large was the successful culmination of the trip. The Hong-Kong stop, – which was also the last visited city in China – ended with a



talk on both the causes and the consequences of the financial crisis. Nobel laureate Mundell expressed his fears concerning the creation of a new financial world order. ■

## German Day on Development *Economic experts meet at the World Bank for stronger ties with German and Washington, DC institutes*

October was a month filled of high profile events and conferences for DIW DC including the German Day on Development held at the World Bank on October 21st. For the second year, the all day event



was organized in cooperation with DIW DC, IZA, DIW Berlin, and the World Bank and took place at the World Bank building. Attended by various World Bank officials, this event provided an excellent opportunity for experts to discuss research results of leading German research institutes on development and migration issues and to enhance collaboration and communication between researchers in Washington, DC and Germany. A welcome and introduction was headed by Dr. Michael Hofmann, Executive Director for Germany at the World Bank,

Professor Dr. Klaus F. Zimmermann, and Dr. Amelie F. Constant, Executive Director of DIW DC. Economics specialists presented extensive research analysis on a large range of topics from the employment crisis and automatic



stabilization to conflict and violent development to ethnicity and migration. Besides their German counterparts, the meeting was well attended by World Bank economists

and others from nearby think tanks. The all day event was comprised of three sessions with lectures rich in topic diversity. Session A included lectures in regards to the employment crisis, automatic stabilization and labor market initiatives. Session B was composed of lectures that focused on conflicts in various parts of the world including behavioral foundations of violent conflict, Ukraine's Orange Revolution and post-genocide Rwanda. Session C paper presentations on ethnicity, migration, and discrimination included Dr. Amelie F. Constant's and Bienvenue Tien's research paper on "Brainy Africans in Fortress Europe: For Money or Colonialism?" The formal scientific meeting ended with an enlightening and witty dinner speech by Professor Tilman Brück of DIW Berlin and Humboldt University on "Development Economics Research in Germany - Past and Present." ■



DIW DC



## German Day on Development Deutsche Tagung für Entwicklung

(IZA, DIW Berlin, DIW DC, World Bank)

Wednesday, October 21, 2009

The World Bank, Room 11-200, 1-Building, 1850 I Street, NW, Washington, D.C.

Hosted by Michael Hofmann, Executive Director for Germany at the **World Bank**, and organized by the **Institute for the Study of Labor (IZA)**, the **German Institute for Economic Research (DIW Berlin)**, and **DIW DC**, this event provides an opportunity to discuss research results of leading German research institutes on development issues and to enhance collaboration and communication between researchers in Washington and in Germany.

### Program

8:30 am - 9:00 am

Registration, Breakfast, Coffee and Pastries

9:00 am - 9:20 am

Welcome

**Michael Hofmann** (Executive Director for Germany, World Bank)

**Klaus F. Zimmermann** (University of Bonn, President DIW Berlin, Director IZA, Chairman of the Board DIW DC)

**Amelie F. Constant** (Executive Director DIW DC, George Washington University and IZA)

### Session A

*The Employment Crisis: Labor Market and Social Protection Instruments in Times of Crises*

Chair: **Markus Frölich** (IZA, University of Mannheim)

9:20 am - 10:00 am

*Labor Market Initiatives to Tackle the Crisis: What Do We Know So Far?*

**Werner Eichhorst** (IZA)

10:00 am - 10:40 am

*Is Informal Sector Work an Alternative to Workfare Benefits? The Case of Pre-Program Expansion*

**Melanie Khamis** (IZA)

10:40 am - 10:50 am

Coffee Break

10:50 am - 11:30 am

*Economic Crisis and Automatic Stabilization: Lessons from Europe and the US*

**Andreas Peichl** (IZA), **Mathias Dolls** (University of Cologne and IZA) and **Clemens Fuest** (Oxford University and IZA)

11:30 am - 12:10 pm

*Unemployment Insurance in Europe: Unemployment Duration and Subsequent Employment Stability*

**Konstantinos Tatsiramos** (IZA)

12:10 pm - 1:00 pm

Lunch

### Program

#### Session B

*Conflict and Crisis: Violent Development*

Chair: **Tilman Brück** (DIW Berlin and IZA)

1:00 pm - 1:10 pm

*Violent Development: Recent Advances in Understanding the Behavioural-Foundations of Violent Conflict*

**Tilman Brück** (DIW Berlin and IZA), **Patricia Justino** (IDS, Sussex) and **Philip Verwimp** (University of Antwerp)

1:10 pm - 1:50 pm

*On the Determinants of Participation in a Revolution: The Case of Ukraine's "Orange Revolution"*

**Tilman Brück** (DIW Berlin and IZA) and **Carlos Bozzoli** (DIW Berlin)

1:50 pm - 2:30 pm

*Time Allocation, Gender and Norms: Evidence from Post-Genocide Rwanda*

**Kati Schindler** (DIW Berlin)

2:30 pm - 3:10 pm

*Measuring Ethno-Linguistic Affinity between Nations*

**Olaf de Groot** (DIW Berlin)

3:10 pm - 3:30 pm

Coffee Break

#### Session C

*Ethnicity, Migration, Discrimination*

Chair: **Amelie F. Constant** (DIW DC, George Washington University and IZA)

3:30 pm - 4:10 pm

*Brainy Africans in Fortress Europe: For Money or Colonialism?*

**Amelie F. Constant** (DIW DC, George Washington University and IZA) and **Bienvenue N. Tien** (DIW DC)

4:10 pm - 4:50 pm

*Displaced People and Roma in Former Yugoslavia*

**Martin Kahanec** (IZA)

4:50 pm - 5:30 pm

*Caste Based Discrimination: Evidence and Policy*

**Zahra Siddique** (IZA)

7:00 pm

**DIW DC Reception**

www.diwdc.org, 1800 K Street, NW, Office Suite 716

Contact person: **Amelie F. Constant** (constant@diwdc.org)



# DIW DC Joins Partner Institute to Celebrate the 2009 IZA Prize in Labor Economics, Policy Forum and Frontiers in Well-being Conference

## *Prominent government officials kick off Policy Forum*

The policy forum on Thursday October 22, 2009 was the kick-off of the 3-day celebration events in honor of Richard Easterlin, the father of the economics of happiness. This year's policy forum on "The Global Economic Crisis and Labor Markets" took place at the Mayflower hotel in Washington, DC. It drew prominent government officials from Washington, DC, economic experts from all over the world and journalists and members of the scientific community. After a warm welcome by DIW DC Executive Director Dr. Amelie F. Constant and chairman of the board and IZA Director Prof. Dr. Klaus F. Zimmermann, David G. Blanchflower gave the keynote address on "What to Do about Rising Unemployment in the OECD?" Two panel discussions followed.

Dr. Amelie F. Constant moderated Panel I with prominent speakers Tilman Brück of DIW Berlin and Humboldt University, Carol Graham of Brookings, Theresa Osborne of the Millennium Corporation and Sonia Plaza of the World Bank. The theme of this panel was "The Economic Crisis: Labor Market Impacts on Developing Countries." Professor Jan Svejnar, the guru of development economics, gave the introduction and set the stage for Panel I. He discussed the current economic crisis and the impact it has had on the labor market of developing countries. The panel assessed the damages, acknowledged the remaining issues and also discussed successful cases, as in South America.



Panel II followed with the theme "The Job Crisis: Do Governments Matter?" Moderated by Professor Dr. Klaus F. Zimmermann, the panel's distinguished speakers were Alan B. Krueger, Assistant Secretary for economic policy and



Chief economist of the U.S. Treasury Department, David G. Blanchflower of Dartmouth College, Lord Richard Layard of The London School of Economics and Political Science and Andrew J. Oswald of the University of Warwick. Professor Rebecca M. Blank, Under Secretary of Commerce for Economic Affairs at the U.S. Department of Commerce gave the introductory speech about the government's role in the job crisis and credit crunch. Alan Krueger enlightened the audience by giving a detailed account

of the Obama Administration's current and future strategies. Both panels ignited lively discussion from the audience of about 100 attendees, previous IZA winners Richard Layard and Alan Krueger and the current prize laureate.

Following the policy forum, Dr. Richard Easterlin participated in a book signing of his newest book "Happiness, Growth and the Life Cycle," where participants and attendees of the conferences had a chance to meet and converse with him and learn about his work and his many contributions to the economics discipline. All other books of the previous IZA Prize winners were also available. The IZA Prize Awards started in 2002 with the late Jacob Mincer of Columbia University. On his behalf, Pedro Teixeira wrote the book "Jacob Mincer: A Founding Father of Modern Labor Economics," that received the "Best Monograph Competition" by the European Society for the History of Economic Thought. Other IZA winners chronologically are: Orley Ashenfelter, Princeton University (2003), Edward Lazear, Stanford University (2004), Dale Mortensen (Northwestern University) and Christopher Pissarides (London School of Economics) (2005), David Card (University of California, Berkeley) and Alan B. Krueger (Princeton University) (2006), Richard Freeman (Harvard University and London School of Economics) (2007) and Richard Layard (London School of Economics) and Stephen Nickell (Nuffield College) (2008). ■



## It Pays to Be Happy

*Dr. Richard Easterlin takes away the 2009 IZA Prize for ground breaking happiness analysis*

Amongst many distinguished guests, international labor market and other experts in economics, pundits and politicians during an extravagant dinner banquet celebration at the Mayflower hotel, Dr. Richard Easterlin accepted the IZA Prize Award. Easterlin is a Professor of Economics at the University of Southern California, a member of the National Academy of Sciences and the American Academy of Arts and Sciences, a former Guggenheim Fellow and past president of the Population

Association of America and the Economic History Association. His outstanding research and analysis has contributed to the advancement of understanding behavior in many fields of economic study including areas of labor supply decisions and the economics of the family. He is mostly known for his ground breaking work on subjective well-being and on the relationship between demographic developments and economic outcomes. For 50 years now, Easterlin is continuing to enlighten and nurture the social sciences and inspire new researchers.

Following the eloquent laudation by Andrew Oswald, a moved Dr. Easterlin was awarded with this year's IZA prize along with an award of 50,000 Euros. The IZA prize winner's accomplishments were further celebrated at the award ceremony where musical performances opened an extravagant dinner event.

It is noteworthy that it took almost 40 years from Easterlin's pioneering work on happiness for governments to react. The famous "Easterlin Paradox," stating that economic development will not raise happiness, is now rediscovered and revisited.





In February 2008, French President Nicholas Sarkozy vigorously pushed to substantially revise the quintessence of the economic progress measurement, which has so far been estimated on the basis of GDP growth. He convened the Nobel laureates

composed Commission on the Measurement of Economic Performance and Social Progress, whose conclusions show quite clearly that a nation lives on more than just impressive-looking GDP statistics and that citizens' happiness should also signal the economic health of a country. ■

## The Economics of Well-being and Happiness

*6th IZA Prize Conference on Frontiers in Labor Economics*

The 6th IZA Prize Conference on Frontiers in Labor Economics, held in Washington DC, was about "The Economics of Well-Being and Happiness" to honor Professor Easterlin. Following the Policy Forum and Official Award Ceremony of October 22, 2009, the program was filled with presentations about the Economics of Well-Being and Happiness. Professor Richard Easterlin, the IZA Prize Winner of 2009 in Labor Economics, opened the conference with his presentation on "Growth and Happiness in Latin America: Trends and Fluctuations." Andrew J. Oswald of the University of Warwick followed with "Well-Being across America: Evidence from a Random Sample of One Million U.S. Citizens."

During the first day of the conference, seven papers were presented overall. Erzo Luttmer of Harvard University with "Health and Happiness," Mary Daly of the Federal Reserve Bank of San Francisco with "Happiness, Unhappiness, and Suicide: What Do the Data Reveal?" Alois Stutzer of the University of Basel with "Economic Shocks, Labor

Market Institutions and Workers' Welfare," Carol Graham of Brookings with "Why Societies Stay Stuck in Bad Equilibrium: Insights from Happiness Studies amidst Prosperity and Adversity" and Rafael Di Tella of Harvard Business School with "Happiness for Central Banks." A popular poster session with another nine papers took place in the afternoon.

"Biomarkers, Well-Being, and Income" was the first paper of the second day by Professor David G. Blanchflower. Professor Andrew E. Clark followed with his paper on "Preferences over Pay Profiles: Evidence from a High-Quit Industry." Seven important papers were presented and discussed during the last day of the conference, including the "Inequality and Subjective Well-Being" paper by Justin Wolfers of Wharton School and the "Does Inequality Harm the Middle Class? Evidence from Switzerland": paper by Rainer Winkelmann of the University of Zurich.

Professor Amelie F. Constant from DIW DC chaired the last session of the conference. In that session, Professor Robert Frank of Cornell University talked about "Why Absolute Income and Relative Income Both Matter."

Claudia Senik of the University Paris-Sorbonne convinced the audience that "You can't be happier than your Wife.



Inequality of Happiness in Couples and Divorce" and Ada Ferrer-i-Carbonell of IAE Barcelona discussed "Inequality Aversion and Risk Attitudes." During the last coffee break,

participants took advantage of their last chance to thank Professor Easterlin for his tremendous contributions to the scientific community and discuss the entire conference and brainstorm for the future of happiness. ■



## From Germany to Georgetown: *Challenging labor market policy and evaluation*

A collaborative coordination between DIW DC, IZA and Georgetown University, produced the 5th IZA Conference on Labor Market Policy Evaluation, held



on October 2-3, 2009 at Georgetown University in Washington, DC. The conference started with a welcome reception at DIW DC the previous evening.

During the intellectually challenging two days, 15 papers covering labor market policy evaluation were presented and discussed.

Professor Francis Vella – the chairman of the economics department – opened the first day of the conference where



nine papers were presented. Among the high profile presenters, Katherine Terrell of the University of Michigan talked about Minimum Wages, Enforcement and Informalization of the Labor Market.

The second day started with a keynote by Albert Abadie (Harvard University) on “A General Theory of Matching Estimation.” ■

## Trans-Atlantic INFRADAY *Conference on applied infrastructure modeling and policy analysis*

DIW DC represented by its Executive Director, Dr. Amelie F. Constant, was honored to give a talk at the welcoming reception of the Transatlantic

INFRADAY Annual Conference, which was held at the Resources for the Future in Washington, D.C. on November 13, 2009. In her address, Dr. Constant emphasized the interdependence between the goals of such a conference and the work at DIW DC and invited the



over 30 assembled researchers (economists and engineers) to continue the cooperation with DIW DC.



Co-organized by DIW Berlin and the University of Maryland, the INFRADAY Conference is in its third year. The popular conference’s theme was “Network Modeling and Infrastructure Policy for a Sustainable Future.” This theme covers a range of topics such as renewable energy, natural gas, transportation and infrastructure investments and pollution. The international

conference was well-attended by researchers from the U.S. and Europe. Three keynote speeches were given by Andy Kydes from the United States Department of Energy,

Professor Dr. Georg Meran of DIW Berlin and Karen Palmer from Resources for the Future. ■

# Pioneering Econometric Analysis of Internet Data for Labor Market Research

*IZA's Google Indicator uses search engine statistics to predict short-term trends in unemployment*

During turbulent economic times such as the current economic and financial crisis, the reliability of economic forecasts is rather questionable. Indeed, over the last year, the world witnessed a plethora with ephemeral and controversial economic prognoses. This is one of the reasons why there has been an increased reliance, particularly in the current situation, on “soft” indicators, such as business and consumer confidence surveys, or trade indices. There is undoubtedly a strong demand for early warning systems that can prepare policymakers for changing situations. However, this requires sophisticated techniques and measures that are either not available or require a lot of time to be produced. Alternatively, there are appropriate indicators, which are available on a timely and continuous basis over the internet through Google search statistics.

With the Google Indicator, IZA has broken new econometric ground by testing, proving and refining the usefulness of these internet data in a natural laboratory – the German economy. This approach accounts for the fact that more and more people use the internet to search for information on labor market issues and, of course, for jobs.

Although soft indicators such as confidence surveys or trade indices say little about the distant future, they do paint a sharp picture of the current state of the economy, at least in normal times. In the current crisis, however, these soft indicators have not always been available in time. After all, it is economic policy itself that makes forecasting more difficult, with policies aimed at stabilizing the economy and by changing the definitions of important variables. Another disadvantage of soft indicators is that they cannot easily be linked quantitatively to relevant variables. This is particularly true when dealing with new phenomena that cannot yet be seen against a longer time horizon. Since

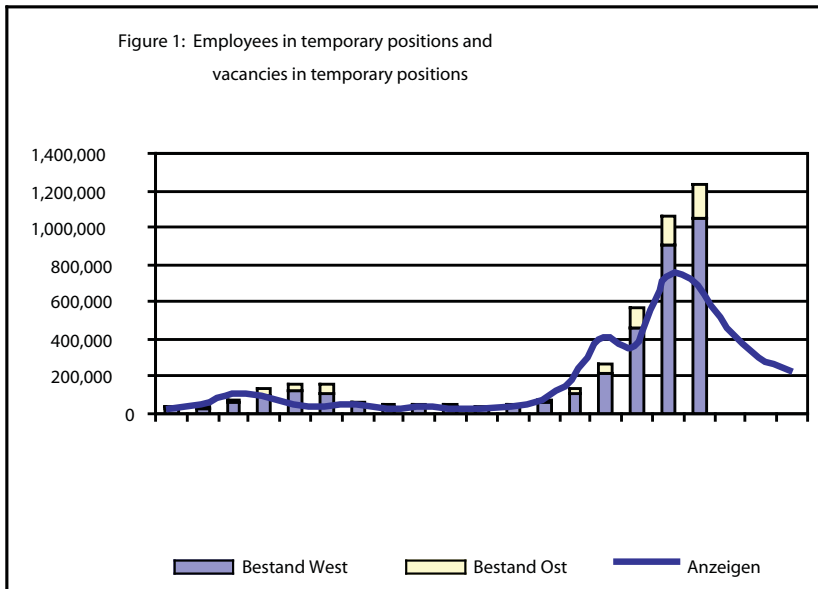
Google data, such as those employed by IZA, are relatively new to scientific analysis, more experience with their use is needed. Nonetheless, IZA's Google Indicator allows an immediate comparison with the target variable as it can be linked directly with the unemployment rate. This is an option not provided by other indicators, which force the observer to estimate trends by interpreting curves.

## Googlemetrics and the Labor Market

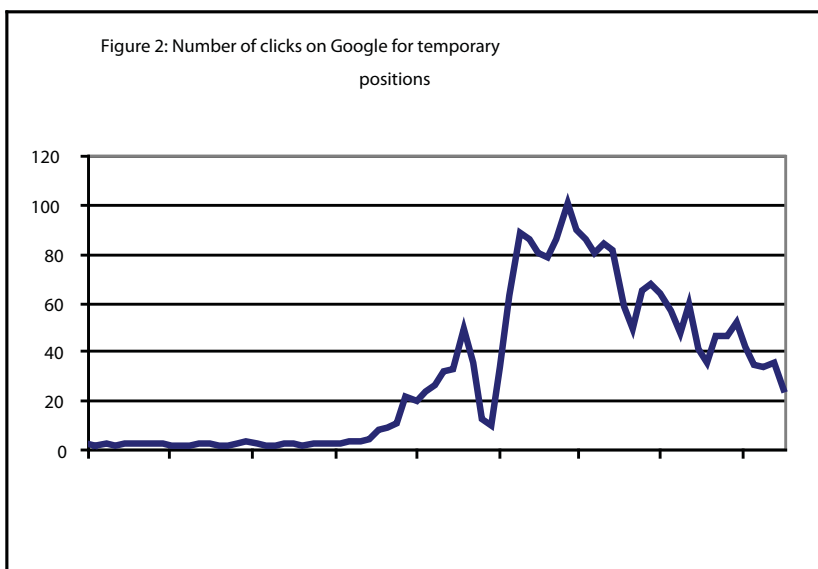
The internet provides information on unemployment – at least indirectly. With an internet penetration rate of close to 70%, Germany exceeds the European average. Data on German internet users therefore offer an interesting, so far mostly unused basis for scientific research. Since the data are immediately available, extensive, and responsive to changes in the economic environment, they have a great potential for the analysis of labor market issues. An analysis of the IZA Evaluation Dataset has revealed that over 86% of unemployed individuals use the internet for job search purposes. This is more than for any alternative search method, such as friends and family (84%), newspaper advertisements (83%) and employment agency (70%), which also allows its customers to use the internet. Almost every jobseeker therefore leaves traces online.

Googlemetrics may develop into a scientific sub-discipline, using internet data to pose and answer questions in ways not imaginable with traditional empirical data. Googlemetrics can thus provide a valuable contribution to making the growing world of internet search activity measurable for behavioral analysis as well as forecasting. So far, Google data have been used, for example, to predict the outcome of the past U.S. presidential elections or the spread of influenza epidemics.





reported at the end of the same month. As the authors were able to show, the rate is strongly correlated with internet search activity during the second half of the previous month. This may be attributable to administrative procedures of the Federal Employment Agency, which cause an informational time lag between the actual incidence of unemployment and its measurement. The official unemployment rate is recorded on a reference date in the middle of the month. Aggregate weekly data for the second half of the month are therefore used to predict the unemployment rate for the following month. As far as the indicator potential is concerned, this means that at the time the official unemployment figures are announced, a forecast for the following month can already be made using this method. The informational advantage is thus one month.



Selecting keywords is obviously of central importance and nailing the right ones is the key. After various alternatives have been tested extensively, three indicator models are used to predict the unemployment rate using different keyword groups:

1. Google 1 – “employment office/agency” “jobsearch” (collection of most popular websites for job searches)
2. Google 2 – “jobsearch”, “short time work”
3. Google 3 – “jobsearch”

The complicated economic and labor market situation over the past months provides an ideal test environment for this innovative forecasting approach. As figures 1 and 2 show, weekly measurements of internet search for short-

time work are strongly correlated with short-time work announcements by employers. However, the internet data have a clear advantage in their continuity and immediate availability at the end of the period under study. Public interest evidently declined during the month of December 2008, then rose in the following year, remaining at a high level through February and March 2009. Since then, the indicator has been falling as well. The model is able to predict the official unemployment rate reasonably well. Until January these forecasts are accurate even one period ahead. With the introduction of short-time work and implementation of other labor market policies as of February 2009, the instrument becomes less certain. ■

## Behavioral Model

In a recent article in *Applied Economics Quarterly*, Dr. Nikos Askitas, Head of IZA's International Data Service Center (IDSC), and Professor Klaus F. Zimmermann, IZA Director and Chairman of DIW DC's Board, have presented an econometric concept that makes search activity on the internet usable for behavioral analysis and economic forecasts, with a specific focus on unemployment. Further studies by the same authors document and discuss their experience with concrete forecasts based on the Google Indicator.

The unemployment rate in a given month is usually

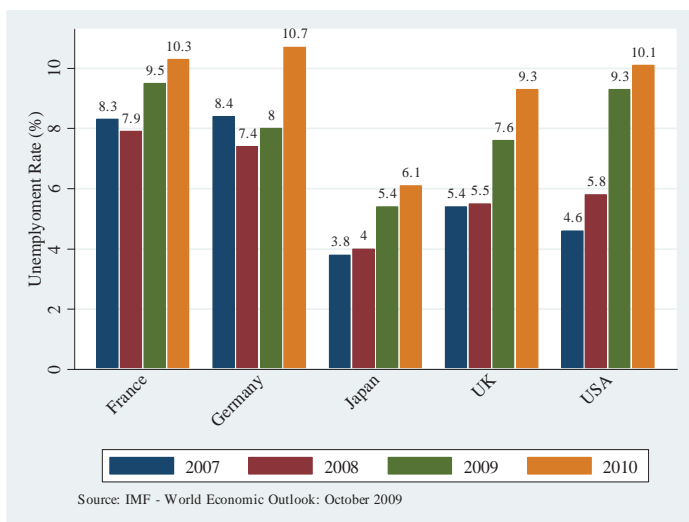
# Selected Economic Indicators from 2007 - 2010

The IMF World Economic Outlook from October 2009 reveals rather worrisome unemployment perspectives worldwide and for some major countries in the developed World. Since 2008, France, Germany, Japan, the UK and the US (in spite of huge government interventions due to the financial crisis) are experiencing a steadily growing unemployment rate, as depicted in Figure 1.

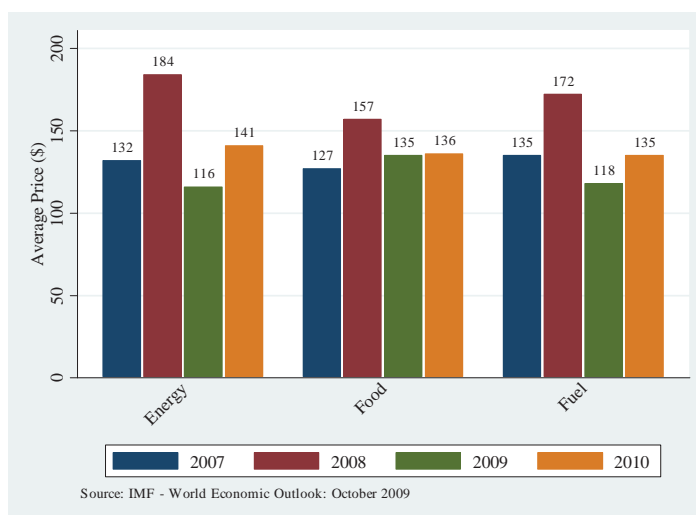
Nonetheless, despite the dramatic fall predicted for this year, the World Trade volume is expected to increase by almost 2.5 percentage points in 2010, approaching the 2008 level of 2.9%.

The world consumption and fuel prices clearly skyrocketed in 2008, as shown in Figure 3. However, in 2009 and 2010, they are expected to fall compared to their level in 2008. Energy and Fuel prices will slightly rise in 2010, whereas the food prices will pretty much remain unchanged.

**Figure 1: Unemployment Rate Developed Nations**



**Figure 3: World Consumption and Fuel Prices**



The World Trade volume looks to be negatively affected by the economic crisis in 2009, as Figure 2 illustrates.

**Figure 2: Annual Change (%) of World Trade**



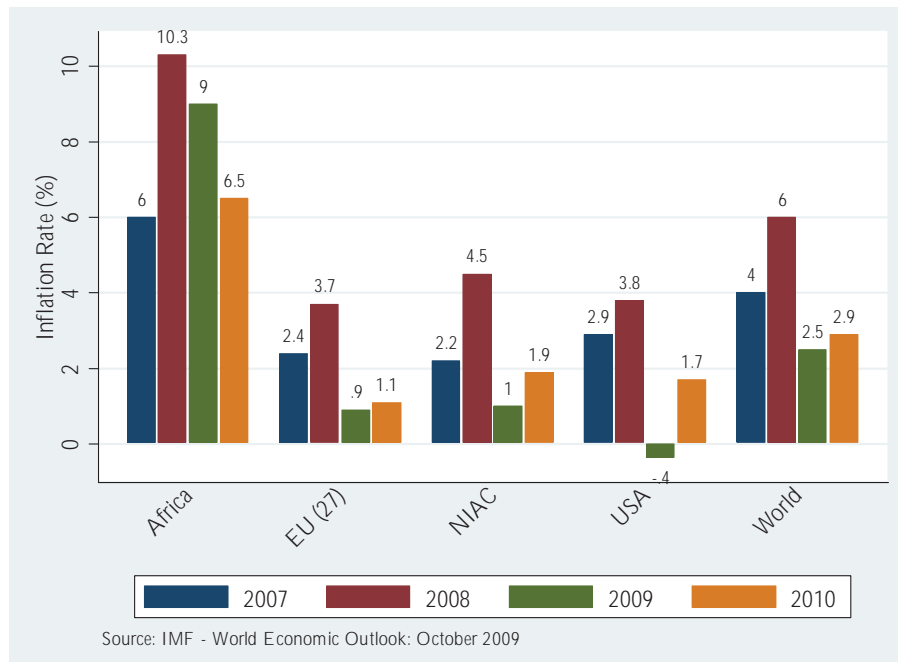
Compared to the average worldwide level of the annual inflation rate change, the EU 27, the New Industrialized Asian Countries (NIAC), and the U.S. will clearly remain below it in 2009 and 2010 similar to the 2007 and 2008 statistics. Although Africa will experience a substantial fall in the price change this year and in 2010, it will still have the highest level compared to the world level. Figure 4 shows that inflation hit Africa the worst in 2008 with an annual rate of over 10%.

An overall recovery of the global economy after the financial tsunami that swept the globe overnight is announced on December 8, 2009 by the Federal Reserve Bank of San Francisco. Based on the OECD release of December 1, 2009 the Fed-SF report said that GDP growth shows global recovery. As portrayed in Figure 5, a positive GDP is recorded for the first time during the third quarter of 2009 for France, Germany, Italy, Japan and the U.S. Unlike

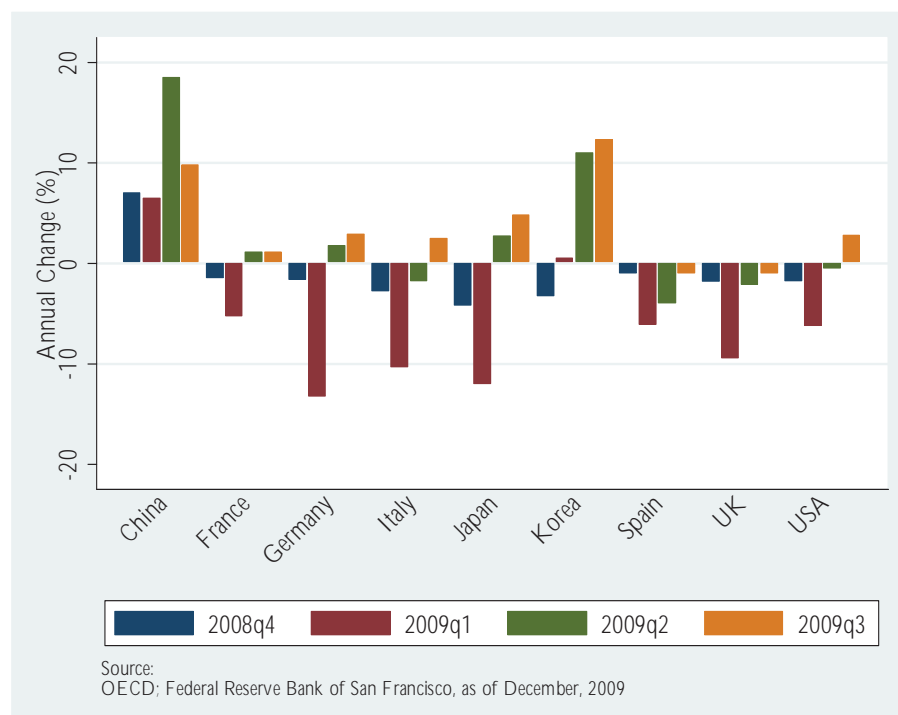
the U.S., France, Germany and Japan already showed a positive GDP in the second quarter of 2009. While Spain and the UK are still within the economic recession and negative zone of GDP, their negative GDP for the last quarter of 2009 is significantly less negative. China has a story of its own, and a successful one; it has positive GDP

levels throughout 2008 and 2009. Next ranks South Korea with positive levels of GDP throughout 2009. In fact, GDP levels during the last quarter of 2009 are higher in South Korea than in China. ■

**Figure 4: Inflation Rate (Annual Change)**



**Figure 5: Selected Countries GDP Growth 2008-2009Q3**





# Time for Financial Supervision; By Whom?

*Never again a systemic financial crisis: who should be the regulator(s)?*

Whether the argument comes from the financial markets' players, the lawmakers on Capitol Hill, or the White House, there is one prevailing consensus: reform the financial system and ensure accountability. The controversial point is, however, who will be the "overseer" and whether there should be an allocation of power among government agencies. While Treasury officials propose giving supervisory authority to the Federal Reserve to oversee the largest, most-complex financial companies – often labeled too-big-to-fail – skeptics argue that this centralizes too much power in the central bank (SouthCoastToday.com October 27, 2009) and it would be wiser to diversify and decentralize the overseers throughout several governmental regulatory agencies. Besides, if the Fed is both a lender and a supervisor, this may create moral hazard and banks may end up taking more risks.

Historically, the regulatory structure for financial institutions in the U.S. has remained largely unchanged since the 1930s, even though the financial environment has undergone many fundamental changes. Beyond the complexity of the regulatory oversight in the U.S., another prominent feature characterizing the financial sector regulation is the large number of agencies involved. Depending on the charter type, four federal agencies, as well as state agencies, oversee banking and thrift institutions in the U.S.. Is it wise to still operate under this outdated system, given the earth shattering results of the global financial and ensuing economic crisis?

The current practice is that banks can choose between the Federal Reserve, the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller and the Currency (OCC) and the Office of Thrift Supervision (OTS) as their primary regulator. But do we really need so many regulators? This is "charter shopping" says Senator Christopher J. Dodd (Chairman of the Senate Banking Committee). He then proposed a plan that would impose sweeping curbs on the Federal Reserve by creating a single banking regulator, a powerful council of regulators to monitor systemic risk to the economy and a Consumer Financial Protection Agency to write and enforce rules on products such as mortgages and credits cards (WSJ

November 11, 2009).

The idea of putting all banking regulation under one roof is not unanimously shared among economists. Some opponents say that this system risks politicization of the Fed, and others highlight regulatory failures leading up to the financial crisis (WSJ November 10, 2009). It is important that the Fed keep its independence. In his testimony in front of the Senate Committee on Banking, Housing and Urban Affairs on September 29, 2009, Martin Neil Baily of Brookings pointed out that "in its role as a regulator of bank holding companies, the record of the Fed is not good. Bank regulation has been something of a poor relation at the Fed compared to the making of monetary policy. The Fed as an institution has more stature and standing than any other federal financial institution, but this stature comes from its control over monetary policy, not on its role in bank supervision and regulation. In addition, the Fed's powers were limited. It could not gain access to key information from many large financial institutions and had no power to regulate them. Lehman and Bear Stearns are two examples" (p. 5).

The Australian "twin peak" model has been often cited as an example of a successful single regulator, and therefore suggested as a role model for the U.S. The twin peak model consists of a single regulator plus a single conduct of business regulator. Martin Neil Baily describes the key of Australia's success as follows: "Australia's prudential regulator had raised capital requirements for banks investing in riskier mortgage products. Consumer protection laws and foreclosure laws also discouraged borrowers from taking out mortgages that they could not afford" (p. 14). While successful stories from other countries are nice heuristic paradigms, can they be successfully adapted in the U.S.?

Proponents think that the "Fed needs more, not less, access to the actual working of financial markets to set policy appropriately, and preserving their regulatory role is one way of them gaining that information" (as reported in the WSJ November 10, 2009). The bottom line is that the system needs to change and adapt to the 'new financial order' in order to prevent future meltdowns.

“Opponents of regulatory consolidation in the United States frequently cite the experience of the United Kingdom, which has a consolidated regulator, the Financial Services Authority (FSA) but did not escape the crisis. In fact, it suffered perhaps even more than the U.S. did. Given London’s status as a global financial center it was to be expected that the UK would face problems in the global crisis, but it is surprising that the extensive regulatory reforms undertaken in the late 1990s did not better insulate the country from the effects of the financial crisis” (Martin Neil Baily, 2009, p. 13).

To the regulation debate in the U.S., overall, it seems like the battle on this bill is far from over. People who acknowledge the imperfections (in the past and/or presently) of the Fed as a financial regulatory institution, are at the same time, uncertain about the promised success of the future independent agency but are advocating that while the Fed is not perfect, it is still better than the alternatives. So it sounds like the slogan “in dubio pro reo” or “in dubio pro liberta.” ■

With regards to the financial regulation practice on the other hand of the Atlantic, after the financial tsunami, the financial sector’s regulation debate is also heated in the European Union. In the so-called De Larosière Proposal, there are two ongoing arguments which have been suggested. The first one is that, ideally, there should be one regulator and one supervisor for the euro zone, and presumably for the entire EU as well. Second, the European Central Bank’s (ECB) essential existence is for macro-supervision; ECB is the least badly competent for micro supervision. The macro-prudential supervision, which is the main task of the European Systemic Risk Council and chaired by the President of the ECB, will inter alia decide on macro-prudential policy and provide early risk warnings to EU supervisors. The micro-prudential supervision, which is the main task of the Authorities – European System of Financial Supervision (ESFS), however, will only gather information on micro-prudential developments (Charles Wyplosz, 2009).

Nonetheless, it is worth mentioning that nearly half of the EU15 central banks are also in charge of micro-supervision. For instance, in France, Greece, Italy, Portugal, Spain, Ireland and the Netherlands the central bank is the supervisor. At the same time, the central bank in these countries is also responsible for financial stability. In other EU countries the central bank is not the supervisory body but it is still responsible for financial stability; the supervisory body in Austria is the Ministry of Finance, in Germany is the Federal Banking Supervisory Office along with the German Federal Bank, in Luxembourg is the Commission de Surveillance du Secteur Financier, in Sweden is the Swedish Financial Supervisory Authority, in Belgium is the Banking and Finance Commission, in Denmark is the Financial Inspectorate and in the UK is the Financial Services Authority.

# The European Year in Perspective:

## *From 2009's Creativity and Innovation to 2010's Year for Combating Poverty and Social Exclusion*

Following the tradition at DIW DC, we take a moment to reflect upon past events and look at the New Year. Mankind awaits the New Year 2010 as



Deus ex Machina to ebb the financial meltdown; but what can governments do to make things better for their people? The European

Commission in the Name of the 27 Member-Countries with different welfare systems designated 2010 to be the European Year for Combating Poverty and Social Exclusion. Usually, when one talks about poverty it is a priori understood that he/she refers to developing countries, where lack of food and clean water can be, or often is, a daily challenge.

However, Europe is also affected by poverty and social exclusion. Recent Eurobarometer data shows that Europeans see poverty as a widespread problem. According to a report, 78 million people in the EU – or 16% of the population – currently live at risk of poverty. Across the EU, citizens feel that



around 29% in their area live in poverty, and that 1 in 10 suffers from extreme poverty. In addition, without any exception in the member states, part of the population is subject to exclusion and deprivation, often facing limited access to basic services. It is disconcerting and disheartening that many children are also in such a plight; 19% of them are at risk of poverty across the EU and 10% live

in unemployed households (Press Releases: IP/07/1905, December 12, 2007).

Social exclusion is a multidimensional process of progressive social rupture, detaching groups and individuals from social relations and institutions and preventing them from full participation in the normal, normatively prescribed activities of the society in which they live (Hilary Silver, "Social Exclusion: Comparative Analysis of Europe and Middle East Youth," Middle East Youth Initiative Working Paper (September 2007, p. 15).

Aware of the situation, the European Commission dedicated € 17 million aiming to achieve four objectives:

- Recognition of the right of people in poverty and social exclusion to live in dignity and to play a full part in society.
- An increase in the public ownership of social inclusion policies, emphasizing everyone's responsibility in tackling poverty and marginalization.
- A more cohesive society, where no one doubts that society as a whole benefits from the eradication of poverty.
- Commitment of all actors, because real progress requires a long-term effort that involves all levels of governance.

Looking to the future, the European Commission has decided to propose that 2011 be designated as the "European Year of Volunteering." While working towards an enabling and facilitating environment for volunteering in the EU, the commission hopes that 2011 will serve to raise awareness of the value and importance of volunteering, empower volunteer organizations and improve the quality of volunteering. The Council is expected to approve this decision in consultation with the European Parliament in 2010. ■



## Professor Jan Svejnar – A Profile

**D**IW DC is honored to have on its Board of Distinguished Advisers Dr. Jan Svejnar. A Princeton graduate, Dr. Svejnar is currently



Professor of Economics at the Economics Department of the University of Michigan, Professor of Public Policy at the Gerald R. Ford School of Public Policy of the University of Michigan and Everett E. Berg Professor of Business Administration at the

Ross School of Business. He is also the Director of the International Policy Center at the Gerald R. Ford School of Public Policy and the Chairman of the Supervisory Board, CSOB Bank, Czech and Slovak Republics.

An entrepreneur and a visionary, Professor Svejnar is a founder of CERGE-EI in Prague (an American-style Ph.D. program in economics that educates the new generation of economists for Central-East Europe and the Commonwealth of Independent States). From 1996 to 2004 he also served as the Executive Director of the William Davidson Institute at the University of Michigan. He is Co-editor of the Economics of Transition Scholarly Journal and a Fellow of the European Economic Association and Research Fellow of the Center for Economic Policy Research (London) and Institute for the Study of Labor (IZA, Bonn).

An international figure in the field of transitional economies, Professor Svejnar has brought an outstanding background in economics to bear on studying the transition from centrally planned to market economies in China as well as in Central and Eastern Europe, earning a reputation for path-breaking work in areas including enterprise behavior and the labor market dynamics of transition. His work in economic development covers a range of major issues in the field, including the effect of government policy on firms' economic performance, the behavior

of multinationals and joint ventures and local firms in transition and emerging market economies.

Professor Svejnar has a prolific career in economics and business. A few examples of his authored and co-authored publications in leading peer-refereed journals are "Enterprise Break-ups and Performance During the Transition from Plan to Market," "Unemployment and the Social Safety Net During Transitions to a Market Economy: Evidence From the Czech and Slovak Republics," "Enterprises and Workers in the Transition: Econometric Evidence," "Behavior of Participatory Firms in Yugoslavia: Lessons for Transforming Economics," *Review of Economics and Statistics* (1994); "Structural Adjustment Policies and Productive Efficiency of Socialist Enterprises," "Market Imperfection, Labor-Management and Earnings Differentials in a Developing Economy: Theory and Econometric Evidence from Yugoslavia." He has also written and edited several books and monographs including "The Czech Republic and Economic Transition in Eastern Europe." Prof. Svejnar has also contributed a number of chapters in edited books. In addition to being a recognized academic, Professor Svejnar has made many contributions to the political sphere as well. He is committed to reforms and the implementation of sound economic advice. He is one of the chief architects of the Czech Republic's economic reforms and he continues to serve as an advisor to former Czech President Vaclav Havel. Professor Svejnar also serves on the advisory board of CSOB, the largest bank in the Czech Republic and serves as a consultant to the European Bank for Reconstruction and Development, as well as The World Bank in Washington, D.C.

In a recent interview with DIW DC's research assistant Bienvenue Tien, Professor Svejnar commented on the 20th anniversary since the fall of the Berlin Wall and the future of the field of economic development.

**Q:** Recently, Germany commemorated the fall of the Berlin Wall on November 9, 1989. You stated that, the dramatic economic slowdown experienced by the Soviet bloc countries over the preceding three decades was "epitomized" by the fall of the Berlin Wall along with the collapse of the Soviet political and economic system. 20 years later, what's your review in terms of the economic transition of the former republics of the Soviet Union, now forming the Commonwealth Independent States (CIS)?

*A: There is no doubt that after the difficulties of the early-to-mid 1990s, the CIS countries made great progress economically in the 1998-2008 period. GDP grew rapidly in most of them and a number of welfare indicators, including real wages, improved. Many of the countries have of course been hit hard by the great global recession that we have entered last year. This was for most part not their fault, but they could not avoid the contagion that reached them from the rest of the world.*

**Q:** What drives you to specialize inter alia in Economic Development and Transition Economies?

*A: Some of the most important economic issues are encountered in the emerging market economies. Moreover, one can get important insight by comparing the performance of those that started from central planning and those that started with an imperfect market system.*

**Q:** Adam Smith was influenced by the Physiocrats. Were you influenced by any development economist? Who is your role model in Economic Development?

*A: When I was a graduate student at Princeton, I had the privilege to study with Arthur Lewis, the first Nobel Prize laureate in the field of Economic Development. His wisdom, analytical intuition and broad historical perspective on development had a major impact on my thinking as an economist and contributed to me becoming a development economist.*

**Q:** Why is Economic Development as a sub-discipline so important in Economics?

*A: For a number of reasons, the most important being that its subject of study is over two-thirds of the world population, these two-thirds comprise the most needy people, and the economic and social phenomena encountered in the developing countries are among the most interesting phenomena from the standpoint of social science.*

**Q:** According to you, what are the questions which are going to trigger the research in Economic Development in the next era of the 21st century?

*A: Since the 1940s, when Economic Development started as a real field, it has always exemplified unprecedented breadth in its areas of inquiry. Development economics has spanned virtually all fields of economics, from trade to labor to*

*industrial organization to health economics, you name it; and it went beyond, being among the first to tackle interdisciplinary issues such as corruption, state ownership and performance of firms under soft budget constraints and the role of power elites. I expect that this breadth and pioneering investigations in a number of areas will remain the trademark of Development Economics. I think we will have a number of focal points, including the traditional question of how to make "poor countries rich", how to alleviate poverty, and how to improve health. Environmental issues will undoubtedly also start playing a greater part. And, as was the case since the 1950s, the varied performance of different developing countries will generate new research agendas. It is useful to look back and reconsider major outcomes in light of where the world was and what development economists were thinking then and now. Based on performance and promise about 50 years ago, the less developed countries that were expected to make it soon into the rank of developed countries were Korea, Taiwan, Israel, and Yugoslavia. Argentina and (current) Czech Republic switched from being developed at the start of the 20th century to being relatively less developed by the end of it. Nobody could predict the phenomenal rise of China 30 years ago. These are intriguing phenomena that will, together with many others, generate many fruitful research investigations at both the micro and macro levels. ■*

# Habemus Feminam A Woman Nobel Laureate!

*First woman to ever win the economics prize*

**O**n October 12, 2009, Elionor Ostrom became the first woman to ever win a Nobel Prize in Economics, since the first Award in 1969. Professor Ostrom from Indiana University was honored along with fellow American Professor Oliver Williamson from the University of California at Berkley for analyzing the “Economics of Governance.” Elionor Ostrom is on the faculty of Indiana University and Arizona State University. She received her B.A., M.A. and Ph. D. in Political Science from UCLA. Ostrom is a member of the United States National Academy of Sciences and was a former president of the American Political Science Association. ■



## DIW DC in Journals

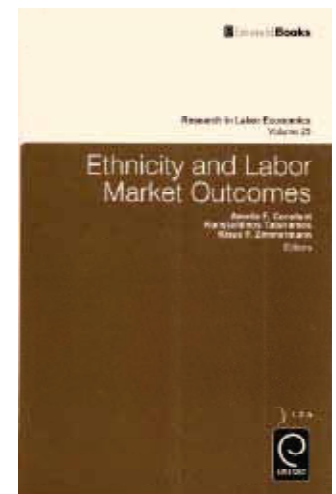
*Scholarly output*

**I**t has been a prolific quarter for DIW DC’s staff. Besides individual refereed publications, the team has also published several books and has been acknowledged for their expert work in the migration field. Dr. Amelie F. Constant, Executive Director of DIW DC along with Professor Dr. Klaus Zimmermann and Dr. Martin Kahanec of IZA have edited a special issue (30/1-2) of the International Journal of Manpower on “Migration, ethnicity and identity in the host labour markets.” Top-notch social scientists in migration contributed thirteen papers on attitudes,

ethnic segregation, prejudices, naturalization, intermarriages, and ethnic entrepreneurship.

Dr. Constant, Professor Zimmermann and Dr. Tatsiramos of IZA have edited the famous Research in Labor Economics series (Vol. 29) with the title: “Ethnicity and Labor Market Outcomes.” Twelve papers by migration scholars make up this volume. They cover important and timely issues in migration such as ethnic identity, assimilation and harassment, dual nationalities, the self-employed and their employees, cross-nativity marriages, race, ethnicity and health insurance.

Prof. Dr. Klaus F. Zimmermann along with Dr. Dorothea Schäfer of DIW Berlin have also been recognized for their new scholarly output on the financial market called “Financial Markets, After the Blaze: Why did it happen and which lessons should we learn from it?” ■





## Brainy Africans in Fortress Europe: For Money or Colonial Vestiges?

A recent paper by DIW DC staff Amelie F. Constant and Bienvenue N. Tien (<http://ftp.iza.org/dp4615.pdf>) examines the determinants that trigger highly skilled Africans to migrate to Fortress Europe. The authors reconsider economic reasons along with the gravity model, cultural affinities and the existence of networks and empirically test the hypothesis that ex-colonial links can still play an important role in the emigration decision.

*The magnitude of the colonial vestiges in Africa is a significant determinant of emigration flows to Europe.*

They employ a general linear mixed model, and apply it to the case of skilled, educated and talented Africans, who migrate to seven ex-colonial powers of Fortress Europe from 1990 to 2001. While they find some differences in the exodus of skilled Africans by sub-regions, the magnitude of the colonial vestiges in Africa is a significant determinant of emigration flows. Overall, Portugal is preferred to the UK which is preferred more than Belgium, Germany and Italy. Brainy Africans are, however, indifferent between the UK, France and Spain as a destination country. Established immigrant networks and higher standards of living with job opportunities in Fortress Europe are also very important drivers of the emigration of brainy Africans. ■

## DIW DC Executive Director Receives “2009/2010 Professional Woman of the Year Award”



recognizes Dr. Constant for her outstanding leadership and commitment within her profession. ■

Dr. Amelie F. Constant has been awarded for her accomplishments, achievements and professional history as Professional Woman of the Year by the National Association of Professional Women. NAPW

## Study on the “Impact of Migration on Employment in the European Union and Outcomes of Policies on Labor Market Integration of Migrants in the European Union”

DIW DC staff is consulting the International Organization for Migration (IOM). DIW DC will serve as a national expert of the independent network for labor migration and integration to carry out the study on the employment impacts on migration and policy outcomes. ■

## DIW DC is Proud to be Affiliated with George Washington University and Georgetown University

As an economics think tank, DIW DC is privileged to have an MOU with George Washington University and a special relationship with Georgetown University. Dr. Amelie F. Constant, Executive Director of DIW DC, who is also teaching at the Elliott School of International Affairs, underscores the importance of such an academic affiliation especially in the context of DIW DC administering the DIW Berlin Graduate School in DC. DIW DC looks forward to future years of collaboration and partnership with both prominent universities. ■

## DIW DC Present at the ASSA 2010 Meetings

Like every year, the staff of DIW DC will attend the largest congress of all economic and social science societies, conduct interviews and hold a booth. Dr. Amelie Constant will preside an AEA session which she organized, on “Performance in Academia” with the following five papers: “Rising Tuition and Enrollment in Public Higher Educations,” “Highly Cited Leaders and the Performance of Research Universities,” “A suggested Method for the Measurement of World-Leading Research,”

“Comparing the Early Research Performance of PhD Graduate in Labor Economics in Europe and the USA” and “The Americanization of European Education and Research.” ■

## Cultural Integration in Europe

Immigration expert Dr. Amelie Constant presented her co-authored paper on cultural integration in Germany at a high profile conference in Paris on December 18, 2009. The goal of the conference was to compare the patterns of cultural and economic assimilation of ethnic minorities in the different European countries. The conference addressed three main issues:

- How do European countries differ in their cultural assimilation process and what are the different models of integration at work?
- How does cultural assimilation relate to economic assimilation?
- What are the implications of cultural assimilation process in terms of public policies?

Papers of the cultural integration of six more European countries including France, Spain, Sweden, UK and Italy, as well as the United States were included in this conference. All these contributions will be published in a book by the Oxford University Press in 2010. The editors are Alan Manning, Alberto Bisin and Thierry Verdier. ■

## Internship Program at DIW DC

DIW DC is currently accepting applications for the fall and spring internships in the fields of economics, public relations and administration. Interns at the graduate and undergraduate level are considered for internship opportunities. Interns at DIW DC experience first hand the execution of real economics research along with the economic and political networking of Washington. Interns provide extensive assistance in planning and organizing various conferences and events and supporting our public relations and administration. Under the guidance of Dr. Amelie Constant, interns attend several conferences by other think tanks in DC, represent the institute at various functions and engaged in substantial economic research and contribute to DIW DC’s scientific and policy outlets.

*If you are interested in interning at DIW DC, please contact Anastasia Xidou, Program Coordinator for more information*

at: [xidous@diwdc.org](mailto:xidou@diwdc.org) or call 202.429.2904 ■

## DIW DC Fellowship Foundation Program

DIW DC is proud to serve as a platform for fellows and specialists that are seeking a base of operation during their stay in Washington DC. Our offices are located in the heart of Washington DC’s golden triangle on 1800 K Street NW which provides convenient access to various prestigious universities, international organizations such as the World Bank and the IMF as well as other economic and political think tanks. Please contact us for further information about our fellowship foundation program at [info@diwdc.org](mailto:info@diwdc.org) ■

# Reforming Sickcare or Creating Healthcare?

*An analysis of healthcare reform and impacts on the labor market*

*Anastasia Xidou: DIW DC*

Reform within the United States healthcare system has been a major economic and political focus throughout the 1990's but has transformed recently into more than a prospect for the future. Healthcare reform is now the center of President Obama's agenda and its figurative conversion has seized the attention of all Americans as well as of the entire world. Obama's attempt to achieve the creation of a public option for healthcare coverage for Americans has been received with both support and opposition by Congress and the American people.

population is additionally uninsured or underinsured. Table 1<sup>ii</sup> illustrates the number of underinsured and uninsured Americans from 2003 and 2007. The surveyed calculation concludes that there are less American adults insured all year without being underinsured from 2003 to 2007.

Additionally, an increasing number of Americans have become underinsured increasing from 9% in 2003 to 14% in 2007 as well as uninsured increasing from 26% in 2003 to 28% in 2007. An increasing gap between high and low wage workers is also of concern in regards to

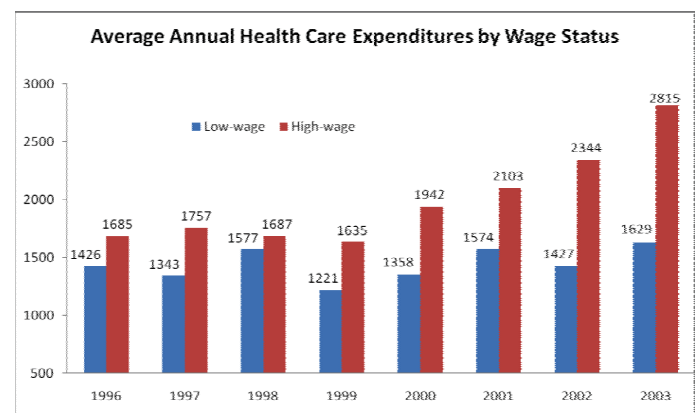
**Table 1<sup>ii</sup>**

Characteristic	2003			2007		
	Insured, all year, not underinsured (n=2,031)	Underinsured (n=310)	Uninsured during the year (n=952)	Insured all year, not underinsured (n=1,535)	Underinsured (n=334)	Uninsured during the year (n=747)
All adults, millions	110.9	15.6	45.5	102.3	25.2	49.5
All adults, percent	65%	9%	26%	58%	14%	28%
<b>Income</b>						
Less than \$20,000	31	17	53	24	26	50
\$20,000 - \$39,999	47	17	35	41	19	41
\$40,000 - \$59,999	79	5	16	69	13	18
\$60,000 - \$99,999	91	4	6	82	9	9
\$100,000 or more	96	1	2	87	7	6
<b>Health status</b>						
Healthier	69	7	24	64	11	25
Sicker	57	13	30	50	18	32

Keeping the most recent proposal for the creation a public option aside, according to the OECD, the United States spends more on healthcare on a per capita basis than any other nation in the world. In spite of the United States high spending on healthcare, the US population's health status disappoints. Variables such as life expectancy and potential years of life lost in the United States seem to drag down its rank to the lower third of OECD countries. Amongst the US population's health status, many other issues have been increasing in size as well as urgency and addressing them is a top priority. High and increasing health expenditures in the United States are principal concerns. The OECD states that the public share of health expenditure (measured at 46%) is much lower than in most other OECD countries, but public expenditure per capita is higher than in most other OECD countries. For this amount of expenditure the United States government provides insurance coverage for only the elderly and disabled through the administering of Medicare and for some low income citizens through Medicaid. An increasing number of the American

access to quality healthcare in the United States. Average annual health-care expenditures by wage status reported by the Commonwealth Fund Publication found that average annual health-care expenditures by high-wage workers nearly doubled between 1996 and 2003, whereas for low-wage workers the increase was only 14%. Figure 1<sup>iii</sup> shows a significant increase in the gap in health-care expenditures

**Figure 1<sup>iii</sup>**





between high and low wage workers demonstrating how low wage workers receive fewer services while high wage workers benefited from large increases in basic preventative services.

Working to propose a successful way for the United States to achieve a better population health status by keeping its costs low and increasing access to high quality health insurance is something that most Americans wouldn't oppose finding a solution to. Disagreements however occur when a different question surfaces; what is the most efficient way of achieving this goal?

Supporters of a reform plan are looking for one thing; affordable quality coverage. Many Americans are convinced that the current system of healthcare coverage is unsustainable and reform must take place. However; debate about whether a public option - a government-run non-profit insurer to offer coverage - or the creation of a health co-operative system would be the best reform for healthcare.

What exactly are healthcare co-operatives? Co-ops are non-governmental firms run by its members, the consumers. Such organizations in any market help their members get access to various goods and services. Health co-ops exist throughout the United States today. Two popular examples of today's healthcare co-ops are HealthPartners which is based in Minnesota and Group Health Cooperative based in Seattle. On a more abstract note, co-ops can be genuinely competitive in the market however; co-ops in the health insurance market in the past keep policy makers critical due to their attachment to government sponsorship.

Previous co-ops in existence have failed to provide quality access and cost effectiveness as many hope healthcare co-ops are able to do. Skeptics of healthcare co-ops illustrate how these organizations suffer from inevitable reverse selection. Co-ops ended up attracting a dominate amount of high cost members more than its low cost members. Their primary inner city focus hindered their ability to attract people in the suburbs. Lack of attracting members from suburban areas is vital to a co-op according to skeptics due to the fact that an overwhelming majority of studies suggest that suburban individuals are healthier than inner city individuals. By not attracting this type of low cost population, high cost populations overwhelm the budget of the co-op and assets begin to decline drastically. Additionally, by attempting to keep costs low, co-ops had no control over escalating hospital costs which additionally added to a decreasing profit line. <sup>iv</sup>

The most recently revised proposal from the House for the creation of a healthcare plan is the H.R. 3962: Affordable

Healthcare for America Act. This proposal includes the creation of a government run public healthcare option. The proposal for H.R. 3962 passed through the House in November 2009 as law makers voted 220 to 215 to approve the plan that is estimated to cost \$1.5 trillion over 10 years. Amongst the many details of the bill, by 2013, a Health Insurance Exchange is to be created in which among other options for health insurance, a public option will also be on the list. According to the Committee on Energy and Commerce, the public option will operate on a level playing field and will be subject to the same market reforms and consumer protections as other private plans. Through the implementation of this plan, insurance companies will no longer be able to discriminate against individuals in regards to their health status, gender or pre-existing health conditions. Affordability credits will also be administered through this proposal. The credits that are given are tied to income and as an individual or family income rises, credits decrease and completely phase out after income rises to 400 percent of the poverty level. The public option will cap out of pocket spending at \$5,000 per individual and \$10,000 for families in order to prevent the risk of bankruptcies due to medical expenses. The plan also proposes employer responsibility laws in which an employer has an option of either providing minimum benefit or contribution requirements for healthcare or contributing funds on the employee's behalf. Employers who choose to contribute will pay an amount based on a percent of their payroll. Small businesses with a payroll that is less than \$500,000 are exempt from the employer responsibility requirement. There would be a 2% penalty for firms that have annual payrolls of more than \$500,000 and an 8% penalty for firms with annual payrolls above \$750,000. <sup>v</sup>

November ended with a Senate vote to start debate on the healthcare bill and amend certain controversial issues such as the government run public option and tax increases. As December came to a close, the Senate came closer to passing a healthcare bill and voted to end debate and approve changes to the bill. A final bill will require approval by both chambers and will likely happen after congress returns from holiday break in January.

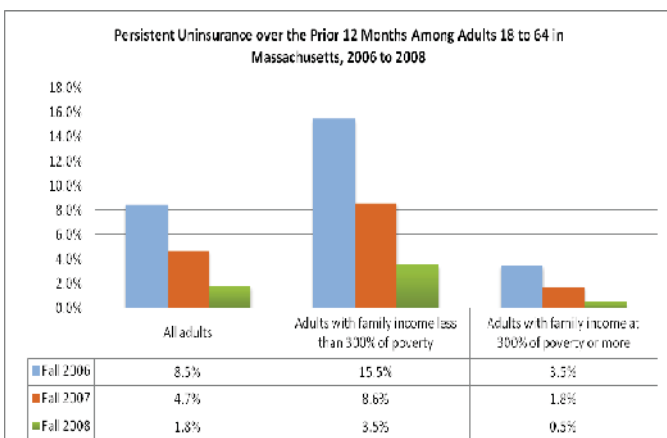
Experts on health and social services programs like Hanns Kuttner, visiting fellow at the Hudson Institute and former member of the White House domestic policy staff under George H.W. Bush, follows the formation of this healthcare proposal closely. According to Kuttner, if the House bill remains unchanged, strong incentives for employers to hire outside companies to do low wage work is a top concern. Kuttner suggests that there's an incentive to influence employers not to hire low wage workers and then have to

provide them with insurance or pay a penalty fee. "It would be economically rational for these companies to outsource this type of work rather than have to pay for healthcare coverage or a percentage for healthcare in order to employ low wage workers." vi

Although the United States does not have an active universal government run healthcare system, some states have taken healthcare reform into their own hands. States like Massachusetts and Tennessee have attempted to provide their residents with low cost state run health insurance in order to help lower the costs of Medicaid. Although both states have similar goals, their state led healthcare systems have experienced drastic differences in regards to the intensity of the issues the systems have endured.

The state of Massachusetts undertook healthcare reform in 2006. The reform law enacted as Chapter 58 requires that all Massachusetts residents attain healthcare coverage. Residents that earn incomes up to the Federal poverty level are provided with subsidized healthcare. Commonwealth Health Insurance connector Authority is the organization responsible for organizing the distribution of subsidies to low income families. Under the rule of Chapter 58 and according to the Massachusetts health reform survey, 439,000 Massachusetts residents were provided with healthcare coverage as of 2008. Several provisions to Chapter 58 however have caused some controversy with the policy. A provision which requires firms with more than ten employees who do not provide, what is noted as, 'fair and reasonable' health coverage must pay an annual penalty. Additionally, individuals who do not comply with the mandatory attainment of healthcare will also have to pay an annual fee. Reports by the Massachusetts health reform survey that an increase of enrollees from 69.2% to 71.4% was priority in regards to addressing other issues. Figure 2 vii suggests the number of uninsured Massachusetts

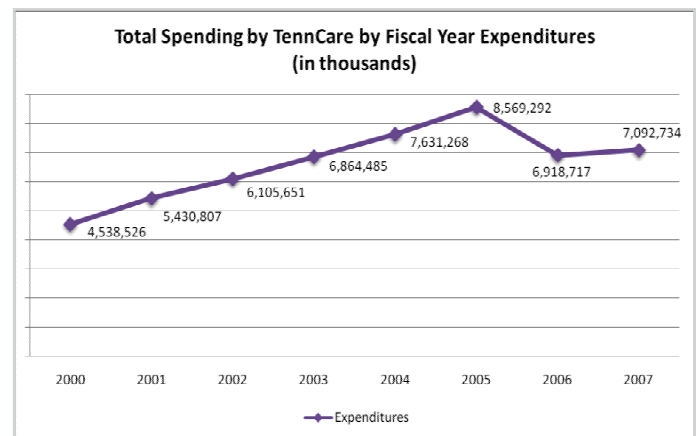
Figure 2 vii



residents decreased significantly from 2006 to 2008 due to the expansion of the program but rising healthcare costs has caught the attention of the creators of the Massachusetts model and projections have reached an annual growth in cost of approximately \$1.35 billion.

TennCare is most often noted by the skeptics of the public option as a prime example of what a government run healthcare plan could possibility look like. The healthcare plan is run by the State of Tennessee and is designed to increase health insurance coverage to the uninsured, provide affordable healthcare insurance and lower the costs of Medicaid which was responsible for the largest portion of the state budget. TennCare is mostly known for its increasing costs and its cheaper pay out to health providers forcing physicians and hospitals to increase charges to private insurers. In its first five years, TennCare has the lowest per capita cost of any Medicaid program in the country by decreasing crowds in emergency rooms

Figure 3 viii



which were packed with uninsured patients. TennCares' \$300 million per year increase however; forced the system to scale back its size unsteadily. Figure 3 viii illustrates the increase in total spending by TennCare from 2000 to 2007. Expenditures in 2000 were approximately 4.5 billion in spending while in 2007 TennCare spending had reached approximately 7 billion with 2005 reaching the highest spending year of approximately 8.5 billion. Increasing costs have forced the state to cut enrollees in TennCare by about 170,000 with hope that a separate limited insurance option called CoverTN that covers only up to \$25,000 in annual medical costs would serve as a safety net for individuals who did not qualify for TennCare.

Why is access to quality healthcare important? In regards to labor economics, the health status of all citizens of a nation is profoundly important. Many labor economists have

done studies on the relationship between health and wages. These studies indicate that poor health is related to lower wages. Health can affect wages in various ways. Poor health may lower productivity, resulting in lower wages. Also, the employer costs of accommodating a worker in poor health may be passed on in the form of lower wages and poor health may also be subject to discrimination.<sup>ix</sup> Due to the broad and unspecified definition of health, little can be said about the relationship of health and its attachment to the labor market and productivity although specialized labor economists seem to find trends that directly assume this connection. “Poor health...may also reduce effective time endowments and affect the marginal rate of substitution between goods and leisure...thus the effect of health on the labor force participation is theoretically ambiguous, although most research seems to assume that poor health will decrease productivity.”<sup>x</sup> Not only have studies been done to show a connection between adult health status and wage and productivity but also the health status of children is being studied to determine future labor market outcomes. Many economists have studied and noted that poor health in childhood is associated with reduced educational attainment. “In turn, individuals with less schooling receive lower wages and have weaker labor force attachment.”<sup>xi</sup>

Concluding how access to health insurance and its effect on the labor market is difficult to identify however; if health insurance reduces the cost of healthcare and if healthcare improves health, then health insurance should affect labor market outcomes by improving health. More concentrated studies have been done however to illustrate the relationship between health insurance and employment. Motivating employers to provide healthcare to their employees may benefit them more than they think. Offering a compensation package comprised of both wages and health insurance is more profitable than offering wages alone. “Health insurance may encourage self-selection of “desired” employees into the firm”.<sup>xii</sup> A correlation between employers offering health insurance and employees becoming less mobile is also apparent. Establishing a long-term employment relationship is also more likely to happen between employees who receive health insurance from their employer. Benefits of providing quality health insurance to citizens of a country exist in regards to labor economics and wage and productivity analysis. How to provide this type of healthcare with efficiency is where policy makers run into danger zones in regards to bi-partisan politics. ■

ii Ibid, 22

iii Ibid. 24 (common wealth fund

iv Hudson Institute: Conference on Health Cooperative: “Available Alternative to the Public Option?” In cooperation with the Heritage Foundation. (October 6, 2009): Print.

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viii “Fiscal Year 2006-2007 Annual Report”. Bureau of TennCare, State of Tennessee. Department of Finance and Administration. 2007. Print

ix Ashenfelter, Orley C., and David Card. Handbook of Labor Economics. 3C. Editors: Janet Currie and Brigitte C. Madrian United Kingdom: Elsevier B.V., 1999. 3333-3360. Print.

x Ibid, 3333

xi Ibid, 3351

xii Ibid, 3360

<sup>i</sup> Carey, David, Bradley Herring, and Patrick Lenain. “Healthcare Reform in the United States.” OECD Economics Department Working Paper No. 665. (2009): Print.

## Upcoming Events

March 19-21, 2010: Second Annual Meeting on the Economics of Risky Behaviors, Atlanta, GA  
April, 2010: Interest Groups, Lobbying and Public Policy, Washington, DC  
June, 2010: Seventh AM<sup>2</sup>, Bonn, Germany  
June, 2010: Third Migration Topic Week, Bonn, Germany

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