

Wage Subsidies in East-Germany - A Cure for the Unemployment Plague?

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Wage subsidies are used as one means to fight unemployment in Germany. Despite their growing importance evaluation studies are rather scarce and aim on the labour supply side. Thereby the possible occurrence of deadweight losses, substitution and displacement effects is neglected. These possible effects counteract the hoped-for positive impact of wage subsidies on the individual level. To overcome this problem we focus on the labour demand side using the IAB establishment panel. Our dataset contains approximately 3,000 establishments where 49% have received a wage subsidy in 2000. To account for the selectivity problem in microeconomic evaluation studies, we use parametric and non-parametric estimation strategies. Since selection can occur due to observable and unobservable factors, we use a mixed simultaneous equation model and a conditional difference-in-differences estimator, which are both able to deal with this sort of selectivity. The empirical application concentrates on East Germany and the time period after the introduction of the new legislation for active labour market policies (ALMP) in 1998. Between 2000 and 2001 around 120,000 workers received a wage subsidies in East Germany making this tool one of the most important measures of Active Labour Market Policies ALMP. Since wage subsidies usually are granted for low-skilled employees we estimate the effects separately for low- (L D U) and high-skilled L D H workers. A successful programme would imply positive effects on L D U , but the effects on L D H are uncertain. This is due to the fact, that the substitution effect as well as the scale effect have positive expected signs for the low skilled group. For the high skilled we expect a negative substitution effect, but a positive scale effect, making the total effect depending on which effect dominates. For the parametric approach we find small but significant positive effects for both skill groups, whereas α

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