

IAB-Colloquium 2008

Professor Klaus Wälde (Universität Glasgow)

## **A DSGE Analysis of Hartz IV – Efficiency and Distribution**

### Abstract

We formulate an equilibrium search model with stepwise profile of benefit payments and endogenous search effort. Time-dependence of optimal search effort generates an endogenous distribution of unemployment duration characterized by a time-varying hazard function. Applying tools from the literature on semi-Markov processes, we obtain the expression for the expected unemployment rate under heterogeneous search effort. We perform structural estimation of the model using the data of a German labour market and discuss the effects a recent Hartz IV reform. Our results show that although the reform has contributed to the reduction of the aggregate unemployment rate, welfare of both employed and unemployed workers has gone down. The result for the value of a firm is ambiguous. However it is unlikely that the reform leaves a scope for a wealth transfer from firms to workers.