THE EUROPEAN LABOUR MARKET
SUCCESS THROUGH FLEXIBILITY AND MOBILITY

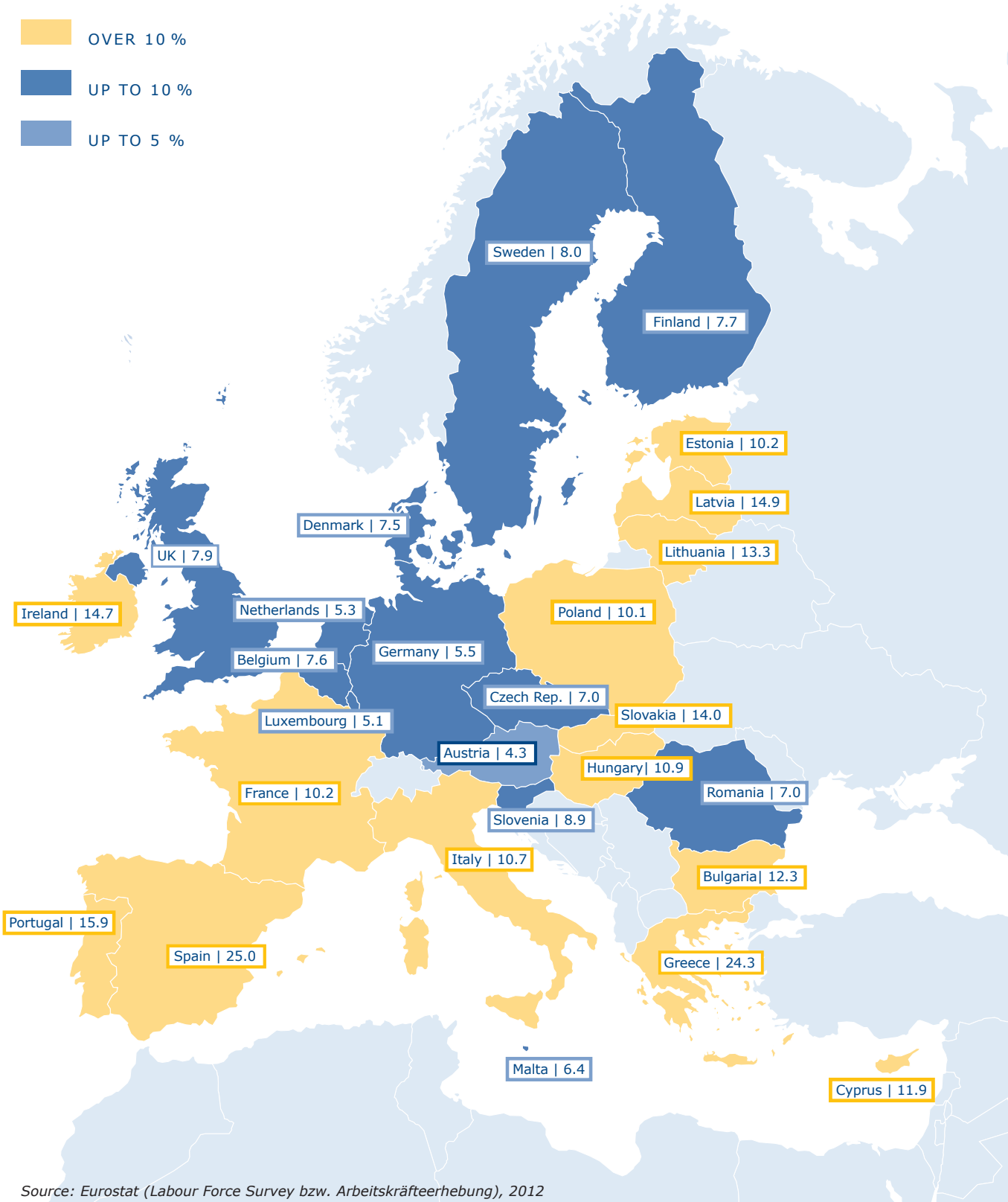
1 SUCCESS VIA REFORM:
THE GERMAN JOBS MIRACLE

C E S
CENTRE FOR EUROPEAN STUDIES

Konrad Adenauer Stiftung

UNEMPLOYMENT RATES IN EUROPE

ANNUAL AVERAGE (IN PERCENTAGE TERMS)



Source: Eurostat (Labour Force Survey bzw. Arbeitskräfteerhebung), 2012

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Preface

The European labour market is facing great challenges. Unemployment has been on the rise in Europe virtually continuously since 2008 and has been on a historic high since 2011. There are currently over 25 million unemployed in Europe and numbers are still going up. These figures are alarming as they affect citizens directly in their daily lives.

The national labour markets, however, have developed very differently during the course of the crisis. While particularly the countries in crisis (Spain, Greece, Portugal and Italy) have very high unemployment rates of up to 21 per cent, countries such as Germany, Austria, Luxembourg and the Netherlands have historically low rates, below five per cent in some cases. Europe is thus facing two great challenges.

On the one hand, there is a need to reduce unemployment and get more people into work overall. Persistent unemployment has a very detrimental effect both on society as a whole and on individuals. Qualifications and acquired knowhow that are not used for extended periods become increasingly eroded. Unemployment robs people of prospects and makes it difficult for them to participate in society. At the same time, increasing expenditure on social benefits is a burden on the national purse and puts the brakes on the national economy. What this means for the European economy is worsening growth prospects and ultimately also declining living standards.

Increases in employment in Europe can only be achieved through structural reforms of the national economies – and particularly the labour markets. The overall aim must be to open up the labour market to as many people as possible and to distribute opportunities and security fairly. Each country will have to decide for itself which reforms are required in concrete terms to pursue this aim. The functioning of a regulated labour market depends on numerous factors, such as the model of the welfare state, the roles played by the social partners, the structure of the economy and the culture of a society – and these differ greatly from one country to the next. There can therefore never be a single right way or a single right model. However, the successful reform routes taken by individual countries can serve as examples to other member states – both positive and negative ones.

Experiences made by other countries can help to shape the debate ahead of large-scale reforms, making sure to involve all actors and bring them on board. They can suggest ideas on how the various problems can be solved creatively. And not least they can, of course, prevent "mistakes", i.e. ineffective reform measures, being repeated.

But focusing exclusively on the structuring of the national labour markets will not be enough. Particularly in view of the euro crisis, the second central challenge will be to reduce the existing disparity between the different national labour markets. One of the key factors here is an increased willingness of the European population to extend the search for jobs beyond national borders.

Increased employee mobility could actually help to ameliorate the problems of the countries in crisis in the short term. Because each unemployed person who finds a suitable job abroad will lower the domestic unemployment rate and lessen the burden on the state. At the same time, this will provide support to the economies in the thriving regions and ease the skills shortage there, which has been making itself felt increasingly of late, particularly in certain sectors. But higher employee mobility does not only bear great potential for economic stability within society. It particularly also enables individuals to come out of unemployment earlier, gain professional experience abroad and thus add to their own formal qualifications through cultural insights and new language skills.

Flexibility and mobility – these are decisive factors for success in the European labour market and thus the foundation for an economically strong, wealthy and stable Europe. What can be done to strengthen the national labour markets? Which reforms result in some labour markets being more successful than others? How can job searching across national borders be facilitated? The Konrad-Adenauer-Stiftung and the Centre for European Studies consider these to be central questions and want to drive the cross-country discussions between the worlds of politics, the economy, the sciences and social partners forward. We are providing a platform for this purpose in the form of a series of booklets entitled "The European Labour Market – Success through Mobility and Flexibility".

The first volume of this series examines the reform options for national markets by the example of Germany. Over the last decade, Germany has found a way of its own to equip its labour market for the challenges posed by globalisation. Dr Werner Eichhorst analyses the German jobs miracle, describes the most important reforms and illustrates the tasks that German economic policy has to contend with today.

We hope that you will find it interesting reading.

Dr. Michael Borchard

Tomi Huhtanen

Summary

Over recent years, the German labour market has undergone an astounding transformation. What was once a problem child has now become an international role model. For decades, Germany suffered from endemic structural unemployment and high numbers of long-term unemployed. It was particularly difficult for unskilled workers to find employment due to significant barriers that prevented them from entering the labour market. In the mid-2000s, a raft of reforms was introduced that resulted in the unemployment rate being halved, despite the difficult economic climate.

The German reform process was modelled on the successful reforms carried out in other countries, but at the same time it found its own path. It mainly followed the Anglo-Saxon model that involved less generous benefit systems and lower levels of protection against dismissal. It also pursued the model of "flexicurity" that combined a fully developed social security system with labour market policies aimed at activating the unemployed. Germany's reform package consisted of the "Hartz reforms" passed between 2002 and 2005 and the more recent "Agenda 2010". The main focus has been on activating job seekers and making the labour market more flexible.

The strategy of "activating" the unemployed was based on the carrot and stick principle. The stick involved shortening the period during which unemployment benefits could be claimed, combining unemployment benefits and social welfare payments and tightening up of the demands placed on benefits claimants. On the other side, the carrot involved providing more support to job seekers and employment agencies and overhauling many areas of labour policy.

At the same time, there was greater liberalisation of flexible working arrangements in order to increase the capacity of the labour market. Today, the increase in the number of temporary workers is causing some controversy. Temporary work has certainly allowed many long-term unemployed to gain a first foothold in the jobs market and the German economy has become much more competitive. But only a limited number of temporary staff then go on to get permanent jobs. The creation of mini jobs provided flexible and cheap part-time labour and these jobs were particularly popular within cost-sensitive areas of the service sector. However, people doing mini jobs generally have little chance of promotion and are usually paid low hourly rates. Regulations were also eased and incentives created to encourage people to become self-employed. However, there were very few changes in the area of fixed-term contracts and dismissal protection.

■ **An important factor in the recovery of the labour market was the way standard employment contracts were made more flexible.** Modernising collective bargaining agreements and making them more flexible, combined with a long phase of pay restraint, were crucial factors in improving the competitiveness of the German economy and making it more adaptable both during and after the crisis. Germany's successes in the area of employment policy are therefore not just down to reforms but are also the result of long-term developments within the private sector.

■ **However, despite the German labour market's new-found strength, today it finds itself facing new challenges.** Structural unemployment has been reduced and the employment threshold lowered. The more flexible labour market means that lower levels of economic growth are now needed to maintain or increase employment levels. In what has been a specifically German adaptation strategy, flexible working arrangements and wage restraint have given a major boost to the competitiveness of the German economy. At the same time, this increased flexibility in the labour market has led to a greater diversity of employment contracts and conditions. The wage gap has widened and there are wider variations in the degree of employment stability.

■ **Germany has become the poster boy of crisis management.** During the crisis it largely managed to maintain steady employment growth and in 2011 it even achieved a record high since reunification. Companies have made use of flexible working hours and the reformed instrument of short-time working to hold on to the majority of their staff during the crisis.

■ **Demographic change is bringing new challenges for labour market policy.** The shrinking working population makes it all the more essential to make the best possible use of the skills of the whole population. This can be achieved by ensuring that young people are given the best possible opportunities to gain skills and qualifications – no one should be left behind. It is also important to increase the number of working women and mothers by improving childcare provision and making working hours more flexible. There has already been success in the area of employment for older workers, but this should be increased still further by offering more training for older people and making efforts to create jobs that are suitable for older workers. There must also be a continuing focus on integrating the long-term unemployed and unskilled workers into the labour market by means of activation and skills-improvement programmes.

■ **Germany has found its own, very individual and very successful labour market model to face the challenges of globalisation.** But its success in Germany does not mean it can simply be transferred to other countries without modification. However, Germany's experiences can certainly help its European partners to find their own ways of reforming their national labour markets.

From Problem Child to Poster Boy

The 2012 statistics for the labour market in Germany will show that there has been a record level of employment this year and a fall in unemployment compared to the previous year. While the global economic crisis has led to a decline in economic activity and a huge increase in unemployment in most other industrialised nations, the German labour market has remained robust and has not suffered from massive redundancies. Other European countries in particular have been following these developments with interest and Germany is seen as a prime example of how to successfully adapt labour market institutions to changing economic circumstances. Following decades of criticism both at home and abroad and wide-ranging efforts to introduce reforms, the German labour market is now internationally considered to be an excellent model in many respects. This represents a remarkable change in the way Germany's development is viewed.

THE GERMAN LABOUR MARKET IN THE 1990S: ANTIQUATED STRUCTURES AND LARGE NUMBERS OF LONG-TERM UNEMPLOYED

Since the mid-1970s, unemployment in Germany has soared over the course of various economic cycles and has never managed to return to those earlier levels, even during times of economic boom. This endemic structural unemployment was characterised by growing numbers of long-term unemployed and significant barriers to people entering the job market, especially if they were not particularly well qualified. Because of the poor state of the labour market, especially in the mid-to-late 1990s, consistently high unemployment and a relatively modest rate of full employment in comparison to other industrialised nations were perceived as a sign of some fundamental weakness in the German economy. Antiquated labour market institutions and a too expensive social security system were seen as a threat to the competitiveness of those doing business in Germany and were blamed by some on "reform bottlenecks" (Manow/Seils 2000). Following reunification, Germany was seen by many both at home and abroad as the "sick man of the Euro" (The Economist, 3 June 1999).

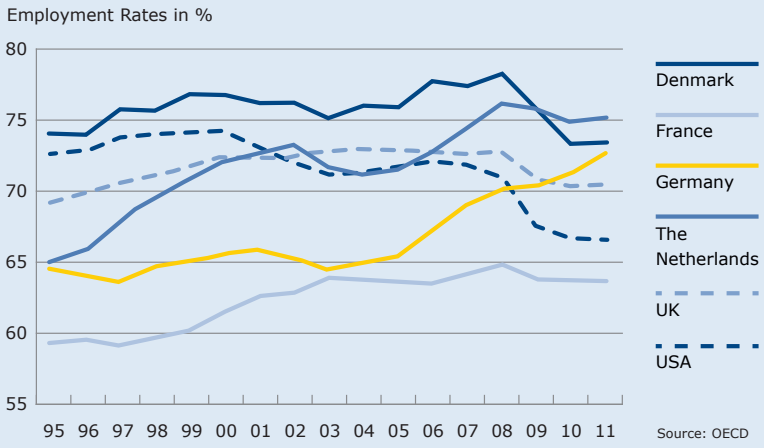
However, since the mid-2000s there have been clear signs of change in the German labour market. The overall employment rate for those of working age (15 to 64 years old) has risen from 65 percent to around 73 percent (Figure 1). At the same time, unemployment levels have nearly halved, despite generally difficult economic circumstances (Figure 2). This amazing change in the German labour market is the result of a number of reforms and developments over the last ten to fifteen years.

The German Reform Process: Learning From Role Models

In searching for ways of overcoming a protracted labour market crisis that involved large numbers of unemployed, a high proportion of long-term unemployed and levels of employment that were generally too low, Germany turned its attention to the experiences of other countries.

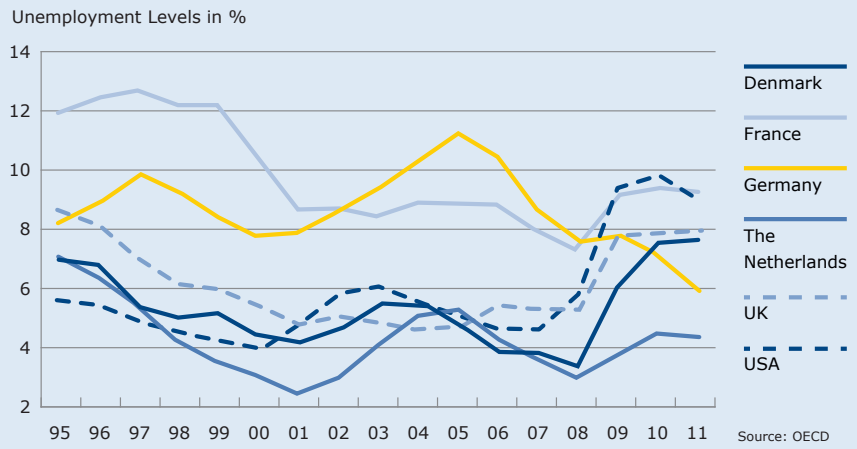
The OECD's employment strategy, which, as a result of comprehensive empirical analysis, favoured deregulation of labour markets as a way of increasing overall employment levels, was an important part of this process (OECD 1994). Implicit in this strategy was the suggestion that the Anglo-Saxon approach in the USA and Great Britain was an ideal model to follow. At the time, these countries viewed less generous benefit systems and lower levels of protection against dismissal as going hand-in-hand with a more dynamic labour market. The OECD Council believed that higher labour market flexibility could also lead to the creation of more jobs and lower unemployment rates elsewhere.

1 | Increasing employment



Nevertheless, no such Anglo-Saxon inspired deregulation policies were implemented in Germany or the majority of other continental European countries in the years that followed. One of the main reasons for this was that this type of reform strategy was con-sidered to be politically unacceptable, as it was perceived by the public as a system that fostered social inequality. Another reason was that the "employment miracles" taking place in the Netherlands, Denmark and Austria were attracting much more attention precisely because they were happening without massive deregulation. They were seen as proof that a high level of employment could not only be achieved but could also be compatible with a well-constructed welfare state and strict regulation. It was felt that a more generous benefits system was clearly compatible with a high level of employment as long as appropriate steps were taken to ensure that job seekers were actively looking for work with the help of targeted labour market policies. A fully developed social security system aimed at supporting active job seekers was also seen as a socially acceptable form of labour market flexibility that where necessary could also be combined with a watered-down form of dismissal protection along Anglo-Saxon lines. This concept, known as "flexicurity", attracted a great deal of interest throughout continental Europe.

2 | Decreasing unemployment



The intensive labour market and welfare state reforms that Germany carried out in the following years, i. e. from the beginning to the middle of the 2000s, owed a lot to these international models. However, the German version was neither a full-blown liberal Anglo-Saxon model, nor a comprehensive flexicurity strategy. It was more a case of following a path that best suited the country's own institutional conditions and political constellations.

The German reforms were therefore not pursued on the basis of some form of consensus with social partners, but as part of a clear initiative by the then red-green Federal Government. The labour market reforms, which were typified by the "Hartz reforms" between 2002 and 2005 and the "Agenda 2010", were largely a collection of more-or-less compatible individual measures that addressed specific problem areas within the country. The impact of these measures was to be clearly felt over the coming years, sometimes surprisingly so. The package of reforms covered two key areas:

1. A restructuring of unemployment benefits and the introduction of active labour market policies aimed at avoiding or shortening periods of unemployment and benefit claiming, and

2. The liberalisation of flexible forms of work in order to improve the capacity of the German labour market.

An "Activating" Welfare State: A Carrot and Stick Approach

The importance of putting specific limitations on benefit payments cannot be overestimated in terms of the activation policy applied to unemployment benefits. This is especially true of the following:

1. Shortening the period during which unemployment benefits can be claimed by older workers,
2. Combining means-tested and earnings-related unemployment benefits and social welfare payments as a means of providing basic security to job seekers of working age, but still at social welfare levels,
3. A stricter formulation and implementation of the demands placed on those receiving benefits, such as a duty to accept job offers and active labour market policy initiatives.

The German strategy of trying to "activate" the unemployed therefore has a combination of carrot and stick elements aimed at shortening periods of unemployment where possible (Eichhorst/Grienberger-Zingerle/Konle-Seidl 2008). A package of more comprehensive but also more flexible measures was put together for the long-term unemployed that could be adapted to the needs of the individual. Support for job seekers was also intensified and the employment services given a thorough overhaul. As part of the Hartz reforms, many labour market policy instruments were amended to make them more effective in helping people to assimilate more quickly into the labour market. For example, long-established re-training programmes were replaced by shorter training courses. In this, Germany was following the example of other countries. The basic principles of labour market and welfare policies designed to "activate" the unemployed, included stricter monitoring of their attempts to find work and imposition of stronger sanctions; the creation of a common point of contact for all (long-term) unemployed; the increased mobilisation of those responsible for implementing labour market policies; the agreement of targets and financial incentives; and the modernisation of the Federal Employment Agency. All these measures owe a great deal to the positive results achieved in the UK, Denmark, Switzerland and the Netherlands.

Making the Labour Market More Flexible

In order at the same time to improve the capacity of the labour market, the Hartz reforms also included greater liberalisation of flexible working arrangements: the so-called 'atypical' jobs. This predominantly had an impact on temporary employment, "mini jobs" and self-employment, without significant changes being made to temporary employment or to existing protection against dismissal for those in permanent employment.

TEMPORARY EMPLOYMENT

Temporary employment was significantly liberalised as part of the Hartz reforms, leading to a massive growth in employment in this area. Restrictions were lifted such as the ban on synchronising and setting fixed terms for employment contracts and allocation to temporary staff agencies and the upper time limit for hiring staff.

At the same time the principle of equal treatment for temporary and permanent staff was established – although exceptions could be made when recruiting unemployed people or in the case of collective bargaining agreements. The consequence of this was that for the first time ever the temporary employment sector was covered by collective bargaining agreements between employer associations and unions. However, pay scales could be significantly lower than those set out in the collective bargaining agreements already in place in those sectors that tended to employ the most temporary staff. This created an incentive for the industrial sector to shift some of its activities over to flexible and less well-paid workers.

The role of temporary employment in helping to better assimilate the unemployed into the labour market – one of the original goals of the Hartz reforms – also changed. The encouragement of temporary employment was justified by pointing to the example of the Netherlands, where it had been shown that placing temporary workers could help job seekers who might otherwise have little prospect of finding jobs to gain a foothold in the labour market and then potentially find a regular job due to the so-called "glue effect".

While the expectation that the long-term unemployed in particular would get an opportunity to enter the labour market has been largely fulfilled, there has been limited success in turning these opportunities into regular jobs. One obstacle is the fact that, in contrast to the Netherlands, there is no effective equality of treatment principle in Germany. The new collective bargaining agreements and the possibility of employing temporary staff indefinitely prompted the creation of pay structures that were lower than for those groups on standard pay scales. Temporary staff are therefore being used by many sectors as a way of creating long-term flexibility and reducing overall staff costs rather than as a way of recruiting permanent staff. Based on what we know today, there is little evidence that temporary work is providing a "wide bridge" to other more permanent working arrangements.

HISTORY OF REFORMS

TEMPORARY WORK

1997: Changes to the Temporary Employment Act
The provisions of the Employee Leasing Law (passed in 1972) are significantly relaxed. The maximum period for hiring out an employee is raised to 12 months. In specific cases, time limits can be fixed in accordance with special rules. Re-employing temporary employees is only permitted once.

2003: Hartz I
Deregulation: the time limit of the hiring period is raised and it is permitted to set a fixed time limit without any special ruling. Re-employing temporary employees in the same temporary capacity is permitted without restriction.
The principle of equality is also introduced to protect the temporary worker, i.e. the principle of equal pay/equal treatment comes into effect at the commencement of the temporary contract.

2011: Prevention of Abuse of Temporary Workers Act
Regulation: it is not permitted to replace permanent staff with temporary workers (revolving door clause); rules are introduced for establishing minimum pay levels in the temporary employment sector; companies employing temporary workers have an obligation to pass on information about vacant positions and to guarantee access to common facilities (company kindergarten, canteen, etc.).

However, temporary staff have proven to be a key factor for the German economy in improving competitiveness, especially for those companies in the export business. The additional flexibility and benefits in terms of overall staff costs has meant that many jobs have been retained in Germany that might otherwise have been lost abroad (Baumgarten et al. 2012, Eichhorst/Marx/Thode 2010, Lehmer/Ziegler 2010).

PART-TIME WORK AND MINI JOBS

Mini jobs existed in Germany long before the advent of the Hartz reforms. However, they became more widespread from 2003 onwards due to certain crucial changes being made. The earnings limit for a job that was exempt from contributions and taxes, now known as a mini job, was raised to €400 per month. At the same time, the restrictions on taking such a job to supplement one's income – put in place at the end of the 1990s – were lifted. The upper time limit for these jobs was also removed, so that longer working hours and lower pay became a possibility for this segment. Since then, mini jobs have become increasingly popular in specific sectors, such as retail and hospitality, as they represent a job model that is both flexible and relatively cheap for the employer. The exemption from tax means that people taking these jobs generally earn low wages and often face significant obstacles when it comes to getting more hours.

Mobilising the work potential of women became easier in the 2000s with the expansion of childcare provision. However, part-time work continued as before to dominate the work done by women, mostly because, in West Germany at least, full-time childcare is not readily available, and also because the laws relating to tax splitting for married couples as well as the option of mini jobs clearly favour part-time work. This applies equally to qualified women returning to work after raising children as mini jobs offer a good way of supplementing the family income, especially when faced with limited childcare opportunities. However, these jobs preclude the opportunity to further develop professional qualifications.

A fourth large group of mini jobbers are those who receive unemployment benefit II. The possibilities for people to supplement their income have been expanded as part of a social security system aimed much more at "activating" the unemployed. Since the new rules were put in place in 2005, it has become much easier than in the past to work without losing benefits. Basically, a form of combined income was introduced. This provided an incentive for people to supplement the benefits they were claiming with part-time work, and in particular with mini jobs. Prior to that there had been no real incentive for these people to do work that took them over the supplementary income threshold, as almost all of the additional money was taken into consideration in calculating their benefits.

The expansion of mini jobs has had a significant impact on the job structures of many cost-sensitive areas of the service sector such as the retail trade, commercial cleaning and the hospitality business. Mini jobs were designed as an instrument to create flexible and low-cost part-time working arrangements. However, the price paid for this move was the expansion of the low-pay sector and a lack of promotion prospects within the segment. The initiative also failed to really move jobs out of the informal economy into the official economy (Eichhorst et al. 2012).

SELF-EMPLOYMENT

Another area of reform was aimed at promoting self-employment in Germany. Liberalisation and the introduction of various measures were intended to make it easier for both the unemployed and those already in jobs to become self-employed. Existing obstacles to self-employment, for example, were lifted. In many trades it became possible to run a business without a master craftsman's diploma, while in other areas there was a relaxation of the strict definition of self-employment to distinguish it from paid employment. The opportunities for fixed-term employment contracts were also expanded for newly-formed companies.

Huge incentives were given to the unemployed to take up self-employed work in the shape of new business founder support as part of the Ich-AG initiative, which was later assessed as being particularly effective and relatively cheap (Caliendo/Künn/Wießner 2010).

FIXED-TERM CONTRACTS AND PROTECTION AGAINST DISMISSAL

The same applied to the employment of older workers on fixed-term contracts, something which has become much easier since the mid-2000s. However, there have been no further changes to the protection provided under employment law. Since 2000 the legality of fixed-term contracts has not changed and these types of contracts have actually grown in importance. The reforms introduced in 2000 limited repeated fixed-term contracts with the same employer without specific reason to a maximum of two years. There were also no significant changes made to the protection against dismissal laws. The last reform, which came into effect in early 2004, simply raised the threshold for applying the protection against dismissal laws from five employees to ten, simplified the social criteria for redundancy and introduced the option of a severance payment.

MODERN COLLECTIVE BARGAINING POLICIES AND INTERNAL FLEXIBILITY

However, labour market reforms are only one of the factors that go towards explaining the reduction in unemployment and the increase in the number of people employed in Germany. Apart from the changes in legislation, an important factor was the increased flexibility of standard employment terms and conditions. This longer-term adaptation of standard employment contracts has contributed significantly to the stabilisation of the number of people working in permanent employment after a period of contraction. This figure has actually shown some modest growth since 2006 compared to other forms of employment (Eichhorst/Marx 2011).

The modernisation and increased flexibility of collective bargaining agreements in Germany has been key to this success. There has been a significant change to the collective bargaining landscape since the mid-1990s for a number of reasons, including the declining competitiveness of German businesses, the relocation of businesses and jobs abroad and an ever-increasing unwillingness on the part of companies to become members of employers' associations. When it comes to

HISTORY OF REFORMS

PART-TIME AND FIXED-TERM EMPLOYMENT

- **1985: Employment Promotion Act**
  Deregulation: it is permitted to limit the term of an employment contract without a material reason to 18 months.

- **2001: Part-Time and Fixed-Term Employment Act**
  Deregulation: the time limit for fixed-term contracts without a material reason is extended to 24 months.
  Regulation: fixed-term contracts can only be offered to new employees and can only be ex-tended three times.

- **2003: Labour Market Reform Act**
  Deregulation: the time limit for fixed-term contracts without a material reason is extended to 4 and 5 years respectively for start-ups and employees over the age of 52.

MINI JOBS

- **1999: Marginal Employment Reform Act**
  Regulation: Introduction of social security obligation for employers and those working in marginal employment. The wage ceiling for marginal employment is no longer linked to national income development and set at DM 630 (West Germany) and DM 530 (East Germany).

- **2003: Hartz II**
  Deregulation: the wage ceiling is raised from €325 to €400 and the maximum number of working hours raised to 15 hours per week. The social security obligation is lifted for those working in marginal employment (mini jobs). A new mini job centre (Minijob-Zentrale) is set up to run the system.

2013: New regulations on marginal employment
Regulation: the wage ceiling is to be raised to €450. An obligation for employers to make pension contributions with the possibility of exemption is to be introduced in order to boost contributions on the part of employers.

SELF-EMPLOYMENT

2003: Labour Market Reform Act
Deregulation: the time limit for fixed-term contracts without a material reason is extended to 4 and 5 years respectively for start-ups and employees over the age of 52.

2003: Hartz II
Regulation: the Ich-AG concept is introduced, which grants allowances for setting up a business, even to those who are self-employed as a sideline.

2004: Third Amendment to the Trades and Crafts Act
Deregulation: the need to have a master craftsman's diploma is lifted for many trades so that it is possible to set up a business without the title of master craftsman.

2006: Advancement of Basic Security for Jobseekers Act
Regulation: Ich-AG and bridging allowance is combined into one single allowance.

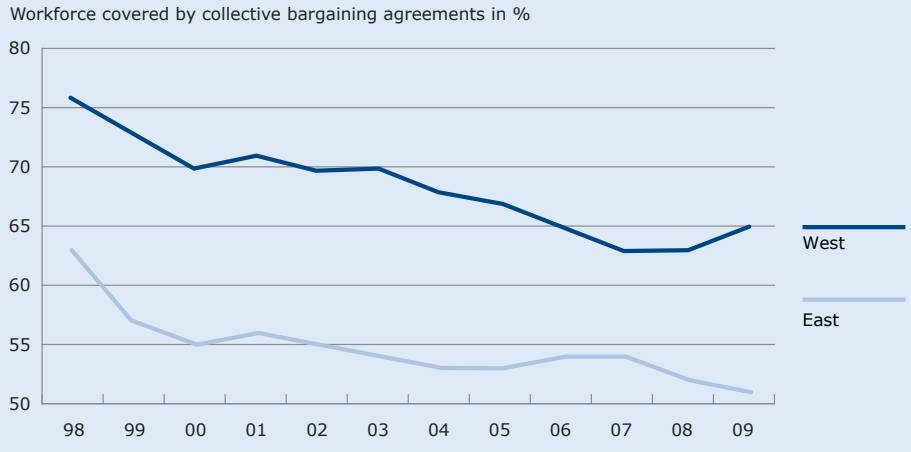
collective bargaining agreements, changes have been made in sectors such as the metal and electrical industries to allow for adaptations and deviations from agreed standards via special clauses [Öffnungsklausel]. This created more flexibility for businesses at company level when it came to pay and working hours. The unions and workers' councils within companies were prepared to make concessions in order to safeguard jobs in the predominantly unionised core workforces. This heralded the beginning of a long period of wage restraint from the mid-1990s onwards that in the medium term led to an increase in the competitiveness of export-oriented industries in Germany thanks to lower unit labour costs.

There was a growing acceptance of more flexibility on wages and working hours within those sectors covered by collective bargaining agreements and this was further enhanced by companies undertaking internal restructuring. This helped to stabilise employment numbers in the industrial sector and even allowed them to increase slightly thanks to the positive trend in German export activities.

However, it should be pointed out that the number of workers covered by collective bargaining agreements has actually declined (Figure 3). More and more sectors of the German labour market are not covered by these agreements, especially smaller, newly-established businesses in the private sector, where there is a great deal more flexibility when it comes to conditions of employment. And in general such companies tend to have management and remuneration policies that are much more oriented towards performance and results.

Germany's successes with regard to employment policy are therefore not just down to government labour market reforms but are also the result of changes in the relationship between the parties to collective bargaining agreements and broader, more long-term developments within the private sector.

3 | Collective bargaining agreements on downward trend



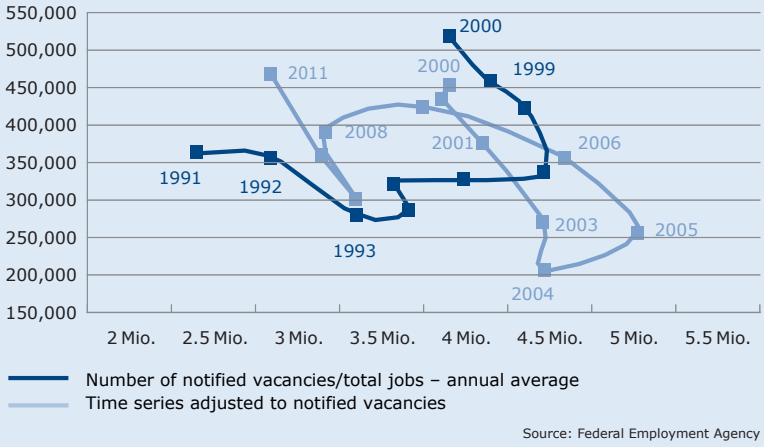
Source: WSI-Tarifarchiv 2011 Statistisches Taschenbuch Tarifpolitik

The German Model: New Strengths, New Challenges

A LOWER EMPLOYMENT THRESHOLD

The intensive reforms introduced between 2002 and 2005 made the German labour market much more dynamic. After 2005, a great many more jobs were created than in previous years, in parallel with the economic upswing. This was accompanied by a drop in the unemployment rate. These are remarkable structural improvements. Germany has succeeded in halting its structural unemployment problems while at the same time lowering the employment threshold. With a much more flexible labour market, the amount of economic growth needed to keep employment levels stable or to allow them to grow is now lower than before the reforms were introduced.

4 | A better functioning labor market



It is this lower employment threshold that accounts for the significant expansion in the number of people in employment since 2005 and the generally favourable progress made during the crisis years. The so-called Beveridge curve, which shows the relationship between unemployment and the number of unfilled vacancies, serves to highlight this development. A shift to the left demonstrates an improvement in the efficiency of the labour market. This has been the case in Germany in recent years, whereas previously the progress was in the opposite direction and suggested there were significant underlying structural problems. (Figure 4)

WIDER RANGE OF EMPLOYMENT CONTRACTS AND A BROADER REMUNERATION STRUCTURE

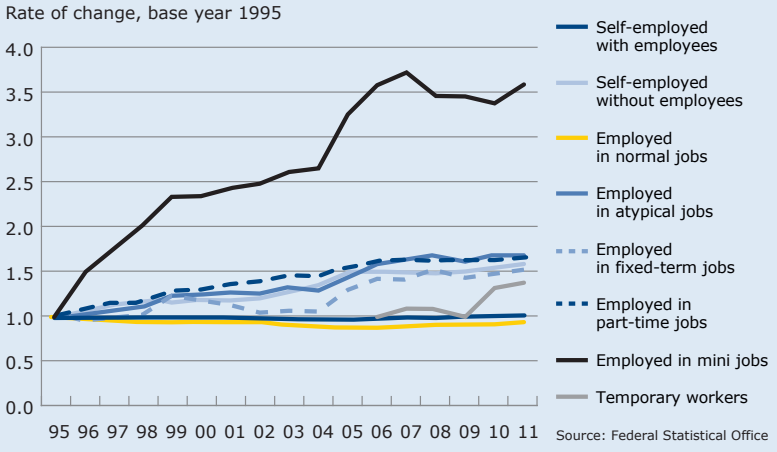
Up until the end of the 1990s, political and academic debate was focused on the country's high unemployment and the low numbers of people in gainful employment, i. e. the divide between the working population and the unemployed. This situation has now fundamentally changed. Germany has succeeded in integrating significantly more people into the labour market, and as a result it is now the differences within the labour market itself that are the subject of debate. A critical eye is particularly being cast over the growth in low-paid work and the growing number of new employment contract types that offer less stability than standard permanent employment contracts.

In principle, these atypical types of job have made a significant contribution to the fact that many more people have been able to gain a foothold in the German labour market than in the past. There have also been changes in Germany that have been slow to take effect compared to other countries and that have only started to have

an impact in the last ten years or so. Figure 5 shows the growth in various forms of employment since the mid-1990s, with those in permanent full-time employment remaining stable as a group since 2000.

Atypical forms of work are often associated with lower pay and more insecurity for those involved. However, not all atypical jobs can be considered "precarious". Part-time jobs, for example, are normally long-term and fully covered by collective bargaining agreements and social security provisions. Fixed-term contracts are often used as extended "probation periods" and very often lead to a permanent position. However, it is in the area of temporary work, mini jobs and self-employment where there is a relatively higher risk of low pay and a lack of stable work.

5 | Different forms of employment in Germany



At the same time, the wage gap has been widening in Germany, even for full-time jobs, and the situation is now similar to that of the UK. This trend towards a growing income gap between those at the top and those at the bottom is closely linked to the fact that fewer workers are now covered by collective bargaining agreements and many more jobs are now in the private sector, where collective bargaining agreements are less common and where the kind of atypical jobs described above are much more widespread. Wage differentiation is much more pronounced in those sectors where there are fewer collective bargaining agreements, and atypical jobs are generally associated with lower pay than is the case with standard employment contracts (see Figure 6 and 7).

6 | Proliferation of low-paid jobs

Percentage of low paid workers by job and contract type, 2010

	Over-all	Normal employ-ees (full time and part time over 20 hours)	Atypical jobs	davon			
				Part-time	Fixed-contract	Mini jobs	Tempo-rary
Overall	20.6	10.8	49.8	20.9	33.5	84.9	67.7
Academic jobs	3.0	1.0	10.5	3.5	5.7	64.9	n.a.
Technical and similar non-technical jobs	7.6	4.0	24.9	4.7	17.3	68.1	29.2
Office jobs	23.4	10.9	48.1	13.2	39.4	80.3	62.5
Service and sales jobs	42.3	28.4	65.4	30.0	58.3	88.6	72.1
Trades	16.1	11.1	48.7	32.6	31.3	81.0	47.6
Machine operators	23.7	17.1	60.6	33.2	39.7	89.3	63.0
Unskilled labour	61.5	39.7	79.2	56.3	70.7	90.3	89.2

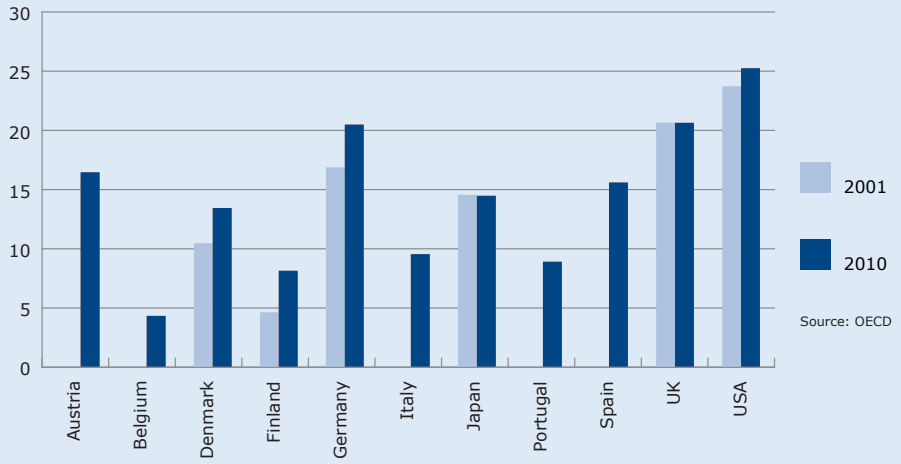
Source: Federal Statistical Office. Low pay threshold of two thirds of the average pay

COMPETITIVENESS THROUGH JOB FLEXIBILITY AND WAGE RESTRAINT

The German economy has become significantly more competitive in recent years. It has been able to keep unit labour costs stable or even reduce them (Figure 8). One reason for this has been sustained productivity gains combined with ongoing wage restraint. Increased flexibility of working hours using short and long-term flexitime systems have helped companies to return to being internationally competitive. This increase in competitiveness through moderate wage demands and more flexible working hours is much higher than that seen in other countries over recent years and reflects a specific German strategy.

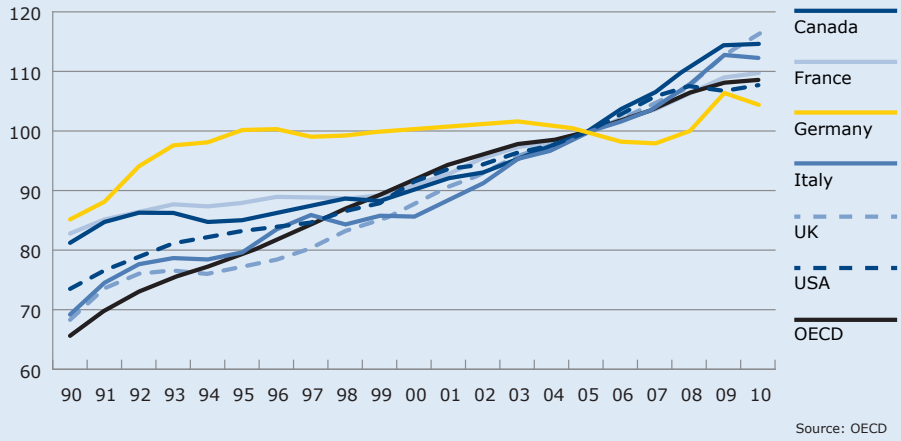
7 | Low-wage workers

People in full-time employment on less than two-thirds of average pay in %



8 | Constant unit labor costs

Comparison of international unit labour costs, base year 2005



WORKING TIME ACCOUNTS

Short-term: In this model, additional hours worked are not recompensed with money, but form part of a flexible weekly working hours system. Entitlement to compensation is often limited to one year. This type of system allows employers to be able to react more effectively to short-term fluctuations in demand. The short-term model is practised in 29 percent of all companies.

Long-term: In this model, additional hours worked are credited to a long-term account. Any time accumulated over the employees working life can be used for extended periods of leave, e.g. sick care, raising children, sabbaticals or early retirement (at present the most popular use of the system). Currently only 2 percent of all companies use this system (generally larger organisations).

Germany as a Role Model for Crisis Management?

Germany has performed remarkably well since the global financial crisis of 2008. It is practically the only country that did not experience a massive rise in unemployment. In fact the country was able to keep the growth in the number of people in work relatively stable and in 2011 actually reached the highest level of employment since reunification.

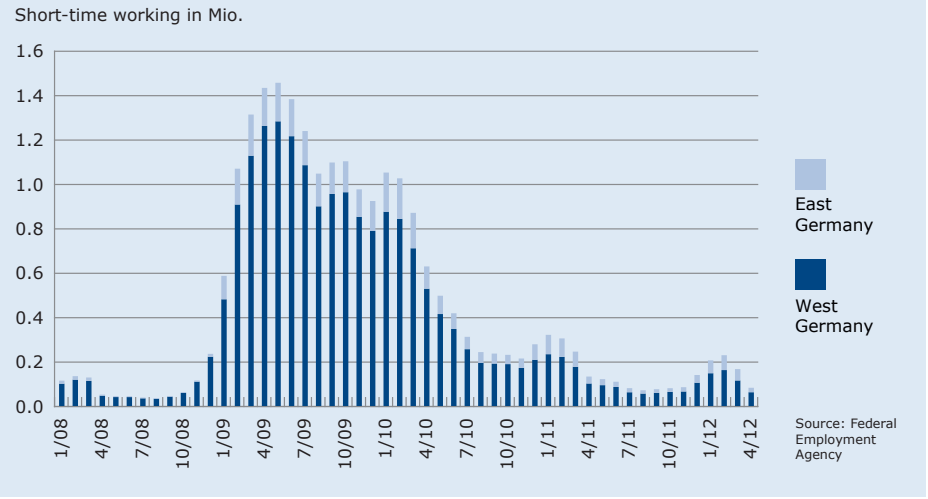
This successful management of the economic crisis with only minor negative consequences for the labour market is mostly down to increased flexibility in terms of working hours and pay, along the long-established principle of short-time working.

Germany can be considered a pioneer in the use of flexible working hours and short-time working as these instruments were developed earlier and used more extensively than in other countries. By making a few small adjustments and promoting short-time working when the crisis was at its most acute, the country was able to safeguard its experienced workforce during the difficult year of 2009, especially in the export-oriented industries.

THE USE OF FLEXITIME

The years leading up to the crisis taught companies that finding new skilled staff would become ever more difficult because of demographic change. At the same time, businesses were only expecting a short-term slump in orders. It was therefore in the best interests of companies to hold on to as many of their staff as possible in order to be able to return to former production levels once the upturn began. Added to this was the fact that there were now limited opportunities for early retirement following

9 | Short-time working



reforms to the labour market. As a result, reducing employee numbers would have actually been much more expensive than in the past.

In order to hold on to their staff, companies turned to more flexible working hours. Cutting overtime that had been accumulated before the crisis and balancing flexitime accounts were important factors in helping to overcome the crisis. (Möller 2009, Rinne/Zimmermann 2012).

SHORT-TIME WORKING

Short-time working has existed in Germany for many years, and it became even more attractive to companies at the beginning of the economic crisis due to several reforms that were introduced. For employers in the export industries in particular, short-time working offered an ideal way for companies to hold on to their skilled staff.

In Germany, short-time working is financed by unemployment insurance contributions and makes up around two-thirds of the loss of earnings due to reduced hours, roughly the equivalent of receiving unemployment benefits. In order to help overcome the crisis, the maximum allowed time for short-time working was extended and employers who resorted to short-term working were also exempted from social security contributions for the hours that were not worked.

According to OECD estimates (OECD 2010), around 350,000 jobs were saved in industry thanks to short-term working, but a similar number of temporary workers lost their jobs. So as a flexible form of employment, temporary work made a significant contribution to overcoming the crisis (Figures 9 and 10).

10 | Boom in short-time working

Source: Federal Employment Agency

SHORT-TIME WORKING

Short-time working has been an established business practice in Germany for decades. Under this system, companies affected by short-term slumps in demand can transfer employees onto shorter hours in order to reduce labour costs. A proportion of the employees' loss of earnings is made up by the state in the form of short-time compensation payments. As a result of special provisions introduced between 2009 and 2011, short-time working was used more than ever by companies affected by the most recent economic crisis. Since then there has once again been a fall in the number of people on short-time working.

A New Challenge for Labour Market Policy: A Shortage of Skilled Staff

After the traditionally very high levels of unemployment had been significantly reduced and the number of people in work had increased, there was then a need to shift the political focus. Education and training policies have become more important in helping to revitalise the economy, in conjunction with labour market reforms.

Demographic changes will lead to the labour market potential shrinking by around 18 million by 2050. This combined with the shortage of skilled labour that is already being felt in some professions, especially in science, engineering technology, medicine and nursing, means it is essential to focus on training and mobilising all available skilled workers. The key to this will be training younger people and encouraging the increased participation of women and older people in the labour market. The main thing is that the majority of positions continue to be successfully filled, even if the hiring process may in some cases take longer than in the past.

GETTING YOUNG PEOPLE INTO WORK

In order to successfully enter the labour market, it is absolutely essential for young people to gain general academic and professional qualifications. This minimum level of qualifications is indispensable for gaining a permanent foothold in the job market.

Therefore the challenge for education and training policy lies in finding ways to maximise young people's professional potential and produce as many well-qualified job starters as possible. This approach of investing in potential can help to avoid problems later on in young people's working lives and their integration into society. In light of Germany's somewhat poor or average position in OECD comparative education rankings there is a growing recognition of the importance of education and training, something that has been heavily influenced by the successes seen in Scandinavia. Since the "PISA shock" of 2011, there has been discussion in Germany about following the example of Finland and other countries by focusing on more intensive education for young children and placing greater emphasis on skills training in schools.

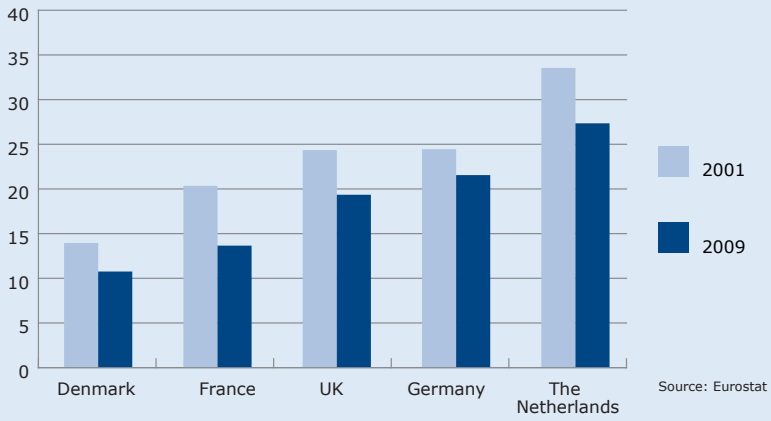
The comparative education studies suggested that there were several major steps that needed to be taken in Germany in order to improve the skill levels of its schoolchildren, including promoting pre-school education for children from more problematic family backgrounds and particularly for children from migrant families; the expansion of all-day schools; systematic setting of targets and educational standards and a longer period of general education. The conclusions drawn from the studies were also to some extent based on Germany's own interpretation of the data. However, in the area of early learning and skills training in schools, it is more difficult to implement structural changes because federal jurisdiction and funding makes it harder to introduce coordinated reforms. Reforming the early learning system will only succeed if the necessary reforms are introduced at national level.

WOMEN IN THE LABOUR MARKET

Even though progress has been made in the number of women and mothers in work, there is still room for improvement. In terms of full-time equivalents in particular, Germany still lags behind many other countries (Figure 11). There is plenty of potential in the area of shorter career breaks after starting a family and in increasing working hours through mini jobs and part-time work. The provision of family allowances, based on the Swedish and Danish models, has already provided incentives to shorten career breaks to around twelve months and has encouraged fathers to share the parental leave. As a result, there has been a growth in demand for reliable, affordable and high-quality childcare – with elements of early learning included – from the age of one onwards. For children of kindergarten age, the focus has been on extending opening hours, not only to make it easier for parents to work, but also from an educational point of view. All-day schooling, as is already the norm in many European countries, and which is currently being expanded in Germany, can help parents to fill childcare shortages and ensure that schoolchildren receive more intensive teaching. Education policy and childcare are therefore complementary approaches, as can be seen by the example of the Scandinavian countries and France.

11 | Female labor force potential

Women lag behind men in terms of full-time equivalent employment in %



There is also a need to play catch-up in terms of making working hours more flexible – not just based solely or primarily on operational requirements but also in order to fit in with the needs of families, something that has so far not been a major focus in Germany. In order to bring more women and mothers into the labour market, it is also important to remove incentives not to work or to only work part-time. The German model of joint income tax assessment with a choice of tax classes and the possibility of taking a tax and contributions-free mini job does not provide a great incentive. In most other European countries, spouses are assessed individually for income tax and there is no special treatment of mini jobs. By removing incentives to work part-time, particularly in mini jobs, many very low-paid jobs would become less attractive.

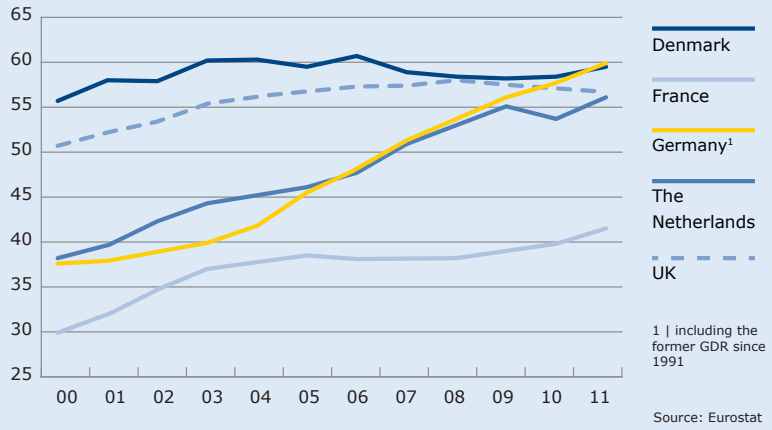
WORKING LONGER IN GOOD HEALTH

In recent years Germany has significantly increased the number of older people in work (Figure 12). This is primarily down to a reduction in early retirement opportunities under unemployment insurance provisions and the country's pension system. This is an area where Germany has reacted earlier and more decisively than many other countries. In contrast to other countries, incapacity to work or long-term illness are not taken into account when it comes to early retirement. Germany was also the first EU member state to raise the official retirement age from 65 to 67. This could eventually lead to the introduction of a generally more flexible retirement age along the lines of the Finnish model. A longer working life

will make it necessary to create a workplace that is adapted to different age groups and will require providing the workforce with systematic training opportunities. Many companies in Germany have already adopted this approach, though the practice is more widespread in Scandinavia and Austria.

12 | More older people in employment

Employment rates for older employees (55–64 years old)



1 | including the former GDR since 1991

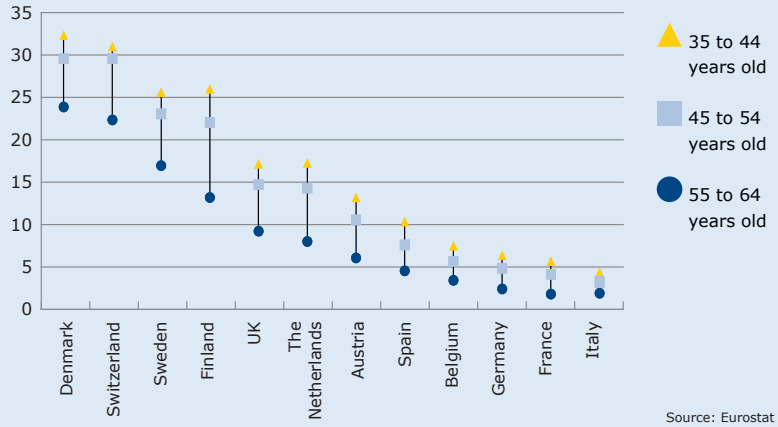
Source: Eurostat

Training for older employees has been somewhat neglected in Germany. Employers tend to focus their training efforts on younger, highly-skilled staff (Figure 13). As time goes by, employees can end up with a lack of appropriate skills, especially those who were not so highly qualified to begin with, and this can make their working lives more difficult in the medium term. Although demographic changes mean that employers are likely to pay more attention to this particular group of employees, it would also make sense to provide public funding to train employees who are left out of employer training programmes.

EMPLOYMENT OPPORTUNITIES FOR THE LOW-SKILLED AND THE LONG-TERM UNEMPLOYED

13 | Lack of further trainings later in life

Participation in training by age (2011) in %



Source: Eurostat

There is still a significant problem when it comes to the long-term unemployed and people with few qualifications or skills. At the bottom end of the labour market it is not so much about increasing the numbers of people employed as about maintaining employment stability while improving upward mobility. Unfortunately, comparisons with other countries do not provide any ideal models when it comes to measures designed to ensure that every group has an opportunity to advance. The general approach continues to be programmes designed to activate the unemployed and improve their qualifications based on their individual circumstances and needs. Generally speaking, full-time jobs continue to carry less risk of poverty and offer more opportunities to advance than part-time jobs, which tend to require "topping up" with benefits.

Careful regulation around the edges of the labour market can help to improve the situation of those in work without unduly affecting the dynamics of these areas or limiting the possibilities for advancement during a person's working life. While a minimum wage is no patent solution to low-paid work, it can be highly effective in setting a minimum level for pay without burdening the labour market too severely. A moderate minimum wage would therefore be preferable to a minimum threshold under collective bargaining agreements, because minimum wages have been introduced into a growing number of economic sectors in recent years. One solution could be that adopted by the UK, where a minimum wage was introduced at a

modest level and is regularly reviewed by an independent body. Such independent fixing of minimum wage levels could help prevent ever higher minimum wages being agreed in individual sectors through collective bargaining and would also cover those sectors in which there are no collective bargaining agreements. Another challenge that has to be faced is the difference in pay levels between temporary work and direct employment. It would be expedient to systematically narrow the pay gap between these two groups in line with the length of time employed, as is already the case in many EU countries and in the metal and electrical industries, where the practice has been introduced as part of collective bargaining agreements.

14 | Overview: The German labour market, 2007 to 2012

	2007	2008	2009	2010	2011	2012 forecast
Real GDP, %	+3,3	+1,1	-5,1	+4,2	+3,0	+0,6
Change in productivity per hour worked, %	+1,7	-0,1	-2,5	+1,8	+1,6	+0,2
Hours worked, %	+1,6	+1,2	-2,7	+2,3	+1,4	+0,3
Employment rate, %	+1,7	+1,2	+0,1	+0,6	+1,4	+1,2
Number of people in employment, 1,000s	39,857	40,348	40,370	40,603	41,164	41,644
Number of people in employment liable for social security contributions, 1,000s	26,943	27,510	27,493	27,756	28,440	29,002
Number of people unemployed, 1,000s	3,760	3,258	3,415	3,238	2,976	2,897
Unemployment rate, %	9.0	7.8	8.2	7.7	7.1	6.8
People in temporary employment, 1,000s	715	761	626	793	882	n.a.
People on short-time working, 1,000s	68	101	1,144	503	148	118

Source: Federal Employment Agency; Fuchs et al. 2012

Conclusion

In recent years Germany has found its own unique, remarkably pragmatic and sustainable, if not perfect, way to adapt to the demands of technological and structural change in a globalised economy.

This model is clearly sustainable and successful, at least as far as Germany is concerned, but would not be easy to transfer to other countries without modification as it relies on a specific combination of labour market and social policies on the one hand, and on wage and working hour flexibility on the other, while according a central role to those involved in individual business sectors and companies.

The driving forces behind the governmental reforms to the labour market were the problems associated with the funding the welfare state and the expectation that high unemployment would be overcome. The driving force for companies was above all gaining greater competitiveness by exchanging long-term, stable employment levels for more flexible pay conditions and working hours.

Labour market reforms in particular were in part inspired by examples from abroad, which were then creatively adapted to suit the situation in Germany. The same applies to its education and training policies, which are recognised as being key components of any necessary reforms but which are yet to be implemented in full.

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