

## OECD: Economic Survey - Germany 2004

### Increasing the capacity of the economy to create employment

#### How should labour market reforms proceed?

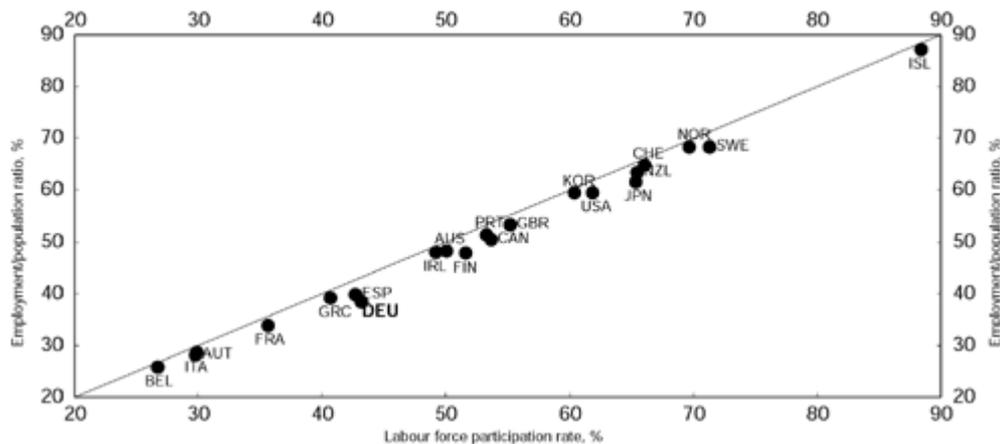
The weak capacity of the German economy to create more employment from economic growth stems from a complex interaction of various factors affecting the demand for and supply of labour with the wage setting system. While overall wage restraint has helped to improve competitiveness and contributed to price stability, wage formation is not flexible enough to prevent the various supply and demand constraints from affecting employment. Although work incentives have been improved, benefit programmes still induce older workers to withdraw from the labour market while high social security charges and cumbersome regulations add to the labour costs employers are facing. The education system is not sufficiently meeting skill requirements of job market entrants, increasing structural unemployment. Some significant steps of labour market reform have been made, and first initiatives have been taken to increase the efficiency of the education system. While this marks progress, reform needs to continue and further measures - explained in more detail below - are necessary.

#### Which barriers to supply labour and take up jobs need to be lifted?

Significant barriers to effective labour supply exist for older workers and second wage earners, in particular women. At present extended eligibility periods for unemployment benefits without obligation to search for a job for unemployed aged 58 and older serve as a channel into effective early retirement. From 2006 onwards the extended duration of unemployment insurance benefits for older unemployed will be cut significantly and older new unemployed will also be subject to job search requirement. While this marks substantial progress, significant age-related extensions of benefit duration and exemptions from job search requirements for the stock of older unemployed will remain. Second earners face larger average effective tax rates than single earners, mostly affecting women with full-time working partners. Households with dependent children find it difficult to reconcile work and family as long as proper child care facilities are lacking. The availability of free healthcare co-insurance for non-working spouses distorts incentives against working. Disincentives to higher labour supply should be removed by the following measures:

- The possibility of stricter application of job search requirements regardless of age should be considered, and the impact of ending the preferential extended duration of entitlement for the older unemployed should be assessed.
- Personal income taxation and child benefits should be reformed so as to minimise distortions of labour-leisure choices across different household situations and average effective tax rates on labour income of secondary earners should be reduced.
- Resources for child support should be reallocated to some extent from cash to in-kind benefits like child care vouchers.
- Introducing charges for healthcare co-insurance for non-working spouses should be considered.

### Participation and employment rates for 55-64 year olds, 2002 <sup>1</sup>



<sup>1</sup> Participation and employment rates are, respectively, labour force and employment of persons aged 55-64 years divided by population aged 55-64.

Source: OECD, Labour Force Statistics; for EU member countries data is from the European Labour Force Survey.

Important steps have been taken to increase incentives for taking up employment. In 2005 unemployment assistance will be combined with social assistance into one single means-tested benefit, and job acceptance criteria will be sharpened. This organisational reform of the Labour Office needs to be properly implemented; and reform widened, in particular:

- The present legislation, which gives the local authorities the option of administering the new benefits and placement services instead of the Federal Labour Agency, should be rethought, as it would compromise the potentially large efficiency gains that could be achieved from having only one agency administering a unified set of placement services and means tested benefits. Instead only one agency should be involved.
- Initiatives to strengthen activation strategies providing counselling advice and support services associated with appropriate sanctioning should be pursued further.
- Active labour market programmes should be rigorously evaluated as foreseen and measures that are not effective should be immediately discontinued.
- First steps to provide labour offices with adequate resources and qualified personnel are welcome and should be pursued further while performance incentives for their management should be extended.

#### How should the labour market become more flexible?

Progress has also been made in increasing the flexibility of labour markets. A number of measures reduce the restrictiveness of dismissal protection, in particular the range of social criteria that employers have to take into consideration in dismissal decisions has been reduced and the threshold number of employees above which dismissal protection legislation becomes binding has been increased from 5 to 10 employees. It remains to be seen whether these changes will reduce the legal uncertainty associated with the present legislation. Measures to increase labour market flexibility should include:

- Evaluating the impact of recent reforms of EPL and considering further easing accordingly. Specifically this might include allowing the option of not adopting dismissal protection provisions as part of the work contract after a probationary period in exchange for higher severance pay and raising further the threshold of applicability of dismissal protection.
- Widening the scope for wage determination at the company level so as to better align wage contracts with labour market conditions.
- Further confining the administrative extension of collectively bargained contracts to minimum wages and a minimum standard of working conditions.
- Discontinuing the practice of conditioning public procurement by Länder on firms paying wages according to local collectively bargained wage rates.
- Evaluating the impact of support for low paid jobs on labour supply and training and considering tighter targeting on benefit recipients.

Germany has low youth unemployment in international comparison, due to a relatively efficient school-to-work transition. However, excess demand for traineeships in recent years has led to serious concerns about rising youth unemployment. A contribution and subsidy scheme has been considered as a possible measure to increase the supply of apprenticeships at times of excess demand. As such schemes would increase non-wage labour costs, which are already high, alternative measures were sought to address the market imbalance between supply and demand directly, resulting in a voluntary agreement of the industry to supply 30 000 additional apprenticeship places. This measure should be supported by allowing for a higher degree of flexibility of pay for trainees and reducing training costs to enterprises. Furthermore, efforts should continue to update training requirements and improve the attractiveness of apprenticeships by an increased flexibility in training periods.

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