

Internationale Arbeitsmarktkonferenz

## **Wege zu mehr Beschäftigung**

International labour market conference

## **Ways and means of increasing employment**

5. September 2000  
Hannover (Expo 2000)

Dieter Sadowski

### **Employment review: Germany**



Institut für Arbeitsmarkt- und Berufsforschung

## „Employment Review: Germany”

Statement for the Panel “Employment Policy Can Be Successful” at the International Labour Market Conference Expo 2000, September 5, 2000

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Although recent labour market developments in Germany are somewhat encouraging, it is not at all clear, whether they are caused by a favourable business cycle or a new trend. The distinction between trend and temporary shock is even more important, though not at all evident, when the performance of the German labour market institutions is to be judged after unification. No other western economy had to cope with such a shock, and the uncertainties of that transformation were huge for all market participants and political actors. Expectations then were high-flying, today disappointment and impatience might prevent a sober look on the achievements and the institutional capacity of a still mildly corporatist country.

I shall provide basic figures by stressing trends more than singular situations along the outline for the review given to us. I mainly select data from IAB, EU and OECD statistics, where anyone interested in a fuller picture must turn to. Eastern and western German labour markets pose different problems, if not in nature, then in intensity. Methodically, I shall stress variation and ambiguities, because actors are no less hampered by them than scientists, and they are as much inclined to avoid the uneasiness of uncertain knowledge by indulging in unjustly firm convictions or prejudices.

### Labour Market Situation

#### Unemployment

*Standardised Unemployment Rates (%), based on a five-year moving average<sup>1</sup>:*

1989: West Germany:	6.4	NL: 7.8	UK: 9.9	US: 6.2
1999: Germany :	9.1	NL: 5.1	UK: 7.3	US: 4.9

Currently, 8.5 % west Germans are unemployed, and 17.1 % east Germans, the trends being positive for western Germany, in the east only labour market measures prevented a further deterioration.

*Long term Unemployment (as % of total unemployment, based on a five-year average)<sup>2</sup>*

1985-1989: West Germany:	48.1	NL: 53.3	UK: 45.2	US: 7.9
1995-1999: Germany :	50.2	NL: 48.3	UK: 37.6	US: 8.8

*Long Term Unemployment (as % of labour force, annual data)<sup>3</sup>*

<sup>1</sup> Bertelsmann Stiftung (Hrsg.) Internationales Beschäftigungsranking 2000. Gütersloh: Verlag Bertelsmann Stiftung 2000, p. 286

<sup>2</sup> Bertelsmann Stiftung 2000: 276. Auf die Unterschätzung durch Bestandszahlen verweist W. Karr, MittAB 1997.

<sup>3</sup> Europäische Kommission: Beschäftigung in Europa 1999, 127ff.

1990: West Germany: 2.2 NL: 2.9 UK: 2.5  
 1998: Germany : 4.9 NL: 1.9 UK: 2.1

*Youth Unemployment (as % of population aged 15-24)*

1990: West Germany: 2.7 NL: 5.0 UK: 7.7  
 1998: Germany : 4.9 NL: 5.1 UK: 9.1

*Male vs. Female unemployment (as % of male and female labour force resp.)*

1990: West Germany: 4.0 / 5.9 NL: 4.3 / 9.1 UK: 7.4 / 6.6  
 1998: Germany : 8.9 / 10.2 NL: 3.0 / 5.2 UK: 7.0 / 5.5

*Unemployment according to age groups (as % of total employment, Sept. 1999)<sup>4</sup>*

Age group (years)	Western Germany	Eastern Germany
< 29	11.0	11.8
25 - 45	43.8	43.9
45 - 55	20.7	22.4
55 - 65	24.3	21.7

*Unemployment rates according to educational attainment<sup>5</sup>*

Educational Level	Western Germany		Eastern Germany	
	1991	1998	1991	1998
Without formal education	12.8	23.3	31.0	53.5
Apprenticeship	3.9	6.9	12.5	18.6
Technical College	1.9	3.6	7.1	5.9
Polytechnic	2.5	2.4	6.8	3.8
University	3.5	3.5	7.3	5.2

*Unemployment rate for foreigners (1998)<sup>6</sup>*

Germany: 11.7 Western Germany: 17.3 Eastern Germany: 2.3

*Unemployment rate of handicapped people (1998)<sup>7</sup>*

Germany: 4.7 Western Germany: 5.7 Eastern Germany: 2.5

<sup>4</sup> BA (2000): Strukturanalyse 1999. Amtliche Nachrichten der BA –Sondernummer 48. Jg.: 116, 194.

<sup>5</sup> Reinberg, Alexander (1999): Der qualifikatorische Strukturwandel auf dem deutschen Arbeitsmarkt. MittAB: 32:434-443.

<sup>6</sup> BMAS (1999): Arbeits- und Sozialstatistik – Hauptergebnisse 1999. Bonn: 62f

<sup>7</sup> ibid. 71f.

*Modified comparable unemployment rates in 1996*

	Rate of registered unemployed (Eurostat)	Comparable unemployment rate (Eurostat)	Unemployment rate including labour market measures	Enlarged unemployment rate (OECD)
Germany	10,5	9,6	11,9	15,0
Denmark	8,5	6,9	11,7	20,5
Netherlands	6,0	6,3	7,3	15,6
Sweden	8,1	10,0	13,9	14,8
US	7,4	8,2	9,2	12,9

Source: J. Fuchs IAB – 2000

*Underutilisation of the labour force in 1996*

	Discouraged workers 1996	Involuntary part-time 1996	Reserve labour force (IAB) 1995
Germany	1,4	0,5	6,7
Denmark	na	na	na
Netherlands	0,5	(low)	8,2
Sweden	1,6	(high)	na
US	(0,9)	(5,0)	na
United Kingdom	0,5	1,3	7,2

Source: J. Fuchs IAB - 2000

*The Rate of Unemployed incl. those in Labour Market Measures (as % of Labour force)<sup>8</sup>*

1991: Western Germany:	7.9	Eastern Germany	29.5
1997:	12.9		27.1

The regional distribution of underemployment reaches a maximum in some eastern German regions, eg. in Staßfurt and Pasewalk, the underemployment rates amounted to more than 33%.<sup>9</sup>

As to the *reserve labour force* (discouraged workers) different degrees of labour market proximity are distinguished. Based on survey research (Socio-Economic Panel – SOEP) Holst (2000:206) estimated for 1996 the following percentages<sup>10</sup>:

Reserve labour force (% of total labour force)	Western Germany		Eastern Germany	
	females	males	females	males
Strongly employment prone	2.9	1.9	1.7	2.8
Weakly employment prone	3.8	1.6	0.4	0.5

## Employment

*Employment growth annual rate of change, five year average)<sup>11</sup>*

1985-1989: West Germany:	1.0	NL: 1.9	UK: 2.1	US: 2.2
1995-1999: Germany :	-0.2	NL: 2.7	UK: 1.2	US: 1.6

From 1994 to 1998, the growth of *Angestellten*-Jobs, in particular for those with intermediate skill levels, in Germany stayed considerably below the EU-average, the same holds for unskilled *Arbeiter*-Jobs. The opposite is true for the UK (Europäische Kommission 1999: 101). Elsewhere, in particular women entered the labour market, a development not observed in Germany.

<sup>8</sup> Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung: Jahresgutachten 1999/2000, 236

<sup>9</sup> Koller, Martin / Barbara Schwengler (1999): Vorranggebiete der regionalen Arbeitsmarkt- und Strukturpolitik. MittAB 32: 564-602, 573

<sup>10</sup> Holst, Elke (2000): Die Stille Reserve am Arbeitsmarkt. Berlin: edition sigma, Die Größenordnungen sind ähnlich den anders gewonnenen Schätzungen des IAB zum Erwerbspersonenpotenzial.

<sup>11</sup> Bertelsmann Stiftung 2000: 284

*Employment Rate (as % of labour force)<sup>12</sup>*

1990: West Germany:	65.9	NL: 62.2	UK: 72.4
1998: Germany :	55.2	NL: 68.3	UK: 71.4

*Part-time Employment ( as % of all employed , in brackets : male part-timers)*

1990: West Germany:	15.2 (2.6)	NL: 31.7 (14.9)	UK: 21.7 (5.3)
1998: Germany :	18.3 (4.7)	NL: 38.8 (18.1)	UK: 24.9 (8.8)

*Self-employed (as % of all employed, in brackets female self-employed)*

1990: West Germany:	8.9 (5.4)	NL: 10.0 (7.7)	UK: 13.4 (7.5)
1998: Germany :	10.0 (6.3)	NL: 10.8 (7.8)	UK: 12.1 (7.2)

*Temporary Employment (as % of all employed, in brackets : male temporary employees)*

1990: West Germany:	10.5 (2.6)	NL: 7.6 (6.1)	UK: 5.2 (3.7)
1998: Germany :	12.3 (4.7)	NL: 12.7 (10.2)	UK: 7.1 (6.0)

While the unemployment figures, their absolute and relative size, result in public pressure for visible action, the pitiful German employment record is in fact the harder problem. 'The traditional German policy means – female family work, working time reduction, early retirement and extension of education – are exhausted. Their costs and political resistance force new ways of job creation. (cf. Heinze / Streeck (2000:234f.).<sup>13</sup>

In 1990, the employment rates in eastern Germany were much higher than in the west, but they have decreased considerably, in some areas, Brandenburg e.g., so much so that this region with a formerly very high employment rate now counts among the regions with the lowest relative employment (Europäische Kommission 1999: 67).

## **Macro-economic Framework**

*Public expenditure ( as % of nominal GDP, 5-year- average)<sup>14</sup>*

1985-1989: West Germany:	45.4	NL: 51.5	UK: 42.0	US: 33.5
1995-1999: Germany :	48.0	NL: 45.0	UK: 41.6	US: 31.5

<sup>12</sup> Europäische Kommission 1999:127ff.

<sup>13</sup> Heinze, Rolf G. / Wolfgang Streeck (2000): Institutionelle Modernisierung und Öffnung des Arbeitsmarktes: Für eine neue Beschäftigungspolitik. In: Jürgen Kocka, Claus Offe (Hrsg.): Geschichte und Zukunft der Arbeit. Frankfurt/M. New York: 234-237.

<sup>14</sup> Bertelsmann Stiftung 2000: 272

*Average growth rates of deflated GDP for the period 1991-2000 (national currencies)<sup>15</sup>*

Germany :1.8    NL: 2.7        UK: 2.1        US: 3.1    EU-15: 1.9

*Change of Real Unit Labour Costs (1991=100, deflated by consumer prices)<sup>16</sup>*

1989: West Germany:    101.7    NL: 100.0        UK: 97.6        US: 100.7  
2000: Germany    :            94.7            NL: 97.3        UK: 97.6        US: 99.0

The inner-German comparison of nominal unit labour costs shows an increasing advantage of eastern German establishments. While in 1990 wages were higher in eastern Germany, in 1997 unit wage costs there had only 63 % of the western level. Since the share of wages in total costs is lower in eastern establishments, their competitive disadvantage must be ascribed to a different production structure or higher costs for other inputs (Görzig 1998).<sup>17</sup>

*International Comparison of Annual Total Costs per Production Worker (US-\$, 1998)<sup>18</sup>*

B: 40,995    D: 35,863    NL: 32,271    UK: 29,277    F: 28,198    SP: 24,454

*Average Annual Hours Actually Worked Per Person in Dependent Employment<sup>19</sup>*

1990: West Germany:    1519    NL: 1433            UK: 1704        US: 1936  
1999: Germany    :            1478    NL: 1365('97)UK: 1696        US: 1974

*Usual Hours Worked Per Week, Full-Time Employees (1998)<sup>20</sup>*

B: 38.6    D: 40.1    NL: 39    UK: 44    F: 39.7    SP: 40.7

*Change in Average Working Hours 1990-98 (in %)<sup>21</sup>*

B: -0.3    D: -0.4    NL: -0.3    UK: -0.2    F: 28,198    SP: -0.2

*Annual Operating Hours (per week, 1994)<sup>22</sup>*

B: 94    D: 60    NL: 81    UK: 67    F: 68    SP: 65

<sup>15</sup> Europäische Kommission (1999b): Die EU-Wirtschaft: Jahresbilanz 1999. Europäische Wirtschaft # 69, 288

<sup>16</sup> Europäische Kommission (1999b): 336.

<sup>17</sup> Görzig, Bernd (1998): Wettbewerbsfähigkeit und Lohnstückkosten in der Strukturanalyse. MittAB 31: 690-696.

<sup>18</sup> IDS Employment Europe #460: 25

<sup>19</sup> OECD Employment Outlook 2000, Stat. Annex 219

<sup>20</sup> Eiro Observer update 3- 2000: 3

<sup>21</sup> Europäische Kommission(1999b): 143ff.

<sup>22</sup> IdW (1998): Deutschland im globalen Wettbewerb. Köln: DIV, Tab. 4.10

*Wage Share (% of GNP, measured in factor costs)<sup>23</sup>*

1989: West Germany:	68.5	NL: 65.6	UK: 73.7	US: 67.8
2000: Germany :	65.7	NL: 65.8	UK: 75.0	US: 67.7

*Earnings Dispersion<sup>24</sup>*

*Wage compression and the high earners (D9/D5, 1993)*

B: 1.57	D: 1.61	NL: 1.84	UK: 1.86	F: 1.99	US: 2.03
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*Wage compression and the low earners (D5/D1, 1993)*

B: 1.43	D: 1.44	NL: 1.54	UK: 1.79	F: 1.64	US: 2.10
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*Average 5 yearly change 1989 till 1993 or 1994*

*D9/D5:*

B: -0.05	D: -0.03	NL: 0.00	UK: 0.03	F: 0.01	US: ~0.08
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*D5/D1:*

B: -0.02	D: -0.08	NL: -0.01	UK: 0.02	F: 0.00	US: ~0.05
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The relationship between wage compression and skill compression has recently been analysed., e.g. for Germany and the US by Freeman/Schettkat 2000<sup>25</sup>. Given their proxies for skills, they state that the narrower distribution of skills in Germany than in the US does not account for the bulk of the difference in dispersion of income between the two countries, but that institutional characteristics of the wage setting process must be held responsible for the lower wage dispersion in Germany. They state, however, that unemployed Germans have skills much greater than unemployed Americans – indeed scores comparable to those of employed Americans. This pattern is not consistent with the wage-compression hypothesis, i.e., the hypothesis that institutionalised wage setting compresses wages and cuts off low skill jobs. Franz (2000: 13)<sup>26</sup> states “...that although international trade via competition from developing countries does affect relative wages and the structure of employment to the detriment of low-skilled workers, this effect can only explain a minor component of the observed changes of the wage structure”. The same holds for the hypothesis of (low skilled) labour-saving technological progress: even “...the empirical evidence on the extent to which computers...have changed the wage structure is anything but unambiguous”, and presumably holds only for certain sectors (Franz 2000: 14). Where it holds, the wage setting should certainly take it into account.

<sup>23</sup> Europäische Kommission(1999b): 332f.

<sup>24</sup> OECD Employment Outlook 1996, 61f.

<sup>25</sup> Freeman, Richard / Ronald Schettkat (2000): Skill compression, wage differentials and employment: Germany vs. the US. NBER WP # 7610, March

<sup>26</sup> Franz, Wolfgang (2000): Real and monetary challenges to wage policy in Germany at the turn of the millenium. CESifo Forum 1: 12-14.



## **Product Market Competition, Employment Barriers, Business Environment**

Beyond the general impression of international competition becoming more and more intense, the deregulation of product markets deserves particular attention. It sometimes needs Nobel prize winners to remind the profession and politicians of the dependence of employment growth on product demand growth and of the fact that increased labour market flexibility is not the only good idea to create jobs (Solow 2000: 5).<sup>27</sup>

There are two major areas where product market deregulation is debated and attempted in Germany: opening hours and bio-genetic research. The deregulation of formerly state monopolies in the telecommunication and postal and transport sector first of all resulted in an immense reduction of personnel, and only in telecommunication and Internet-close companies newly founded competitors create new jobs. The long-run net employment changes remain to be seen.

Without precise knowledge even about the short-term employment effects, it is worthwhile to recapitulate the American deregulation experience. Peoples (1998: 128f.)<sup>28</sup> summarises some of its mixed labour market effects. While per worker labour costs and industry labour earnings premia fell sharply in trucking, somewhat in airlines, slightly in telecommunications, and barely in railroads, the size of the workforce dramatically increased in trucking and airlines, held roughly steady in telecommunications, and fell dramatically in railroads. The gain in consumer rent was considerable, and the losses to labour are greater than just the erosion of worker wages. Deregulation led to smaller percentages of workers belonging to unions, which in turn reduced the bargaining advantage of unions in transportation and telecommunications.

The presumably low unionisation of employees in the new IT- and telecommunication companies in Germany suggests similar developments in Germany.

Three short remarks regarding the overall business environment in Germany.

- The recent reform of income taxes - with a major reduction of the peak marginal tax rate and a preferential treatment of self-financing for corporations - was widely hailed in the business community.
- The low exchange value of the EURO triggers record export values for German companies, it favours import price inflation.
- The “greying” of the population with its likely consequences for retirement pensions and/or social security contributions are perceived as menacing, but no solution has as yet found majority support in the parliamentary process.

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<sup>27</sup> Solow, Robert (2000): Unemployment in the US and in Europe. CESifo Forum 1: 3-5.

<sup>28</sup> Peoples, James (1998): Deregulation and the Labor Market. Journal of Economic Perspectives 12: 1998: 111-30.

## Wage bargaining, Industrial Relations – Social dialogue - Corporatism

Although there are many studies about the relationship between collective bargaining, corporatist policy making and macroeconomic performance, there are no definitive results, essentially because of methodical flaws. Flanagan (1999: 1172)<sup>29</sup> ends his thorough review of the existing literature by stating "... that predictions about the relationship between institutional structure and macroeconomic outcomes are far more conditional than most studies acknowledge, and further progress requires a research approach with targeted hypotheses addressing specific complementarities".

An OECD study trying to discover links between earnings inequality, low-paid employment and earnings mobility is but one example of the inconclusive evidence in cross-country research: "While labour-market institutions and the incidence of low pay vary considerably across countries, the analysis... suggests that the similarities with respect to earnings mobility are more marked than the differences...Country rankings are quite sensitive to the measure used..." (OECD 1996: 60)<sup>30</sup>.

Therefore a short overview of major developments in Germany is given without explicit international comparisons and without attempting to draw conclusions about the superiority or inferiority of industrial relations systems.

### Recent developments in Germany

There is a certain tendency towards decentralisation in collective bargaining in Germany, that centres around the inappropriateness of industry-wide collective agreements, in particular in eastern Germany.

### *Coverage of Collective Agreement in 1998*

Binding with respect	sector. collective agreement		firm collective agreement in		no collective agreement in	
	West	East	West	East	West	East
to employees	67.8 %	50.5 %	8.0 %	12.7 %	24.2 %	36.8 %
to firms	47.7 %	25.8 %	4.8 %	7.6 %	47.5 %	66.6 %

Source: IAB-Betriebspanel, 6. Welle West/3. Welle Ost 1998

A slight but continuous increase of collective agreements at company level leads to a certain loss of influence of employers' associations, who are exclusively responsible for the negotiation of collective agreements at the sector level.

<sup>29</sup> Flanagan, Robert (1999): Macroeconomic Performance and Collective Bargaining: An International Perspective. *Journal of Economic Literature* 37: 1150-1195.

<sup>30</sup> OECD (1996): Earnings inequality, low-paid employment and earnings mobility. *Employment Outlook* 1996: 59-108.

## *Wage Bargaining*

In 1999, many collective agreements followed the pilot agreement of the chemical industry, which had concluded an agreement for 21 months instead of the usual contract length of one year. The average wage increase of all sectors has been roughly 2.3% for 2000 and about 2.1% for 2001. The bargaining results are in general welcomed as moderate and may be seen in direct relation to the declarations of the national “Alliance for Employment”.

## *Partial Retirement of Older Employees (Altersteilzeit)*

The Law on Partial Retirement of Older Employees (*Altersteilzeitgesetz*) which was enacted on August 1<sup>st</sup> 1996 and slightly amended on June 27<sup>th</sup> 2000 enables employees from the age of 55 on to reduce their working time by 50%. Employers are obliged to increase the remuneration by 20% so that employees receive at least 70% of their former net income and 90% of pension contributions. If a vacant position is given to a formerly unemployed person or an apprentice these employers are reimbursed for the additional payments by the Federal Labour Office (*Bundesanstalt für Arbeit*) for up to six years.

## *Development of Partial Retirement Agreements and Employee Coverage*

	1997	1998	1999
No. of employees covered by a partial retirement agreement	5.5 million	10.1 million	13 million
No. of partial retirement agreements	~ 70	~ 200	349

Source: BMAS (1997, 1998, 1999): Tarifvertragliche Arbeitsbedingungen im Jahre 1997 resp. 1998 resp. 1999, all: Bonn: BMAS

The most favoured model of part-time work for older employees is to carry on working full-time for the first interval (usually five years) and then to stop working completely during the second interval.

## *Working Time and Pay Flexibility in Collective Agreements*

‘Standard work weak corridors’ and ‘working time accounts’ have already been presented - cf. above: working hours flexibility as means - to increase the costs of adjustment to changing order inflows. “Pay corridors”, which allow for rates up to 10 % below standard rates and lower starting rates for new recruits and formerly long-term unemployed people were the most common elements agreed upon with regard to pay flexibility.

An innovative arrangement has been negotiated at the Volkswagen AG. The project is called “5,000 x 5,000”, because it aims to create 5,000 new jobs with a monthly pay of DM 5,000. The main difference to older systems of work organisation would be that a team of employees has to produce a fixed number of vans per day. If the weekly target is reached, work can be halted. If not, the team has to continue working up to the legal maximum of 48 hours. No extra payments are foreseen for overtime or Saturday work. The project will start in 2001 and is limited to a period of three years.

## **The German „Alliance for Employment, Initial Training and Competitiveness“**

The European Guidelines to promote employment in the Member States have been incorporated in the German national action plan from 1999 onwards. The cornerstone to foster the realisation of the action plan's targets is the „Alliance for Employment, Initial Training and Competitiveness“ (*Bündnis für Arbeit, Ausbildung und Wettbewerbsfähigkeit*). Within the alliance a wide range of employment related issues, from working time flexibility over initial vocational training, tax and social security reform to general wage guidelines are to be discussed, all referring to various points of the 1999 European Guidelines. Aside from the Alliance for Employment – but nevertheless strongly linked to it – two special additional programs for employment promotion have been initialised. The first one is the emergency programme to reduce youth unemployment – JUMP (*Sofortprogramm zum Abbau der Jugendarbeitslosigkeit – Jugend mit Perspektive*), the second one the programme „Women and Work“ (*Frau und Beruf*) which aims at creating equal opportunities in the field of employment between male and female employees. (In addition to the „Alliance for Employment“ at the federal level, there are currently nine local or regional pacts for employment with the aim of enhancing employability and promoting employment in their respective jurisdictions.)

The *Sofortprogramm* aims for the creation of 100,000 training vacancies for young people and the improvement of employability of young people up to an age of 25, e.g., via additional training programs or wage subsidies to firms that hire unemployed individuals of this age group. Until the end of 1999, 179,000 different young people had benefited from programme measures, which were sponsored with approximately 1.9 billion German marks. As a result, youth unemployment decreased from December 1998 to December 1999 by 40,000 or 8.7%. The number of young people looking for a training vacancy decreased by 18.0% during the same time span. The programme has been prolonged to future years.

### *A cautious assessment of the “Alliance for Employment”*

The *Bündnis für Arbeit* can never reach any binding conclusions, because the actors involved might (i) behave opportunistically without having to expect any direct legal sanctions and (ii) the actors involved in the „Alliance for Employment“ are not the actors who are directly involved in collective bargaining negotiations. Whether the *Bündnis für Arbeit* can function successfully in the longer run, depends largely on the authority structures within the social partners organisation. To what extent the DGB and the BDA will be able to discipline their affiliated member organisations is an open question.

The *Bündnis für Arbeit* and the *Sofortprogramm* aimed at increasing the number of initial vocational training vacancies significantly and at reducing youth unemployment in general. Within the bargaining round 2000, numerous agreements were concluded that contained provisions to create new training opportunities and to give a regular job to young people who have successfully finished their apprenticeship for at least one year. Furthermore, the social negotiators agreed in many cases on regulations governing working time flexibility and the introduction of working time accounts. This topic has been subject to the alliances' peak talks as well. An even more prominent issue on the alliances' agenda has been the facilitation of early retirement and partial retirement for elderly employees in order to create vacancies for the unemployed. After having reached a consensus on this subject during the 5<sup>th</sup> peak meeting of the alliance, an amended law on partial retirement has been enacted by the government to support partial retirement more strongly. The central and one of the most controversial issues within the alliance talks has undoubtedly been the issue of wage moderation. After having agreed on a long-term oriented and employment-promoting wage policy in July of 1999 and January of 2000, the bargaining rounds in 2000 reflected this approach strongly. Despite some radical rhetoric's

on both sides, all major negotiations finally resulted in collective pay-agreements that were valid for between 21 and 31 months – usually pay agreements are only valid for one year – and contained modest wage increases of approximately 2.2% per annum on average. This is significantly less than the inflation rate plus productivity increases and therefore leaves some room for employment creation according to the joint declarations of the „Alliance for Employment.“ In sum, one can state that the *Bündnis für Arbeit* has set guidelines that were broadly recognised by the social partners during the bargaining session 2000. The work of the Alliance can be interpreted as being successful during the reference period in this respect.

## Labour Market Flexibility

The hypothesis that stronger employment protection destroys employment opportunities still receives some popular support – but it is contradicted by established statistical evidence.

Employment protection refers to regulations on hiring and firing, notification periods, severance pay, special requirements for collective dismissals and short-time work schemes. The OECD compiled information on 22 indicators for 27 countries. For each country a summary score was determined, so that the overall strictness of employment restriction could be calculated for the last decade on a scale ranging from 0 to 6.

	<i>Overall Strictness of Employment Protection</i>	
	Late 1980s	Late 1990s
Germany	3.2 (6 <sup>th</sup> rank)	2.5 (6 <sup>th</sup> )
Netherlands	2.7	2.1
United Kingdom	0.5	0.5
United States	0.2(least)	0.2(least)

Source: OECD (1999): Employment Outlook 1999

Compared to the reference countries, German employment protection is strict. Nevertheless, empirical analysis finds consistently that overall unemployment is not significantly related to the strictness of employment protection (OECD 1999: 77). Youth unemployment may be increased. The regulations on regular employment appear to matter most for stimulating increased self-employment. For temporary employment, the OECD analysis does not find an increase with stricter employment protection.

And looking for changes in strictness, the authors conclude “...that it is difficult to confirm that recent employment protection reforms have been associated with changes in employment and unemployment” (OECD 1999: 82).

Looking at labour market dynamics, the evidence is strongest for stricter employment protection slowing the inflow rate into unemployment and lengthening the mean duration of unemployment, thus producing two offsetting effects on unemployment (OECD 1999: 86). Buchele / Christiansen (2000)<sup>31</sup> did a somewhat similar international comparison studying bivariate effects of *worker rights*, especially representational rights and rights to social protection and income security. They found a positive effect on unemployment and a negative effect on the employment ratio, a negative effect on average annual hours worked –

<sup>31</sup> Buchele, Robert / Jens Christiansen (2000): Worker Rights and Socio-Economic Performance in the OECD. Mimeo. Smith College Northampton, Mass. July

and a negative impact of stronger worker rights on poverty rates, infant mortality and incarceration rates, concluding "...that European countries, even those with high unemployment, most likely have more to lose than to gain by weakening worker rights" (Buchele/Christiansen 2000: 7).

### *Working Hours Flexibility*

In Germany, the share of workers working overtime, the most important means of flexibility, has been increasing from 35 % in 1989 to 56 % in 1999. Paid, "definitive" overtime has been slightly decreasing over the decade (fluctuating with the business cycle), but unpaid, "transitory" overtime is gaining ground: such hours are compensated by free time. Working time accounts are the major instrument for working time flexibility without additional costs for the employers. In 1999, already 38% of employees in western Germany and 32 % in the east had working time accounts. While in 1989 the relationship between definitive to transitory overtime was 1:0.6, in 1999 it was 1:1.2.<sup>32</sup>

Working time accounts also permit employers a cost neutral reduction of working time, and therefore the much more restricted and cumbersome instrument of short time work has considerably lost in importance in Germany. In addition to "working time corridors", which allow the flexible determination of the standard work week to avoid overtime premia or company short time premia – at first realised in 1993 by a collective agreement in the chemical industry – the reduction of the costs of adjusting working time to fluctuating production and even changing operating hours have been considerably reduced. The increased cost competitiveness should translate in higher employment or at least in higher job security.

Apart from wages, adjustment costs are an important part of the user costs of labour, that is rarely documented in international comparisons. As outlined, the reduction of adjustment costs has figured prominently in collective bargaining during the last decade. This should be considered whenever the innovative capacity of the German IR system is to be assessed.

The standard work week was a hot issue in Germany during the 80s. Although the average contractual working week was reduced from 36 to 34 hours from 1989 to 1999, employees would have liked to work two hours less in each case, given their hourly wage. The same desire to work less prevailed in the Netherlands, although there the actual work week was two hours shorter. In the UK, dissatisfaction grew over the decade: in 1989, on average 35 hours were contracted, but 34 desired, while in 1999, 34 were contracted and only 31 desired.<sup>33</sup> There seems to be some potential for further working time reductions.

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<sup>32</sup> Autorengemeinschaft (1999): Der Arbeitsmarkt in der Bundesrepublik Deutschland in den Jahren 1999 und 2000. MittAB 33: 5-38, 19ff.

<sup>33</sup> Europäische Kommission (2000): Ad-hoc-Umfrage zur Arbeitsmarktlage 1999. Europäische Wirtschaft Beiheft B # 3, März, p.5

## Labour Market Policy

*Public expenditure and participant inflows in labour market programmes 1998<sup>34</sup>*

Programme categories	Germany 1998		Netherlands 1997		United Kingdom '97-98		United States '97-98	
	Expenditure as % of GDP	Participant inflows as % of labour force	Expenditure as % of GDP	Participant inflows as % of labour force	Expenditure as % of GDP	Participant inflows as % of labour force	Expenditure as % of GDP	Participant inflows as % of labour force
Public employment Services	0.23		0.40				0.06	
Labour market training	0.34	1.5	0.35	3.0	na	0.9	0.04	0.8
Youth measures	0.07	0.9	0.11	0.8		1.0	0.03	0.6
Subsidised Employment	0.39	2.1	0.26	1.3		na	0.01	na
Measures for the disabled	0.25	0.3	0.53	0.2		0.2	0.04	
Unemployment compensation	2.29	na	3.63	na		na	0.25	
Early retirement for labour market reasons	-		-					
Total	3.56	4.8	5.28	5.8		2.1	0.43	
Active measures	1.27		1.65				0.18	

<sup>34</sup> OECD: Employment Outlook, 1999, Statistical Annex 245-252

*Activity Degree ( active measures as % of overall expenditure in labour market programmes, 5-year average)*<sup>35</sup>

1985-1989: West Germany:	41.9	NL: 28.1	UK: 34.9	US: 34.5
1995-1999: Germany :	35.4	NL: 32.4	UK: 29.7	US: 40.2

In Germany, active labour market policies certainly reduce the narrowly defined unemployment rate. In 1998, for instance, the number of unemployed would have been almost 1 million higher without those policies, i.e., 13.8 % instead of 11.1 %. The discrepancy was particularly strong in eastern Germany, where the unemployment rate had increased from 18.2 to 26 % without active labour market measures.<sup>36</sup> Here part-time secondary employment now prevails.

Despite this immediate impact, there is now a controversial debate about the long-term effects of active labour market measures in Germany and its efficiency, that has its origins first of all in the insufficient data bases to perform efficacy and efficiency comparisons with well-specified control groups. While there is no doubt that any interruption of long-term unemployment careers is per se beneficial for the individual, the economic efficiency of several well-established and even popular measures has been called into question.

The literature résumé of Fitzenberger / Speckesser (2000)<sup>37</sup> is sobering.

In most *microeconomic* studies, the evaluation of further training in eastern Germany could not establish any significant effects on the participants' post-measure employment performance. In western Germany, most of the effects are even negative except for particular groups, like low-skilled persons. The job creation measures for eastern Germany most of the time also have a negative employment impact. In *macroeconomic* analyses, job creation measures - the second labour market - reduces structural unemployment, while further training and retraining reduce long-term unemployment.

Pfeiffer (1998) establishes a positive effect of subsidies to setting up a business out of unemployment in a micro-econometric study, but each success was very expensive. Above all for methodical reasons, the question therefore must be held as undecided what forms and what degree of active labour market policy should be recommended. Given public pressure for action against unemployment and the participation of social partners and different government levels, any withdrawal of measures or a general attentism is hard to sustain.

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<sup>35</sup> Bertelsmann Stiftung 2000: 274

<sup>36</sup> Autorenkollektiv 1999: 27ff.

<sup>37</sup> Fitzenberger, Bernd 7 Stefan Speckesser: Zur wissenschaftlichen Evaluation der Aktiven Arbeitsmarktpolitik in Deutschland: ein Überblick. ZEW-dp January



## Social security system

*Monetary Social Security Benefits (as % of GDP at market prices)*<sup>38</sup>

1991: Germany:	15.7	NL: 15.3 ('95)	UK: 14.0	US: 10.9
2000: Germany :	18.7	NL: 12.3	UK: 13.0	US: 11.0 ('98)

Neglecting the macroeconomic impact of social security budgets, the effect of social security contributions on labour costs and wages and the resulting employment consequences are highlighted in public debates. Reform proposals aimed at enhancing the first labour market for low-skilled persons look either at the disincentive effects of a too generous unemployment insurance or of public welfare benefits or they attempt to reduce the labour costs for employers, for instance by wage subsidies in the form of reduced social security contributions.

*Net replacement rates for a married couple with two children (including unemployment benefits, family benefits and housing benefits after tax in the initial phase of unemployment with comparable work histories)*<sup>39</sup>

B: 60	D: 72	NL: 85	UK: 64	F: 74	US: 60
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Just looking at the efficiency of the unemployment insurance, net replacement rates of about 70% are considered to be efficient among the economic profession– for low income unemployed up to 100%, if a definite time limit is imposed. Given this benchmark, it is not the level of the replacement ratio which is detrimental to the German labour market performance, but rather the long duration of benefits.

In a micro-econometric study for West Germany in 1983 to 1994, Steiner (1997)<sup>40</sup> found:

- Almost every second male and every third female unemployed person without any claim to unemployment assistance still is unemployed after six months.
- The longer unemployment benefits are awarded, the longer the unemployment spells last, in particular for male unemployed.
- If any claim to unemployment assistance stops, the probability of continuing unemployment falls distinctively for men, less so for women.

There is a far reaching understanding that unemployment benefits should be limited in time to increase the intensity of job search. The conditions of reasonableness (*Zumutbarkeitsbedingungen*) should not be too low to induce efficient search especially for the short-term unemployed.

The disincentive effects or social security trap for people who live on public assistance and find employment are well known and widely discussed. In Germany, the children allowances

<sup>38</sup> Europäische Kommission (1999a): 418f.

<sup>39</sup> OECD (1999): Observer #219, p.60

<sup>40</sup> Steiner, Viktor (1997): Kann die Effizienz der deutschen Arbeitslosenversicherung erhöht werden? Beihefte der Konjunkturpolitik #46, 137-168

in particular differ between DM 650 per child in public assistance and DM 270 per child in employment – a disincentive well criticised by the Sachverständigenrat (1999: 172)<sup>41</sup>.

Earned Income Tax Credits or “Kombi-Löhne” – the supplementing of earned income by public benefits – are offered as solutions to increase the willingness to work of low-wage earners. The Scientific Advisers of the Benchmarking Group within the “Alliance of Work” in Germany plead for the asymmetric reduction of social security contributions for low-income jobs.

*Social Security Contributions for average single employees (as % of labour costs, 1997)*<sup>42</sup>

	Employer	Employees	Total
Belgium	10	26	36
Germany	17	17	34
Netherlands	30	7	37
France	13	29	42
United Kingdom	8	9	17
United States	7	7	14

The employment effects of reduced social security contributions for low-income earners are studied by Buslei /Steiner (1999), based on the empirical experience with special-target programs in Germany in 1995.<sup>43</sup> The results of their simulations are not very encouraging.

- The elasticity of the macroeconomic labour demand with respect to wages is  $-0.65$  for low-skilled men and  $-0.17$  for low-skilled women.
- With regard to labour supply single persons behave differently from couples. In western Germany, the elasticity of the labour supply living in couples with regard to wage increases was  $0.15$  for low-skilled German men and  $0.03$  for women. In Eastern Germany and for foreigners living in couples the elasticities measured were negligible. The same holds for singles.
- The elasticities were used in a partial labour market model to measure the employment effects of a wage subsidy for employers. The reduction of social security contributions may be interpreted as such, being a subsidy to the employment of all low-wage earners, not only a special target group like the long-term unemployed. The assumed subsidy was on average  $16\%$  of the hourly wage. The simulation studies showed an employment increase in Germany of  $55,000$  persons, because of their higher supply elasticity women would be particularly favoured.

(A hypothetical reduction of social assistance benefits by  $10\%$  resulted in stronger reactions by men, especially living in couples in Western Germany. They would make up two thirds of the over all increase of employed persons of  $45,000$ .)

<sup>41</sup> Deutscher Bundestag (1999): Jahresgutachten 1999/2000 des Sachverständigenrates zur Begutachtung der gesamtwirtschaftlichen Entwicklung. Drs. 14/2223

<sup>42</sup> OECD (1997): Tax/Benefit Position of Employees

<sup>43</sup> Buslei, Hermann / Viktor Steiner (199): Beschäftigungseffekte von Lohnsubventionen im Niedriglohnbereich. Baden-Baden: Nomos.

The net costs of such wage subsidy are considerable. Taking into account the higher income taxes of the newly employed and the transfers becoming unnecessary, Buslei/Steiner (1999) estimate net costs of 7 bill. DM for the employment gain of about 55,000 persons. The costs and some of the distributive implications (no means testing, e.g.) puts the efficiency of this reform proposal in doubt. Additional field experiments in the Saarland and Rheinland-Pfalz starting this year are therefore highly welcome.

## Education and Training

### *Some performance indicators*

	Public expenditure for education ( % GDP), 1998	Educational attainment of adults (25-64): Upper secondary or higher	15-19 in general or vocational education (% of population) 1996
Belgium	4.8	53.5	93.8
Germany	4.5	81.5	91.9
Netherlands	4.3	62.5	81.3
France	5.8	60.2	92.2
United Kingdom	4.2	76.3	70.9
United States	5.2	85.7	14

Sources: OECD (2000): *Bildung auf einen Blick – OECD Indikatoren*, p.17; Europäische Kommission (1999a: 127ff.)

The relatively good performance of German youth unemployment has its origin in the apprenticeship system with the social partners explicitly trying to balance major disequilibria in the west, and the state providing about 20 % of all training places in inter-company training centres in the east.

Recently, the public debate in Germany put stress on a painful deficit of IT-personnel (“green card initiative”). But skill shortages are not confined to the IT sector: The latest IAB/ifo-survey on labour market scarceness reveals that (only?) 11% of all establishments (representing 13.5 of all employees in western Germany) report bottlenecks in skilled personnel (IAB-Kurzbericht 10, 14.7. 2000: 5).

The much debated tax reform in Germany is unlikely to abolish incentives for highly qualified personnel to leave the country, because the peak tax rate for natural persons of 45% is internationally still very high, in particular in the eyes of skilled persons who are mobile.

Another point of a heated, still unsettled debate is immigration and the eastern enlargement of the EU. While some fear that the prevailing guest country principle will demand too much of the western welfare states ( H.W. Sinn, FAZ 12.8.2000: 13), others expect an immigration influx not

big enough to compensate for the labour market bottlenecks caused by the demographic development in Germany (K.F. Zimmermann, Tagesspiegel, 25.5.2000).

## How to get a turnaround

1. Employment problems in Germany are strongly influenced by the German unification: the dismal state of the GDR economy, the financial repercussions for the western German social budget – and a then widely held, but unjustified belief of its general and immediate beneficial character have caused major problems.
2. The resulting impatience led to overoptimistic expectations of productivity growth and wage bargains. The disadvantages of eastern German establishments have been even stronger in other input costs (energy, interest rates, e.g.). Both disadvantages have had a strongly negative effect on employment in eastern Germany.
3. The job creation capacity of the German economy is too low. The lack of jobs for the low-skilled, in particular in the service sector, counts for much of the unemployment in the western Länder.
4. High-labour costs, including social security contributions, reduce the willingness of employers to recruit; too long a duration of unemployment benefits as well as employment traps reduce the efforts of unemployed to find employment. Proposed reforms – like subsidies of social security contributions – to increase the participation rate in the first labour market produce only marginal effects, at considerable macroeconomic costs, however.
5. Despite widespread allegations to the contrary, international comparisons show that the strictness of employment protection is not a significant cause of unemployment. Neither differences nor changes in legal restrictions are concomitant with changes in unemployment or employment.
6. The manifold efforts of active labour market policies appear to suffer from a similar problem. Methodologically sound evaluations often reveal at least a marginal effectiveness, but their efficiency is to be put into question. Appropriate data sources could clarify this issue beyond anecdotal evidence and wishful thinking. Till then, there is the danger that the public quest for action forces activism that is perhaps politically adequate, but economically inefficient.
7. The reduction of real wages and of the wage share in NDP over the last decade as well as the cost-neutral increase of working time flexibility show that workers bargaining position deteriorated. For the legitimacy of any bargaining system it is important credibly to separate the necessities of competition and common interests on the one hand, and the exploitation of temporary bargaining power on the other hand.
8. German youth employment still fares relatively well, although more and more employers calculate a withdrawal from the apprenticeship training system, most likely even affecting their proper private interest.
9. As none of the explanations that are so prominent in the public debate seems to unravel the core of the German employment problems, no simple and clear actions can be recommended. One should certainly be sensible enough not to pursue a rebuilding or even destruction of institutions that have been built up and proven their value over the years.
10. Although the "Alliance for Work" does not form an established part of German labour market policy making, a general mode of co-operation has been characteristic for the German industrial relations system, in training, labour market policy making and administering the social security system, but also in managing plants and companies (co-determination). As there are permanent distributive conflicts, at best compromises, but no consensual decision making across the whole range of issues can be expected to evolve from the Alliance. There is, however, one important potential of peak-level talks: everywhere, expectations are built by exchanging information, plans and ways of viewing

the world between opinion-leaders and actors. Optimistic expectations are at the heart of any economic upswing, as common sense and economic history tell us. Lasting crises were often the result of “crises of orientation”: ‘Many actors then found it hard to translate their experience into perspectives for the future and to ascribe predictive content to retrospective trend descriptions. As a consequence, a common weakness to take decisions became prevalent.’ (Siegenthaler 2000: 97).<sup>44</sup> That is the reason why market-driven developments may gain a lot by “consent talks” between major actors, in times of crises in particular.

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<sup>44</sup> Siegenthaler, Hansjörg (2000): Arbeitsmarkt zwischen Gleichgewicht und Ungleichgewicht im Zeitalter modernen Wirtschaftswachstums. In: Jürgen Kocka / Claus Offe (Hrsg.): Geschichte und Zukunft der Arbeit. Frankfurt a M. / New York 2000:88-109.