

Discussion paper

EUROPEAN EMPLOYMENT OBSERVATORY
GERMANY

Labour market improvements in a stagnating policy environment

Quarterly review of labour market trends and policies
3rd Quarter 2006

by

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Glossary

Subsistence-based partnerships	<i>Bedarfsgemeinschaft</i> : These partnerships are defined by the Hartz-IV act as the private income and property units obliged to individual transfers among its members.
Business Foundation Allowance	<i>Gründungszuschuss</i> : New regulation of business foundation support for unemployed, valid since August 1 2006. For a period of 15 months at maximum, UB-I recipients. During the first nine months, a lump sum of EUR 300 is paid in addition to unemployment benefit I for the cost of social insurance. During the following six months only the lump sum can be paid if the business became the main entrepreneurial activity.
Hartz reform	Reform of unemployment insurance under the Federal Employment Service (<i>Bundesagentur für Arbeit</i>) and active labour market policies, named after Peter Hartz, principal staff manager of Volkswagen and the president of “Hartz Commission” established by the German government in 2002. The reform has four parts: Hartz I (2002): introduction of public temporary work agencies (Personnel Service Agencies – PSA) Hartz II (2002): reorganisation of public employment services; mini-jobs, ICH-AG Hartz III (2004): restructuring of public employment services to the Federal Employment Agency Hartz IV (2005): merging of unemployment aid and social assistance to UB-II
ICH-AG	<i>Existenzgründungszuschuss (§ 421 I SGB III)</i> : Business foundation grant for UB-I recipients, which supports unemployed becoming self-employed for up to three years (1 st year: EUR 600 per month, second year EUR 360, third year EUR 240)
Mini Jobs	<i>Geringfügige Beschäftigung</i> : Jobs with monthly incomes up to EUR 400. These can be regular or occasional jobs and jobs in addition to regular employment. Employers pay 25 % of wages to social insurance.
Midi-Jobs	Registered employment with monthly wages between 401 and 800 € and reduced social insurance premiums.
National Training Pact	Agreement between the Federal Government and the employers associations to offer 60,000 additional dual training places in 2004, and another 30,000 in 2005.
1 € Jobs Auxiliary public jobs	Temporary jobs in the area of social and public services for UB-II recipients. They are remunerated by EUR 1 or 2 in addition to UB-II benefits. Jobs need to be for the public benefit and have to be additional to jobs in the premier labour market.
Rehabilitation benefit	<i>Eingliederungszuschuss</i> : a wage subsidy for employers who employ long-term or disabled unemployed. Subsidies are limited to 50 % of wages for 12 months. For disabled or older workers the limits are 70 % of wages for a maximum period of 24 months.
UB-I	<i>Arbeitslosengeld I</i> : Regular unemployment benefit
UB-II	<i>Arbeitslosengeld II</i> : Means-tested basic income for job seekers, paid after expiration of regular unemployment benefit

Executive Summary

Regarding employment policies in Germany the third quarter was a quarter of debate rather than action. While the government decided on the health reform and parent allowances, the debate on the emergence of an underclass and on low-wage employment dominated in the public. The widening income and wealth gap appears to be the major issue of controversies. As this is at least partly associated with the Hartz reforms and other steps undertaken during the last years, the debate has considerable impacts on the reform process. All political parties – the two coalition parties in particular – are profiling in the area of “social justice” and integration.

Critical assessments of policy decisions are expressed by the economic experts and employer organisations. The health reform was characterised as “the evidence of political incapacity” by the Council of Economic Experts and the reform process is seen as caught in the “cops of contradicting interests”. They therefore urge for further steps to reform social systems and labour markets.

This however contrasts to the high priorities for a socially balanced policy among all groups of the German population. The priorities were reflected by the recent elections at Länder level which confirmed the majorities of socially-oriented parties. The reluctance of the coalition government to promote reforms therefore has to be addressed to changes in the political spectrum rather than the “incapacities” of the political class.

The conflict is presently mitigated by the strong economic upswing in Germany which is now going to show labour market impacts. In autumn 2006 the business upswing strongly affected the German labour market. Employment growth accelerated significantly to an annual rate of 0.9 %. The number of registered jobs, which was declining for years, now also grew by 1 %, both in Western and Eastern Germany. Unemployment decrease strengthened with a reduction by 10 % within one year.

The precarious labour market situation in Eastern Germany however will not be removed by the business cycle. Following a recent report by the Federal Government, sustainable economic dynamics cannot be discerned yet in the East. Moreover, the dual training market is still waiting for positive impacts – or a fundamental reform of the German training system.

1. Introduction

The third quarter of 2006 was not the quarter of labour market policies. The government decision on health reform and the introduction of the parent allowance scheme were the major policy actions. The political debate meanwhile concentrated on the continuation of the reform process in Germany. Very critical statements came from the Council of Economic Experts and other research institutes who see a slow-down of the reform process in the “copse of contradicting interests” (*German Council of Economic Experts 2006, p. 1*). In particular the health reform was criticised as being inadequate and counter-productive to the employment targets.

Therefore the policy debate is the focus of this quarterly report for Germany. The sudden rise of an “underclass debate”, the different positions on low-wage employment, the unsatisfactory labour market situation in Eastern Germany, and the reform of the Hartz reform are the main issues.

2. Update on economic and labour market trends

Recent labour market trends

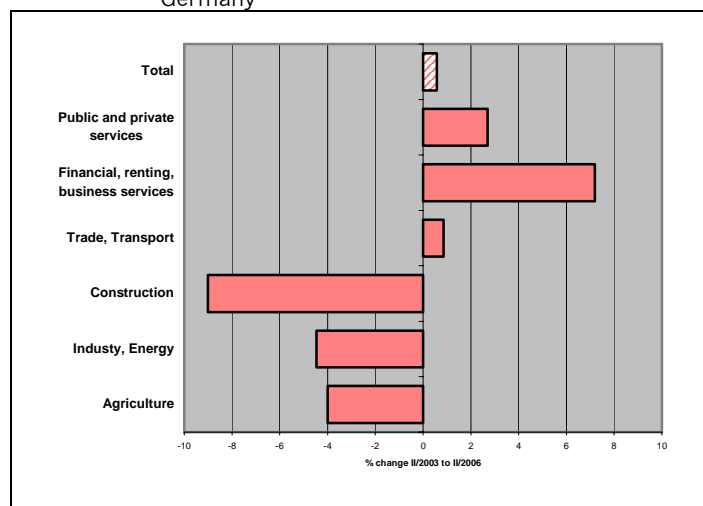
In autumn 2006 the business upswing strongly affected the German labour market. Employment growth accelerated significantly to an annual rate of 0.9 %. The number of registered jobs – which was declining for years – now also grew by 1 %, both in Western and Eastern Germany. Unemployment decrease strengthened with a reduction by 10 % within one year.

Employment: The number of persons employed is now estimated to 39.5 million (Federal Statistical Office, September 2006). The overall growth rate of 0.9 % conceals considerable sectoral change of employment (Chart 1). Most of the additional jobs were created in the financial, renting and business services sectors. Public and private services also contributed to rising employment together with trade and transport. Jobs were destroyed mainly in construction but also in manufacturing and agriculture.

Unemployment: Compared to the previous year, registered unemployment declined by 471,000 to 4.085 million in October 2006. 1.4 million were UB-I recipients and 2.7 million UB-II recipients. This is the reversal of quantitative relations between the two support schemes: The Hartz-IV reform started with 2.4 million UB-I beneficiaries and 1.8 UB-II beneficiaries. This change now gave considerable reason to debate the financial implications of this change as municipalities have to fund large parts of UB-II benefits.

The unemployment rate went down to 9.8 % (8.1 % by ILO standards). This is an improvement by 1.2 percentage points since October 2005. Western and Eastern Germany both profited from the trend to a similar extent. Beyond the positive cyclical effects, the

Chart 1 Sectoral employment change
% change of domestic employment
II/2003 to II/2006
Germany



Source: Statistisches Bundesamt (September 2006)

Federal Labour Office attributed the reduction of unemployment to the greater efficiency of placement services (*Bundesagentur für Arbeit 2006*).

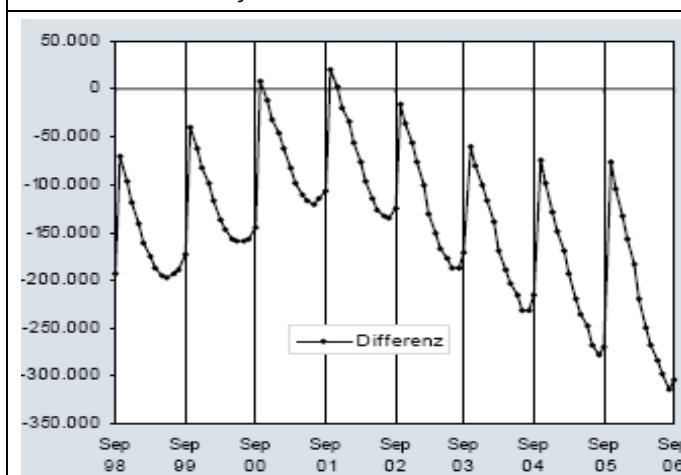
Vacancies: Job vacancies increased by 38 % since the previous year. This refers to registered vacancies while the total unfilled post is estimated over 1 million.

Dual training: With the end of the previous school year in September 2006, the Federal Labour Office drew a critical balance of the development on the dual training market. Following the trend since 2001, training offers declined in school year 2005/06 by 3 % while the number of applicants increased by 3 %. The negative balance on the German dual training market therefore is bigger than ever during the last nine years (Chart 2).

In particular, the situation on the West German training market deteriorated. Dual training could not profit from the positive employment trends in the services sectors. Manufacturing and crafts business made great efforts to increase the number of training places but this was not enough to compensate the negative balance. Eastern Germany performed better but nevertheless the number of training places declined.

Chart 2 Balance on dual training market

Difference between registered training places and registered applicants
Germany



Source: Bundesagentur für Arbeit (2006)

Training markets are increasingly burdened by waiting applicants in preparatory training measures. While this – until recently – was mainly observed in Eastern Germany, it is now also strongly affecting the Western German training market.

Active labour market policy: The number of participants in ALMP measures increased considerably by 10 % since the previous year. 1.6 million participants were counted in October 2006. The majority of these were in job integration programmes (435,000 in total, thereof 289,000 in self-employment support measures). 372,000 were in public job creation programmes, mainly in 1-EURO-jobs. Finally, 295,000 young persons were in preparatory training measures and 266,000 in continuing and re-training programmes. Job creation programmes experienced the strongest increase by 17 %.

Economic forecasts

Economic forecasters were busy to catch up with the strong economic upswing. As an example, last autumn the Council of Economic Experts – the official government advisors – expected 1 % growth for 2006. Their present expectation is at 2.4 % and this is in line with most of the other forecasting institutions (Table 1). The increase of the VAT rate is still assumed to have negative effects on the business cycle however at the present level of growth this is not seen as a significant problem. Surprisingly, employment growth will not be affected by this. Growth rates around 0.6 are expected for this and the next year. The unemployment rate will decline by about 0.5 percentage points to 9.8% as the 2007 average.

Table 1 Economic forecast for 2006 and 2007– Germany

Institution	Date of publication	GDP (% change to previous year)		Employment (% change to previous year)		Unemployment Rate (%)	
		2006	2007	2006	2007	2006	2007
German Council of Economic Experts	November 06	2.4	1.8	0.6	0.7	10.4	9.8
Association of Economic Institutes (ARGE-Institute)	October 06	2.3	1.4	0.5	0.6	10.4	9.9
Federal Government	October 06	2.5	1.5	0.6	0.6	-	-
Ifo Institut	October 06	2.7	2.6	-	-	-	-
IfW (Institut für Weltwirtschaft)	August 06	2.4	1.0	0.7	0.8	11.5	10.8
IWH (Institut für Wirtschaftsforschung Halle)	September 06	2.0	0.8	0.4	0.1	10.4	10.1
IMK (Institut für Makroökonomie und Konjunktur)	July 06	1.9	1.1	0.3	0.3	10.5	10.2
DIW (Deutsches Institut für Wirtschaftsforschung)	July 06	1.8	1.4	-	-	10,2	10.1

Source: Economix

3. Labour market policy developments

3.1. Policy actions

Health care reform

After long lasting discussions of expert groups and the coalition committee the government agreed upon the modification of the following issues:

- A new public health care fund shall be implemented by 2009, collecting insurance premiums at equal rates and financing the 253 health insurance organisations.
- If the revenues of health insurances are insufficient they shall be allowed to raise additional contributions. These must not exceed 1% of the household income and can be raised without verification of household incomes as long as they do not exceed EUR 8 per month.
- People who do not have insurance protection shall be able to revert to public health insurance.
- Public insurances get more freedom in forming contracts with health service providers.
- A reform of the remuneration system is planned together with the opening of hospitals for ambulatory treatment.
- Private health insurance will be obliged to offer basic insurance contracts to all persons without risk checks.
- The spending on health care shall be further restricted.

Beyond the details of this planned reform, two major critical arguments were raised in the public debate:

- *The rise of contribution rates:* The Council of Economic Experts stated “It is the evidence of political incapacity that a reform which should achieve the reduction of wage-based contributions starts with a considerable increase...”. The tax-based contribution – dedicated to compensate non-insurance equivalent expenditures – will be cut by EUR 6.5 billion rather than raised. The expected increase of health contribution rates by 0.5 percentage points is therefore assessed as an extraordinary tax on employees to consolidate the federal budget (*Sachverständigenrat 2006, p. 11*).

- *The health insurance fund:* The centralised fund is expected to distort competition in the health insurance system as means-tested rather than risk related contribution rates will prevail. The objective to raise competition among insurance organisations will thus not be achieved. Moreover, it will increase the bureaucratic burden rather than reducing it.

The media sees the suspension of the health care reform until the year 2009, which is right before the next Bundestag elections, as a sign that the idea of the health care fund has little chance of survival.

Parent allowance

The Bundestag decided on the introduction of a parent allowance (*Elterngeld*) by 2007. For a maximum period of 12 months the partner who takes care of the child will receive 67 % of the former net income. The monthly rates are a minimum of EUR 300 per month up to EUR 1,800. Non-active persons (housewives, unemployed etc.) receive the minimum rate. The period can be extended to 14 months if the other partner stays at home at least for 2 months. Part time employment up to 30 hours per week is possible. The allowance is tax free. The parent allowance substitutes the existing upbringing allowance (*Erziehungsgeld*) which provided a benefit of EUR 300 per months for 24 months to the partner who left the job or reduced working hours. This allowance was means-tested (e.g. for a couple: EUR 30,000 in the year before birth) and income limits declined over the period of support.

3.2. Public and scientific debate

The underclass debate

Provoked by early press releases of the SPD think tank Friedrich Ebert Stiftung, an intensive debate on the emergence of an underclass started. The study which will be published by the end of the year came to the result that 8 % of the German population can be classified as a group of detached precariousness. This means people who are vulnerable in many respects: housing conditions, income position, and job situation. Two thirds of the group are unemployed. They have above-average health problems and a low education. Most importantly, however, they lack prospects of improvement and are resigned. This result was the reason for the public debate, as the affiliation to the underclass appears as a long-term societal position rather than a transitional phase.

Recent figures of the Federal Statistic Office confirm the findings in principal: 13.2% of Germans lived in poverty in 2005. Poverty is conterminous to the lack of opportunity of advancement. Since 2001 the poverty rate is noticeably higher than in the 1990s (~11%). Compared to the European average of 15 %, the German poverty risk of 11% appears to be low. However, the size of the precarious group increased in the course of time. The reasons for this development are speculative. A few SPD devotees refer to the Hartz-reforms. In fact the reason might be that incomes diverge increasingly. In the period 1993-2004 the net income of the richest quarter in western (eastern) Germany increased by 28% (86%) while the income for the poorest quarter decreased by 50% (21%).

According to the government, the increased poverty risk is no durable situation. In the period 1998-2003 one third of the phase beneath the poverty risk threshold for the people concerned was over after one year and two thirds after two years.

German unification

16 years after unification, the Eastern German labour market is still strongly imbalanced and "...a self-supporting upswing has not yet been achieved" (*Bundesministerium für*

Verkehr, Bau und Stadtentwicklung 2006, p. 9). Only specific sectors and regions are developing well, in particular manufacturing in the regions of Dresden, Leipzig and Berlin. A broad economic recovery, however, is not visible. By contrast the risk of persistent low-growth areas is increasing with limited income perspectives, continuous emigration and the continuation of economic disadvantages (see *Vogler-Ludwig 2006*).

According to the recent government report on German unity, the specific disadvantages of the Eastern German economy lie in:

- A lack of large companies and headquarters which leads to a high share of production activities but a small share of services.
- A small share of research and development activities (only 6% of company-based R&D is done in Eastern Germany)
- Greater problems of companies with external financing
- Less developed company clusters and networks.

Facing this difficult situation, the German government developed a policy programme for the Eastern Länder which refers to standard measures of regional policy. It lacks a specified labour market policy adequate to the size of the problems in Eastern Germany (see *Vogler-Ludwig 2006*).

Low-wage sector

The coalition parties drew different conclusions from an expert hearing organised in October 2006 to prepare the governmental report on low-wage employment:

In agreement with trade unions the SPD re-assessed its suggestion to introduce minimum wages. This is seen as the appropriate instrument to counteract the declining protection through collective agreements. The regulation for despatched workers (*Arbeitnehmer-Entsendegesetz*) should allow extending collective agreements to non-unionised companies by decree-law. Until now this is only allowed in the construction industries, and the regulation will probably be applied to cleaning services. For branches without collective agreements the SPD suggests legal minimum wages. It has to be noted that some of the trade unions expect minimum wage regulation undermining the autonomy of collective bargaining.

The Christian Democratic Union (CDU) rejected the idea of minimum wages as it will increase unemployment. It suggested a further reform of the Hartz-IV regulations instead (see below).

In the scientific debate, the positions are heterogeneous. While Peter Bofinger – member of the Council of Economic Experts – suggested the introduction of a EUR 4.50 minimum wage per hour, the other four members voted against the idea with the reference to the negative employment effects. The recent review of minimum wage studies undertaken by the US scientists Neumark and Washer (2006) supports the position of the majority of economic experts. Two thirds of the 85 studies on minimum wages reviewed identified negative employment effects from minimum wage regulations while one third showed neutral or positive effects. In particular panel studies pointed to negative effects.

Reform of the Hartz IV reform

Following the CDU suggestions the Hartz IV regulation should be further developed through the following measures:

- A wage subsidy should be introduced for the long-term unemployed – those aged under 25 years or older than 50 years, covering 40% of wage costs for a maximum period of three years. Two thirds will be paid to employers and on third to employees. This is known as the CDU-Kombilohn-Model.

- In order to avoid the combination of UB-II benefits and mini-job incomes, which is going to become the preferred solution among UB-II recipients, labour incomes should be taken into account from EUR 40 upwards instead of EUR 100 as it is now. In parallel, the deduction of labour incomes above EUR 400 from benefits should be reduced to increase incentives to search for regular jobs.
- EUR 1 job holders should not receive more than EUR 1 per hour as it is actually the practice in many cases. The incentive to accept a regular job has to be raised.
- Parents should be obliged to support their children financially as it was the case among the former social aid regulation.
- The competence of municipalities should be strengthened as regards UB-II recipients.

The position regarding the *Kombilohn* is supported by the Institut für Weltwirtschaft (IfW). In a still unpublished study by Brown and Merkl the IfW argues in favour of selective wage subsidies for vulnerable target groups rather than the support of unspecific target groups (Handelsblatt 9.11.2006). A targeted wage subsidy programme of EUR 2 billion could create 400,000 jobs while the unspecific application would have little employment effects. This is a clear argument against an income tax credit instrument which would be applied to all tax payers. The subsidy should be paid in form of a recruitment voucher in order to guarantee the limitation of support. Unlimited support periods would be totally inefficient.

Reform of unemployment insurance

The prime-minister of North Rhine-Westphalia Jürgen Rüttgers (CDU) proposed to link the UB-I payments to the duration of work time. Long-term employees becoming unemployed should receive benefits up to two years until they switch to UB-II. The suggestion is supported by the CDU and the CSU (Christian Democratic Union). The measurement should be “revenue neutral” which means that younger unemployed and women will receive fewer benefits for the older employed to be more compensated. The proposal was therefore criticised as discriminatory towards younger people and women in general. In addition it would provide a new submission for early retirement programmes.

4. Recent labour market reports

Friedrich Ebert Stiftung (forthcoming): Studie zur Unterschicht. Unpublished report.
http://www.fes.de/index_g.htm

The Friedrich-Ebert Stiftung (FES, the SPD think tank) investigated the reform willingness of Germans and defined target groups for political education. The first results of the study which will be published by the end of the year, were launched through press releases. This provoked a discussion about the new German underclass since a larger group of the German population was defined as a “group of detached precariousness” (*abgehängtes Prekariat*) meaning a socially vulnerable group in precarious existence.

According to the press release, the study targets at the measurement of value preferences in the population and the identification of a political typology. The survey the group of detached precariousness concerns people whose circumstances are precarious regarding housing conditions as well as the income and employment situation. They have above-average health problems and lower education. Two thirds of the group are unemployed. They lack prospects of improvement and are resigned. A high share is characterised by minor familial support. Many are singles or single parents depending on social benefits. Overall 8% of Germans (6.5 million) belong to this group. These are 4% of all Western Germans and 25% of all Eastern Germans.

The German population is described as a three thirds society. While the upper third faces sustainable chances and perspectives, the uncertainties have meanwhile reached the mid-

dle class. Among the lower third, the discontent with the social and political realities is growing together with the awareness of the risks of social and economic descent. All three groups nevertheless show a strong preference for the principles of social justice.

Bundesministerium des Inneren (2006): Evaluation of Immigration Act (*Bericht zur Evaluierung des Gesetzes zur Steuerung und Begrenzung der Zuwanderung und zur Regelung des Aufenthalts und der Integration von Unionsbürgern und Ausländern (Zuwanderungsgesetz) Juli 2006*)

Two years after coming into effect the Federal Government came to a positive assessment of the new immigration law. The new regulation for labour migration – which had a focus on integration courses – appears to be appropriate and the simplification of application procedures is feasible and effective. The continuation of the labour immigration stop is adequate to the labour market situation in Germany. The special regulations for highly qualified and self-employed immigrants worked well. Integration courses are accepted by great numbers of immigrants and migration counselling appears to be an important element of integration.

During the last ten years immigration was dominated by asylum seekers and family members rather than job seekers. This is however expected to change in the future. The restriction of labour immigration for non-EU immigrants and workers from the new Member States does not need to be changed. For low-skilled jobs immigration occurred mainly for seasonal jobs. The new and simpler application procedures appeared to be useful. For skilled jobs – IT specialists in particular – the number of immigration licences decreased from 6,604 in 2001 to 2,273 in 2004. A change of practices is not planned.

The recommendations for further legal adjustments include the strengthening of public authorities to enforce the participation at integration and language courses.

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