

Discussion paper

EUROPEAN EMPLOYMENT OBSERVATORY
GERMANY

Upswing on the German labour market

Quarterly review of labour market trends and policies
1st Quarter 2007

by

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Munich April 2007

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Glossary

Business Foundation Allowance	<i>Gründungszuschuss</i> : New regulation of business foundation support for unemployed UB-I recipients for a period of 15 months at maximum (valid since 1 August 2006). During the first nine months, a lump sum of EUR 300 is paid in addition to UB-I as a contribution to social insurance costs. During the following six months the lump sum is continued to be paid only 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 the “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): merger of unemployment aid and social assistance to UB-II
Midi-Jobs	Registered employment with monthly wages between 401 and 800 € and reduced social insurance premiums.
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 30 % of wages to social insurance.
National Training Pact	Agreement between the Federal Government and the employers associations to offer additional dual training places. The pact started in 2004.
Registered employment	<i>Sozialversicherungspflichtige Beschäftigung</i> : Employment contracts subject to public social insurance, i.e. dependent employment with salaries above 400 EURO per month.
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.
Social benefits	<i>Sozialgeld</i> : non-employable persons in a subsistence-based partnership with at least one employable person receive social benefits. Above the age of 16 rates are equivalent to UB-II.
Subsistence-based partnerships	<i>Bedarfgemeinschaft</i> : These partnerships are defined by the Hartz-IV act as the private income and property units obliged to individual transfers among its members.
UB-I	<i>Arbeitslosengeld I</i> : Regular unemployment benefits for singles provide 60 % of the last net income for 12 months. For parents the rate is 67 %.
UB-II	<i>Arbeitslosengeld II</i> : Means-tested basic income for job seekers, paid after expiration of regular unemployment benefit. The basic rate is 345 EURO per month.
1 € Jobs Auxiliary public jobs	Temporary jobs for UB-II recipients in the field of social and public services. 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.

Executive Summary

The upswing on the German labour market continues. Employment was growing at a rate of 1.5% p.a. and the unemployment rate decreased to 9.8% in February 2007 (7.5% by ILO definition). All regions and most of the branches of the German labour market were profiting from the upturn. Vacancies were increasing as every fifth company was searching for new staff.

Active labour market policy was adjusted to the favourable employment situation. Support of job seekers and job creation programmes were reduced while free-selection measures by local employment agencies were extended. Overall, the number of participants decreased by 3% compared to the previous year.

Economic forecasts continue to be more optimistic. For 2007 employment growth is expected to range around 1.1%. For 2008 a further but smaller increase is forecasted. Unemployment rates will range around 8.8% in 2007 and 8% in 2008. The reasons for the unexpected improvement on the German labour market are identified in economic restructuring and low wage increase. Both contributed to the competitiveness of German companies in a significant way.

Policy actions in the first quarter of 2007 included the launch of a childcare programme by which one third of the children younger than three will have access to day care facilities by 2013. A "JobPerspective" programme was initiated for long-term unemployed. The programme targets especially older long-term unemployed without qualifications and with additional placement obstacles. Subsidised jobs with training will be provided to these people.

Collective bargaining started a new round of negotiations which can be expected to terminate the long phase of low wage increase. First agreements on collective wage increases in the construction and chemical industries were around +3.5%.

The public debate concentrated on low-wage employment. The coalition working group on "labour market" presented its report with suggestions for the low-wage sector, however, without achieving conclusions. The instruments of combined wages and minimum wages remain strongly controversial among the coalition parties and in the public. Among the three available models for combined wages, the workfare model with a mandatory obligation for work might have the strongest labour supply effects. All models will afford about half a million public jobs.

The minimum-wage debate was fostered by trade unions and the Social Democratic Party. New empirical data revealed that 11% of German workers are paid less than EUR 7.5 per hour, many of them female, young or foreign workers in Eastern Germany and small businesses. No political decision was taken yet but a consensus was achieved to restrict immoral wage cuts in the non-unionised sectors.

1. Introduction

After a long depression the German labour market is not only recovering but developing unprecedented dynamics. This provided not only a new perspective on its employment performance but affected the policy debate in Germany. As indicated in previous reports, the favourable macro-development allows to solve a series of imbalances addressed by active labour market and social policies. Moreover, investments into childcare and training are facing lower financial barriers.

This quarterly report on Germany therefore concentrates on the description of the improving labour market situation and its prospects. It follows the changes of the policy debate which shifted its focus on low-wage employment and the introduction of minimum wages. Moreover, two publications are presented, the latest vocational training report of the government and the latest evaluation results of active labour market policy.

2. Update on economic and labour market trends

2.1. Recent labour market trends

The upswing on the German labour market continued with accelerating momentum. Through a 1.5% plus to the previous year employment growth achieved a new peak in February 2007 (Chart 1). 571,000 additional jobs were created within 12 months. This made registered unemployment decrease significantly by 869,000, and the rate of registered unemployment declined from 12 to 9.8%. By ILO definition, the unemployment rate was 7.5% in February 2007.

Employment: Employment growth was broadly based on improvements of both registered and unregistered employment (Bundesagentur für Arbeit 2007). Registered employment increased by 3.2% in Eastern and 2.2% in Western Germany since February 2006. Approximately half of the additional jobs were full-time. All regions participated in employment growth which was particularly strong in Brandenburg and Saxony. Most of the sectors – except banking and insurance – expanded employment: business services were again on top of the ranking, supported through strong growth of agency work. In addition, transport and communication, hotel and catering, and the construction sector showed high employment growth.

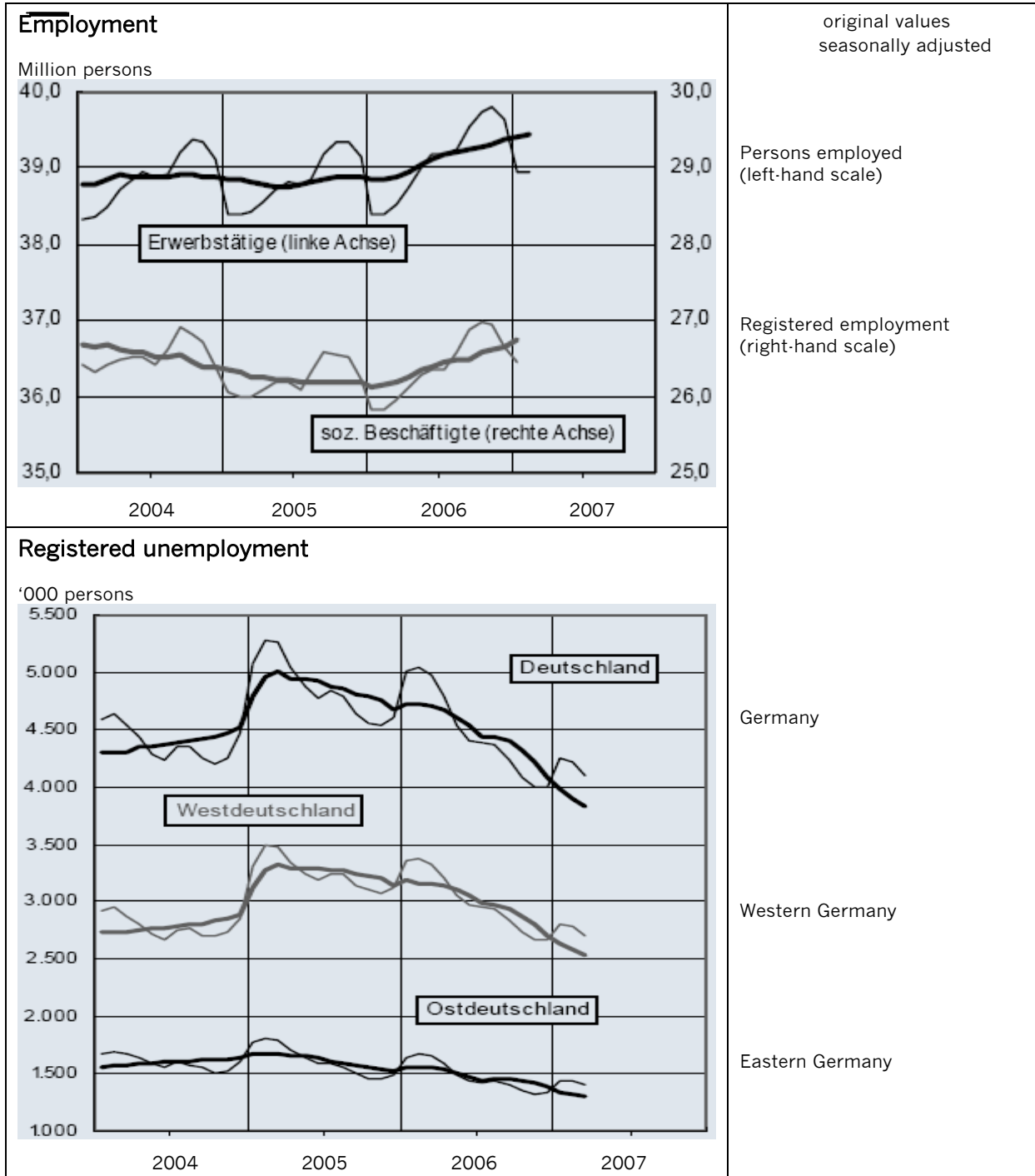
Unemployment: In Eastern Germany the unemployment rate decreased by 2.8 percentage points to 16.5%, and by 2 percentage points to 8.1% in the West. This means that Eastern Germany continued to suffer from twice the unemployment rates than those of Western Germany. The stronger reduction in Eastern Germany however gives hope that the difference might become smaller in the course of the upswing.

The labour market improvement mainly affected UB-I recipients. Their number declined by 25% in the course of the last 12 months while the number of UB-II recipients stagnated. The actual share of UB-II recipients among all aid recipients is 80%. About half of these are unemployed while the other half receives social benefits.

Vacancies: Actual labour demand increased considerably to 1.4 million vacancies in the 4th quarter of 2006 (Spitznagel, Kettner, forthcoming). This was an increase by 260,000 compared to the previous year. Every fifth company was searching for additional staff. The majority of posts were for immediate placements. Job placements were not facing any significant obstacles. However, the labour market is gradually tightening which might lead to rising competition for labour among companies and increase wage demands.

Dual training: At mid-term of the actual training year 2006/07 the overall number of applications for dual training declined by 7% compared to the previous year but the number of available training places also declined by 4%. This means that the long-lasting deficit of training places declined only slightly. The lack of training places still amounted to 196,000 in March 2007. This is 38% of all applications. The major part of this deficit can be expected to be removed in the course of the training year.

Chart 1 German labour market 2004 to 2007



Source: Bundesagentur für Arbeit (2007).

Active labour market policy: The number of participants in active labour market policy decreased slightly by 3% compared to the previous year (Table 1). In particular, measures supporting job seekers, self-employment and job creation were reduced. The measures of local employment agencies, which can be chosen in context to the local employment situation, however, almost doubled in terms of the number of participants.

Table 1 **Active labour market policy**
Germany

	March 2007 (1000 participants)	% change from previous year
Improving chances on primary labour market	602,7	-14,2
Counselling and support to job seekers	85,2	-50,7
Training and qualification	220,2	-3,2
Preparatory measures to training	297,3	-1,7
Support of people on jobs	357,4	-11,6
Support of employees	123,3	-2,2
Support of self-employment	234,1	-15,8
Employment creation	328,9	-4,0
Employment opportunities for UB-II recipients	287,6	-2,7
Job creation measures	41,3	-12,2
Other support measures (free selection)	178,2	93,0
Total	1467,2	-3,0

Source: Bundesagentur für Arbeit (March 2007)

2.2. Economic forecasts

The economic upswing in Germany is a surprise in its strength and intensity. GDP forecasts are now at 2.4% for 2007 and at the same growth rate for 2008 (Table 2). This is double the growth rate expected one year ago. All concerns about rising VAT rate and turmoil of the world economy are largely forgotten. The German economy appears to be strong enough to recover on its own from the long phase of low growth since the year 2000.

The reasons for this recovery can be found in economic restructuring of many companies, which led to improved technological and cost competitiveness. For many years, this was associated with strong job losses in the manufacturing sector in particular. The second reason is the moderate wage increase and the extension of working hours, which also contributed to work place competitiveness. The government's contribution was mainly the labour market reform (Hartz Reform) which changed the access to public aid and thus contributed to a stronger employment orientation of the labour force. "The parents of the German upswing, however, are companies and social partners" as the chairman of the Expert Advisory Board, Bert Rürup, stated on various occasions.

The improvement of the labour market situation is expected to continue. Recent forecasts range around 1.1% employment growth for 2007 and an unemployment rate of 8.8%. For 2008 forecasts still contravene: employment growth ranges between 0.4 and 1.3%, but unemployment rates are seen around 8%.

Table 2 Economic forecast for 2007 and 2008
Germany

Institution	Date of publication	GDP (% change from previous year)		Employment (% change from previous year)		Unemployment rate (%)	
		2007	2008	2007	2008	2007	2008
Association of Economic Institutes (ARGE-Institute)	April 07	2.4	2.4	1.2	07	8.7	8.0
IMK (Institut für Makroökonomie und Konjunktur)	April 07	2.2	2.1	1.1	1.0	8.7	7.8
IfW (Institut für Weltwirtschaft)	March 07	2.8	2.4	1.2	1.3	8.8	8.0
IWH (Institut für Wirtschaftsforschung Halle)	March 07	2.0	2.5	1.0	0.4	8.8	8.2
Ifo Institut	February 07	1.7	2.8	-	-	8.2	8.0
RWI (Rheinisch-Westfälisches Institut für Wirtschaftsforschung)	December 06	1.9	-	-0.1	-	9.5	-
IMF	December 06	1.5	-	0.5	-	7.8 ¹	-
OECD	November 06	1.8	2.1	0.6	0.5	7.7 ¹	7.2 ¹
Expert Advisory Board	November 06	1.8	-	0.7	-	10.2	-
European Commission	Autumn 06	1.2	2.0	0.5	0.6	8.4 ¹	7.8 ¹

¹Standardised unemployment rate
Source: Economix

3. Labour market policy developments

3.1. Policy actions

Childcare

The government coalition decided to launch a new childcare programme. 300,000 childcare places shall be established until 2013 in addition to the 286,000 places already financed by the existing day care investment programme. For every third child younger than three years, a day care place should be available. A working group of Federal and Länder governments and municipalities was established to negotiate on the details of the programme, in particular the distribution of resources among the Länder and the provision of financial resources. As expected, financial issues are still strongly controversial.

JobPerspektive

In March 2007 the coalition agreed upon a new program for difficult to place long-term unemployed. The aim of the coalition is to organise stable and socially approved jobs for recipients of ALG II, who do not fulfil the demands of employers. The programme targets especially older long-term unemployed without qualifications and with additional placement obstacles. The coalition aims to place these people into subsidized jobs in the service sector, social sector, and clerical sector or in sports clubs, provided these jobs are subject to social insurance. Participants shall be additionally supported with further training and psychological courses. The subsidy for integrative firms will correspond to the

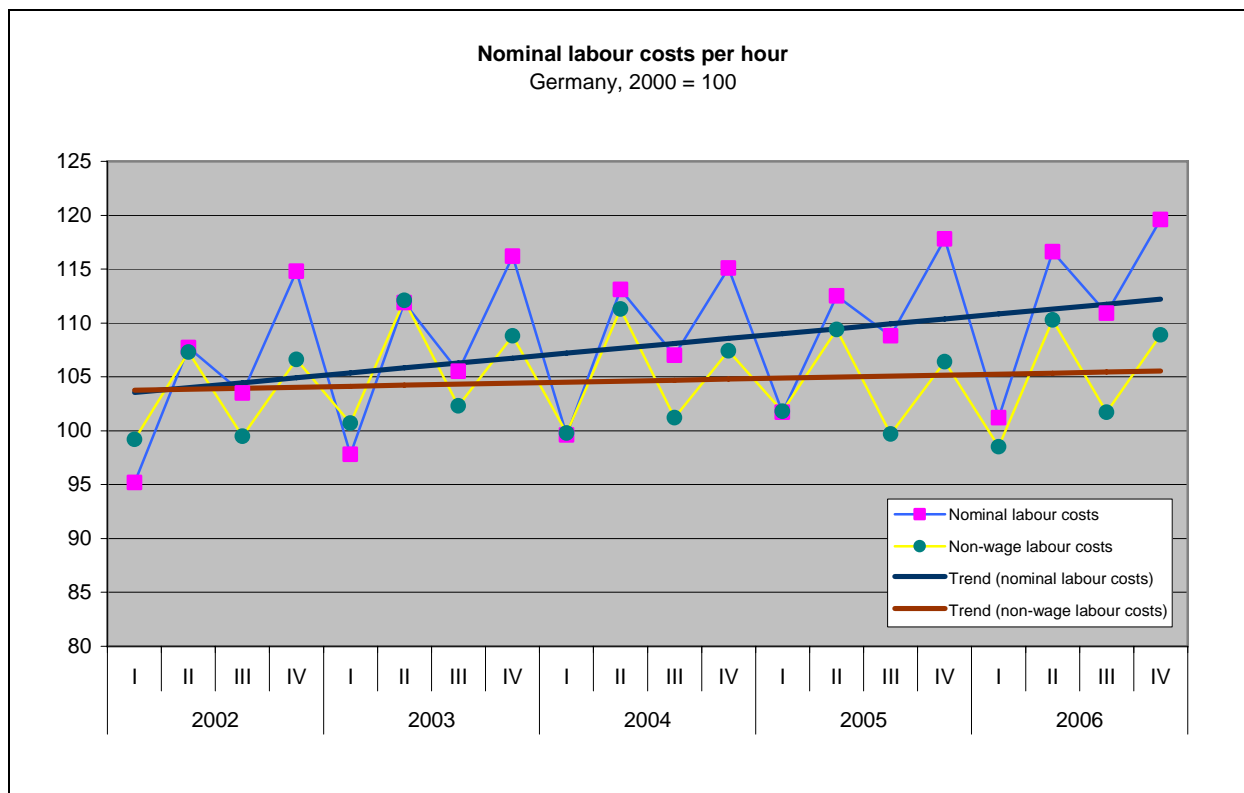
productivity losses they sustain through employing a difficult to place employee. The program is planned to be financed via Social Code II (SGB II).

Collective bargaining

After a long period of moderate wage increase, trade unions are determined to achieve high real wage gains in this year's collective bargaining rounds. A comprehensive analysis of wage development was recently published by the German Trade Union Federation, arguing for strong wage increase to overcome the low growth of consumer expenditure (DBG 2007). IG-Metall is in the forefront with wage demands of 6.5% for the 3.4 million metal workers. Other labour unions have similar targets. The IG BCE was seeking to achieve at least 4% wage increase for the 550,000 chemical workers. IG-Bau demanded 5.5% for the 700,000 construction workers. Employers, however, warned that the business climate is beyond its zenith and especially medium-sized companies would suffer from tightening competition. First wage contracts concluded in the construction and chemical industries were around 3.5%.

The potential for severe conflicts during this round is shown by the announcement of warning strikes in the metal industries, and particularly by the ongoing negotiations with the biggest telecommunication provider Telekom AG. The company is planning the outplacement of 50,000 workers to a subcontracting company, which will employ the workers at lower wages and longer hours. This reveals the severe interest of Telekom to avoid prevailing collective agreements – a plan which is strongly objected by the workers and the trade union VER.DI.

Chart 2 **Nominal labour costs per hour**



Source: Statistisches Bundesamt.

This year is a strong contrast to previous collective bargaining rounds where the protection of jobs had stood in the foreground for many years. As Chart 2 shows, nominal labour costs per hour increased by 1.7% per year since 2002. Non-wage labour costs grew even less. In real terms, wages declined by 0.5% in 2005 and 0.7% in 2006. This contributed

to cost competitiveness of companies in a significant way as unit labour costs increased in other European countries. The positive contribution of moderate wage increase can now be seen in relatively strong employment growth.

3.2. Public and scientific debate

Low-wage employment

Eight months after its foundation, the coalition working group “labour market” – established to develop a policy concept for the low-wage sector – presented its report on April 26 (Bundesministerium für Arbeit und Soziales 2007). However, the paper comes out without any definite decision. The instruments of combined wages and minimum wages remain strongly controversial among the coalition parties, accompanied by an intensive public debate. The report includes the results of the working group’s debates on five issues: the combination of labour income and UB-II benefits, combined wage models, minimum wages, long-term unemployment and the efficiency of the Social Code (SGB II) regulations.

Combined wages

The actual regulation for additional labour incomes of UB-II recipients under SGB II stipulates a tax free labour income of EUR 100 per month, and deduction rates of 80% for labour incomes between EUR 101 and 800, and 90% up to EUR 1,500. This is criticised for locking UB-II recipients in minor low-paid and part-time jobs. In addition, employers increasingly anticipate additional transfer incomes in their wage offers.

Three alternative models were developed to alter the regulation¹:

- *Income incentive approach*: The Expert Advisory Board suggested to reverse the regulation and to deduct labour incomes up to EUR 200 totally (Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung 2006). Labour income up to EUR 800 should be taxed by 50%, and income up to the limit of EUR 1,500 by 90%. In parallel, UB-II benefits should be generally reduced by 30% in order to raise incentives to accept jobs. For those without a job, auxiliary public jobs should be provided.
- *Negative tax approach*: Bofinger² and Walwei³ developed a model which applies a uniform deduction rate of 85% on labour incomes up to the basic income of EUR 750 (Bofinger, Dietz, Genders, Walwei 2006). Social contributions by employees should be reimbursed depending on the number of hours worked (50% for 15-30 hours per week, 100 % above 30 hours). Between EUR 750 and 1,300 an adjustment zone is defined, reducing the advantages in a linear way. Mini- and Midi-Jobs should be cancelled, and a general minimum wage of EUR 4.50 should be implemented.
- *Workfare approach*: The Federal Ministry for Economics and Technology (BMWi) links public benefits to the obligation for all employable recipients to work either in regular or auxiliary public jobs. Incomes below UB-II standards should be balanced.

Micro-simulations by the Institute for the Study of Labor (IZA 2007) showed that the workfare approach of the BMWi can be expected to have strongly positive labour supply effects. 1.4 million additional workers can be expected on the labour market, while the negative tax approach will activate only 145,000 workers (in full-time equivalents) and the income incentive approach 350,000. The stronger supply effects of the workfare approach

¹ Regulations are presented for singles only. For couples different income limits may apply.

² Peter Bofinger, member of the Expert Advisory Board.

³ Ulrich Walwei, Vice-Director of the Institute for Employment Research of the German Federal Labour Agency.

are linked to the legal obligation to take a job. Around half a million auxiliary public jobs will be required to provide job opportunities to all recipients.

Minimum wages

The debate on minimum wages has intensified during the first quarter 2007 as all political parties published their suggestions and the scientific community contributed further evidence. The trade unions of the food industries (NGG) and the service sector (VER.DI) founded the “Minimum-Wage Initiative” claiming a EUR 7.50 minimum wage per hour. This would mean a gross wage of EUR 1,250 per month and a net wage of EUR 928. The German Trade Union Federation (DGB) followed this suggestion and demanded the general introduction of a minimum wage in Germany in addition to mandatory collective agreements. Political parties had different opinions: while the Social Democratic Party (SPD) stands behind the trade unions, the Christian Democratic Union (CDU) might accept minimum wages only in the case of severe market failures. As a minimal step towards minimum wages, the government coalition decided in March 2007 on the extension of mandatory collective wages to the cleaning business. Negotiations on minimum wages will be continued by the coalition parties in May.

Empirical data shows that 11% of German workers are paid less than EUR 7.50 per hour. In Eastern Germany the share is 21%, and in Western Germany 9% (Brenke, Eichhorst 2007). The shares of women, young persons and foreigners are above average. Most of the low-paid workers are in small businesses of the agricultural and services sectors. About one third is working full-time while most of the others have mini-jobs and are living in households with additional employees or transfer incomes. Low-paid workers contribute about one fourth to household incomes. About half of the low-paid workers assess their wage level as unfair.

The minimum wage debate was steamed up by the observation that a rising share of UB-II recipients hold mini-jobs without little incentives to look for full-time employment. The low wage elasticity of these people lowered wage offers by employers and thus led to cost shifting to public unemployment programmes. Income support through combined wages and the introduction of minimum wages thus appears to be closely linked. This is also a result of international experience with combined wages. The alternative is to enforce workfare demanding for similar work inputs either to public work programmes or regular employment.

The introduction of minimum wages at the level of EUR 7.50 would mainly affect employment in Eastern Germany and in small businesses. A regional differentiation is therefore suggested. However, if minimum wages are low, they are unable to improve the income situation of low-wage earners. If they are high, they affect the number of jobs. This is the well-known dilemma of minimum wage regulation.

4. Recent labour market reports

Berufsbildungsbericht 2007. (Report on vocational training in Germany), published by the Federal Ministry of Education and Research. [[Internet Access](#)]

The report “Bildungsbericht 2007” by the Federal Ministry of Education and Research is the official assessment of the vocational training system in Germany. It contains an analytical appraisal of vocational training trends in Germany, starting with a review of the vocational training market in 2006 and continuing with a forecast for the training year 2006/07. The report is published annually.

In 2006 there was a positive development regarding the number of concluded dual training contracts. Overall 575,153 training contracts were concluded until September 2006, which is

4.7 % more than in 2005. Nevertheless the number of registered applicants without an apprenticeship training position increased to 49,453, which is 22.1% more than in 2005. An intensive placement campaign by the employment offices and chambers helped reducing the number of youth without a training position by 17,400 until January 2007. The increase of training positions was highest in trade and commerce (+ 20,770, or 6.6 %), followed by craft (+ 5,579, or 3.6 %), farming (+ 1,028, or 7.0%) and home economics (+201, or 4.9 %). In professional occupations and navigation the number of apprenticeship training contracts declined.

For 2007 the Federal Ministry of Education and Research expects a continuation of the positive development in the number of placements. They assume an increase of training places by 26.000, so that the number of overall training places will exceed 600,000 in 2007.

Although the overall number of school leavers will decrease noticeably until 2015, the number of school leavers looking for an apprenticeship will probably increase. In order to cope with the increasing numbers of placements needed, the authorities try to improve the dual training system and to enforce a European wide collaboration.

Zeitschrift für Arbeitsmarktforschung/Journal for Labour Market Research, Evaluation of Active Labour Market Policy in Germany, issue 3 and 4/2006.

The 3rd and 4th issue of the Journal of Labour Market Research 2006 deals with the evaluation of active labour market policy and the Hartz Reform in Germany. In addition to independent evaluations of active labour market policies, the volume contains the description of methods and detailed results of the Hartz evaluation presented in the last EEO Quarterly Report for IV 2006 (Vogler-Ludwig 2007, page 10).

The Hartz evaluation is described as the most comprehensive project of labour market in research in Germany. About 100 persons are working for this project, engaged by 20 different research institutions. Total expenditure will be EUR 10.3 million. The evaluation was demanded by the Deutsche Bundestag in order to observe the implementation of the reform and to draw political conclusions. The Hartz evaluation concentrates on measures concerning UB-I recipients (regulated in Social Code III) while UB-II recipients (regulated in Social Code II) are still largely excluded.

It is structured into three working packages:

- *(I) Effectiveness of instruments:* Prepared by two conceptual papers the evaluation was divided into six parts, separated by the major ALMP instruments. Labour market integration was determined as the dominant target indicator for all evaluations. Micro-analytical methods were suggested.
- *(II) Reorganisation of the Federal Labour Office:* The evaluation should assess the effectiveness of new organisational concepts introduced in the course of the Hartz reform.
- *(III) Acceptance of the Federal Labour Office:* In three waves from 2004 to 2006 employers, job seekers and the public are surveyed regarding the perception and assessment of the Federal Labour Office.

With the evaluation, labour market policy has the chance to become a learning system in Germany. This happens after a long period of expressed resistance against scientific evaluation. The interim result will certainly influence the current legislation for the update of the Hartz reforms.

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