



# THE IMPACT OF THE LABOUR LEGISLATION REFORM IN GERMANY

LABOUR MARKET REFORMS  
AND THE "JOBS MIRACLE" IN GERMANY



*European Economic and Social Committee*



**European Economic and Social Committee**  
Workers'Group

**"The impossible gets done at once; the miraculous takes a little longer."**

## **LABOUR MARKET REFORMS AND THE "JOBS MIRACLE" IN GERMANY**

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## Executive summary

Radical labour market reforms were implemented in Germany between 2002 and 2005, reforms that overturned the received idea that Germany was suffering from "reform paralysis". However, the part of these reforms that specifically concerned *labour law* was very small; their main purpose was to overhaul the social security and activation system for the unemployed and others of working age who are in need of support in line with a "*work first*" strategy. These reforms were extremely controversial and changed the party-political landscape in Germany.

Shortly after the reforms were introduced, a *trend reversal* took place on the German labour market: *unemployment fell, employment* with mandatory social insurance contributions picked up again, and the German labour market proved extraordinarily *resilient* through the 2008-2009 financial and economic crisis. Since then, the German economy has been so strong as to arouse increasing concern about economic imbalances within Europe. At the same time, however, neighbouring European countries are endeavouring to emulate Germany's supposed path to success by implementing "structural reforms" along the lines of the German model, in the hope of achieving similar results.

It is tempting, given their synchronicity, to see a causal relationship between the labour market reforms and the trend reversal on Germany's labour market, and to counter criticism of their negative repercussions by pointing to their effectiveness in addressing the main issue. In fact, the *impact of the labour market reforms has been much more limited* than is generally assumed. The fall in unemployment can be attributed to a shrinking labour pool, slowing productivity growth and distribution of hours worked between more people; the mismatch component of unemployment was not lessened. The astonishing performance of Germany's labour market during the 2008-2009 crisis comes down to constellations of factors and mechanisms that reflect a return to the traditional model of a "coordinated" national economy (Hall and Soskice 2004) rather than the neoliberal spirit of the labour market reforms. But *the negative effects of the reforms were also more limited* than their critics maintain: although wage stagnation, increasing wage inequality, a growing low-wage sector and an increase in atypical forms of employment are absolutely consistent with the reforms, these phenomena had started appearing many years before, and some such trends actually eased off after the reforms. That leaves the increase in temporary agency work and "mini jobs" as attributable to the reforms, in substance and timing.

We therefore think that in addition to the so-called Hartz labour market reforms, two other fundamental system changes must be considered, namely *pension reforms* and the *weakening force of collective agreements and workplace representation*. The slackening of the collective bargaining system is a much more significant factor than the labour market reforms with respect to the stagnation of real wages, growing wage inequality and above all the widening gap between wages in the production sector and in the service sector. It is questionable whether Germany's export success is really due to wage restraint, which is much less extreme in the export-oriented manufacturing

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sector than in the services sector, and whether a strategy geared more to boosting domestic demand would not ultimately have created more jobs. Pension reform has helped to ensure a higher increase in the employment rate for older people in Germany than in any other EU Member State. This reform also prevented businesses from using the traditional solution of early retirement schemes to reduce staff numbers during the 2008-2009 crisis, forcing them to rely even more than before on "internal" rather than "external" flexibility in their human resource deployment. However, the likelihood of older workers starting work with a new employer has not increased relative to that of younger workers. More older people in employment essentially means that workers continue longer in their current jobs and remain in a company longer than earlier cohorts.

So what impact have the labour market reforms actually had? They appear to have *accelerated the transition from unemployment to employment*. This does not mean, though, that the employment opportunities of the long-term unemployed have improved. The acceleration effect is limited to the short-term unemployed, who can still claim insurance-based unemployment benefit and who want to avoid being relegated to means-tested income support. For the same reason, workers' fear of unemployment and consequent willingness to make concessions have increased, so that they are prepared to sacrifice more in return for keeping their job. This helped in riding out the 2008-2009 crisis. But such fear also makes workers less prepared to take risks. Labour *turnover* in the wider economy has fallen despite economic and employment growth. The average *time spent* in an employment relationship has increased despite the expansion in "flexible" forms of employment. The German labour market has therefore become less efficient in reallocating workers. This could be attributable not just to the deterrent effect of the labour market reforms, but also to falling entry-level salaries in new jobs.

Thus the labour market reforms have so far helped to prevent signals of changes in supply-demand ratios (a shrinking workforce with expanding employment) from being registered by market players and reflected in the price of labour, despite growing complaints of labour shortages. The result is less pressure to streamline, a slow-down in productivity growth and weak investment despite abundant financial capital.

Overall, the German model is therefore not one to follow, though this is not to rule out certain aspects of it providing further ideas for possible reform options in other countries.

## 1. Introduction

In 2003, a German economics professor was still describing Germany as "the sick man of Europe" (Sinn 2003). In the early 2000s, the German media were full of reports about the success of labour market reforms in neighbouring countries. The Hartz Commission set up in 2002 by the then chancellor, Gerhard Schröder, had reports drawn up on various countries (Frick 2002, Hartmann 2002a, 2002b, 2002c) and conducted fact-finding trips to some of those countries (Hassel and Schiller 2010). Much of what was reported in Germany at the time about its neighbours did not stand up to close scrutiny (Knuth et al. 2004), and some ideas were completely overturned just a few years later – the durability of labour market reforms is limited in other countries too.

The tide has now turned. Since 2009, the whole world has been talking about a "German jobs miracle", and the chairman of the Christian Democratic group in the German *Bundestag* boasted that "now Europe is speaking German". People in other countries must now accept Germany being held up as an example of how to address a labour market crisis. The European Commission has proposed a system for continually obliging the Member States to adopt "structural reforms" (European Commission 2013). Even now, nobody looks too closely if a country has a "German story" that can lend conviction to its own political message.

Between Germany's sickness and its miraculous recovery lay what was probably the most thoroughgoing social reform in the history of the Federal Republic. Within the EU, the reform is notable for the *simultaneous and radical* change in the structure both of the unemployment benefit system and the organisation of "labour market services". No other EU country has implemented such extensive reforms in both these areas in such a short time (Knuth 2008). The complete overhaul by 1 January 2005 of the system of benefits and the way services are delivered is the apparently impossible task that was achieved "overnight".

It was natural in both the debate in Germany and the international assessment for a causal relationship to be assumed between the reform and the apparent fundamental change in Germany's labour market conditions. Pressure is being exerted more or less openly on other countries to achieve the same as Germany. Before following such advice, however, the following questions must be answered:

- What exactly did Germany do?
  - Is the current favourable labour market situation in Germany even attributable to the reforms?
  - What less desirable effects did the reforms have, or what less progressive trends did they encourage?
  - What factors other than the labour market reforms were responsible for both the positive and negative trends?
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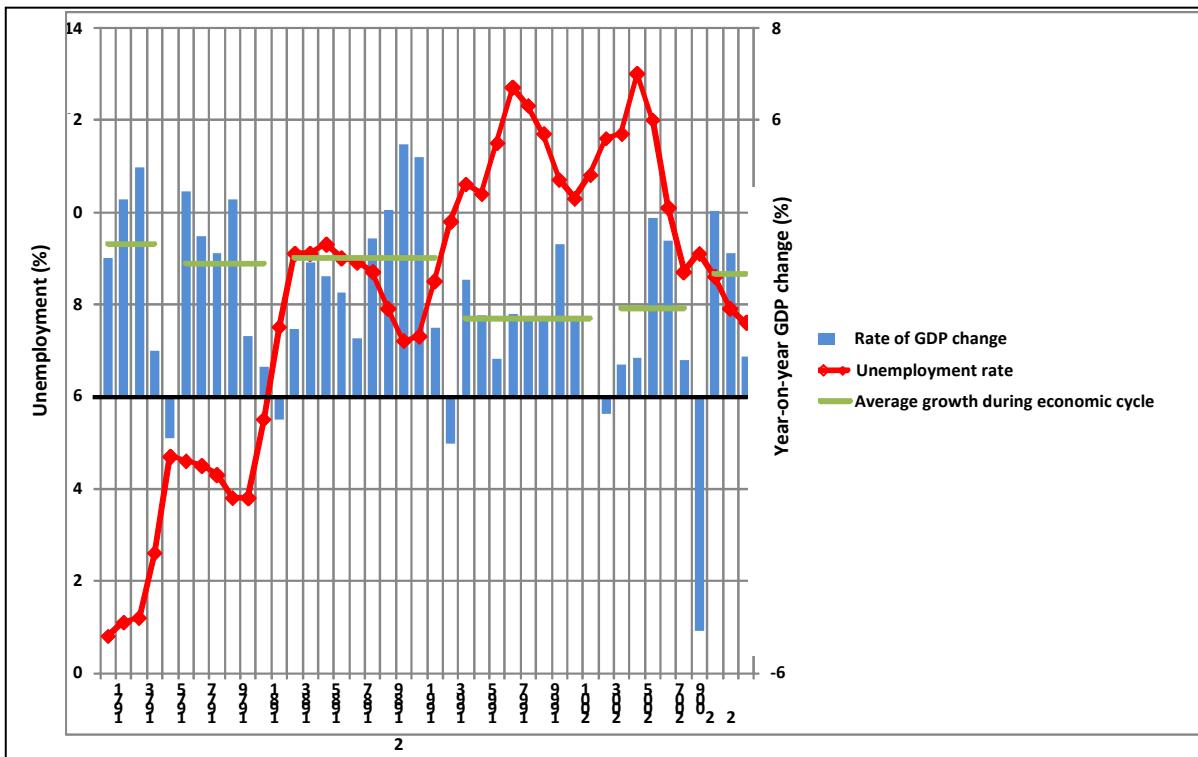
This paper is structured as follows. Section 2 describes the essential features of Germany's labour market transformation by looking at long-term trends over several decades. Section 3 considers the three organisational changes in the German labour market that we consider fundamental: the Hartz reforms, pension reforms and the declining force of collective agreements. Section 4 asks whether the Hartz reforms have delivered on their key promise, namely to improve job placement and break the pattern of entrenched long-term unemployment. Section 5 analyses the increase in employment levels with reference to the age structure of the population and types of employment, and asks why the German employment system proved so surprisingly resilient during the 2008-2009 crisis. Section 6 looks at developments in the level and structure of earnings, and Section 7 addresses the dynamics of the German labour market, or its tendency to stagnate. The paper is introduced by an executive summary.

## **2. Main long-terms trends on the German labour market**

The past seven years have seen a fundamental change in Germany's labour market. From the early 1970s until 2005, the unemployment rate climbed from one economic cycle to the next: when growth was weak or even negative, unemployment surged, but when the economy picked up again unemployment did not return to its previous level (Figure 1).

This pattern now seems to have been broken: even in 2008 during the crisis unemployment continued to decrease, and in 2009 the biggest recession in 80 years had only slight and transitory effects on the unemployment rate. Average growth rates since 2004 have been at a level that would previously have been associated with rising unemployment. Any "miracle" on the German labour market is due not to stronger growth but to a heightened responsiveness of the unemployment level to growth triggers.

**Figure 1: Average yearly unemployment rate<sup>1</sup> (left-hand scale) and changes in GDP (right-hand scale) 1971-2012**



Source: Federal Employment Agency - 2013 Statistics; Federal Statistical Office 2013a

Figure 2 shows some of the reasons for this new trend: the working-age population has been falling since as far back as 1999; but the number of people in work was already rising from the end of the 1990s, with short dips or reversals only during economic downswings. The employment rate thus hit a historic high of nearly 73% (in 2012)<sup>2</sup>. On the other hand, the total number of hours worked declined between 1992 and 2006, i.e. during this period more workers shared a shrinking work "pie" by working on average fewer hours<sup>3</sup>. The increase in "mini-jobs" and "solo entrepreneurs" (see point 5.2) explains how it was possible for employment and jobs subject to social security contributions<sup>4</sup> to move in opposite directions up until 2005; the latter have only been rising again since 2007. This trend is reinforced by the fact that total hours worked apparently stopped falling in 2006. If the

<sup>1</sup> This means registered unemployment according to the national legal definition, which is substantially different from the internationally comparable measure based on labour force. See also footnote 18.

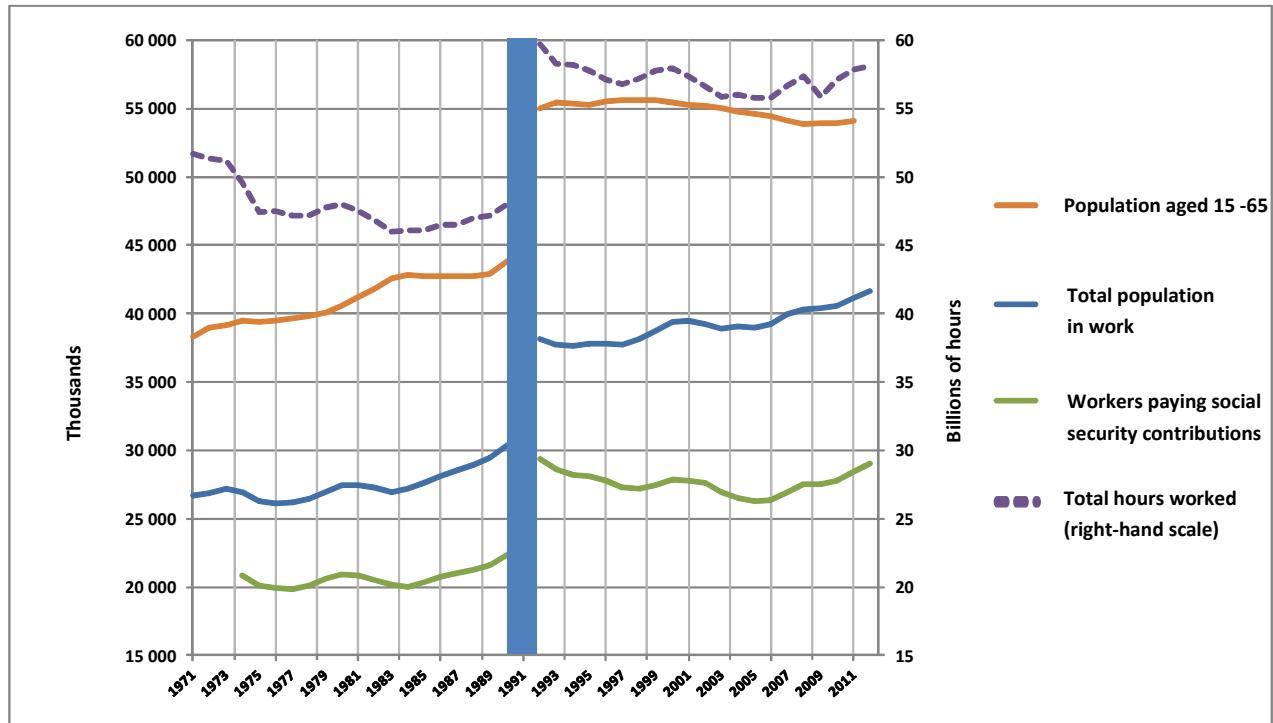
<sup>2</sup> The growing number of people in employment would still lead to a fall in the unemployment rate even if absolute jobless figures did not fall, because the denominator used to calculate the unemployment rate is increasing. In absolute terms, the unemployment trend is therefore not as favourable as Figure 1 suggests.

<sup>3</sup> The distribution was very uneven, especially with respect to gender. The increasing number of above all western German women in work was accompanied by an increasing number of part-time contracts and "mini jobs". Within Europe, the *gender working-time gap* is greater only in Austria, Ireland, the United Kingdom and the Netherlands. Comparing the working-hours profiles of men and women in the United Kingdom, Germany, Sweden and Slovenia, only in the United Kingdom was the proportion of women in "very short" part-time work (under 20 hours) higher than in Germany (Kümmerling 2013, p. 5).

<sup>4</sup> Civil servants, self-employed people and "marginal" workers earning up to EUR 400 (EUR 450 since 2013).

number of hours worked is static or increasing during a period of moderate growth, this indicates that productivity growth is slowing (Klinger 2013), which may be due to weak wage growth (low pressure to streamline) (see Section 6) and could in the longer term – combined with a widening investment gap (Bach et al. 2013) – be a problem for competitiveness.

**Figure 2:** Working-age population, number of people in work, workers paying social-security contributions (left-hand scale) and total hours worked, 1971-2012<sup>5</sup>



Source: Institute for Employment Research 2013b, and earlier editions.

*Preliminary conclusions: decrease in the working-age population due to demographic changes, slower productivity growth and falling average working hours explain the substantial increase in employment despite only moderate GDP growth rates.*

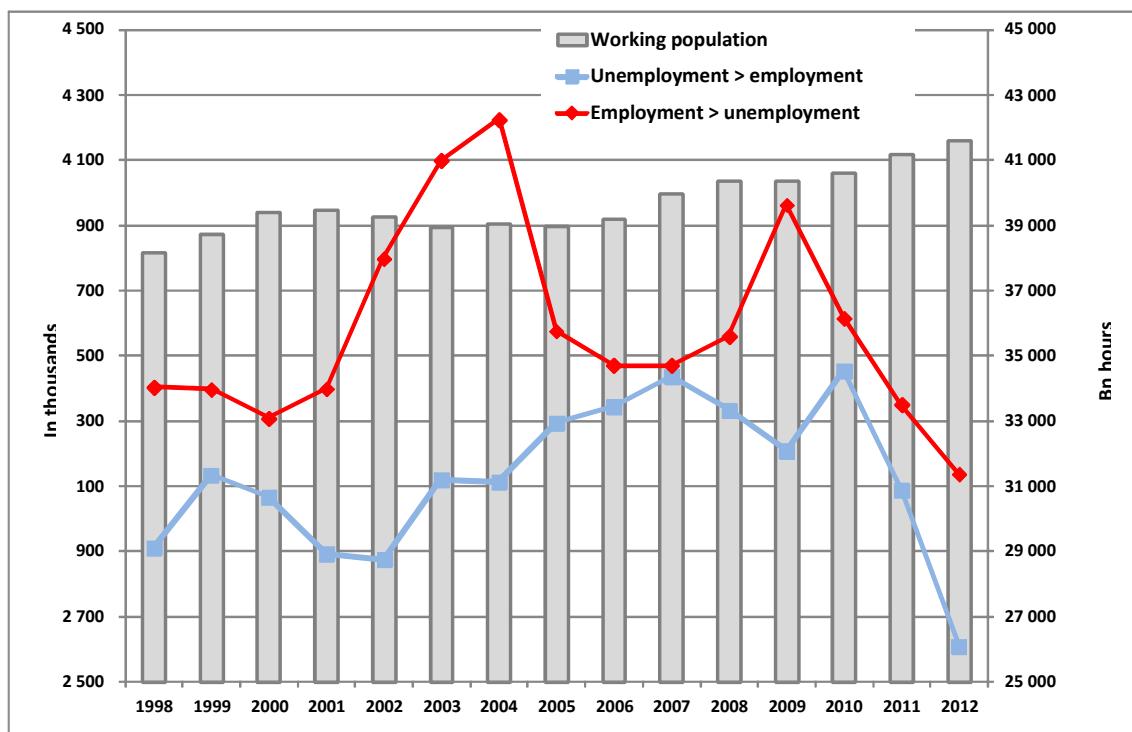
Nevertheless, it is not obvious that this constellation of factors should result in a substantial decrease in unemployment: as long as there is a "hidden reserve" of around 1.1 million people of working age who are neither working nor unemployed, but in principle wish to work (Federal Statistical Office 2013), then employment growth could be fuelled from this source. For unemployment to fall, more unemployed people must be "included" in the rising employment figures.

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The absolute figures necessitate the break to account for German reunification, indicated by the blue bar.

Figure 3 shows that this actually was the case. In western Germany especially, the number of people moving from unemployment to employment around the year 2000 had become almost totally independent of the increase or decrease in employment, and the flow in the opposite direction (moves from employment to unemployment) had substantially increased. From 2005, however, moves from unemployment to employment are at a slightly higher level, and the two curves are much closer together<sup>6</sup>. This is consistent with the finding of Hertweck and Sigrist (2012) that the unemployment rate tended to be determined by flows into unemployment before the reforms but by flows out of unemployment after the reforms. In 2009, the economic crisis is reflected by flows in the direction that would be expected, although virtually no effect on the level of employment can be seen.

**Figure 3: Flows between unemployment and employment (left-hand scale) and level of employment (right-hand scale), 1998-2012**



Source: Federal Employment Agency, 2013

The shape of the two curves is probably due from around 2004 to a triple effect of the "activation" measures, which will be explained in more detail in the next chapter. Firstly, pressure on the unemployed to take a new job quickly increased after 2005. Secondly, in conjunction with pensions policy, it became virtually impossible to claim unemployment benefit as part of an early retirement arrangement (cf. Knuth and Kalina 2002), which means that there are automatically hardly any more

<sup>6</sup>

The proximity of the two curves since 2006 equates to a decrease in unemployment: since long-term exits from employment are the result not just of moves into work, but also of moves into retirement, unemployment can also fall if flows from employment to unemployment are slightly higher than flows in the other direction.

older unemployed people who are not intending any return to employment. And thirdly, for this very reason there were considerable "last chance" effects (Dlugosz et al. 2009b, 2009a) in 2004 when the content of the reforms was already known, with companies and older workers seizing their final opportunity to take this type of "early retirement". In 2005 there were already substantially fewer moves from work to unemployment, even though the economy did not start picking up until 2006. This brought forward some of the "demographic pressure" of the post-reform phase into the reform phase.

More recently, in 2011 and 2012 flows between employment and unemployment were still below levels seen at the end of the 1990s. This trend reflects the decrease in jobless figures, but also a decrease in 2012 in the *rate* of movement from unemployment into employment (as a proportion of the number of unemployed), as well as new vacancies notified to the employment service (though not the number of vacancies reported by companies in repeated surveys) (Brücker et al. 2013). This combination of factors indicates that the potential labour force among the remaining unemployed population is becoming less attractive to companies.

Two questions will now be addressed in parallel: (1) to what extent are the apparently positive changes in the labour market at macro level linked not just to the demographic and productivity factors that are explored above but also to organisational changes? (2) and what has been the less positive fallout of those organisational changes? To answer these questions, however, the organisational changes themselves must first be presented.

### **3. Labour market reforms and phasing in of organisational changes from 2000**

Not all the new rules governing the German labour market are based directly on legislative reforms; the gradual loss of powers of structures that were once important is equally relevant. This section therefore takes a look at three aspects of labour market regulation:

- (1) the so-called Hartz reforms of labour market policy and regulation of employment relationships;
- (2) the progressive changes in the framework for transition to retirement based on reforms to pension law<sup>7</sup>;
- (3) the decreasing force of collectively agreed terms for industrial relations.

#### **3.1 "Hartz reforms"**

The reforms to labour market policy and employment law, which were implemented through several legal acts<sup>8</sup> between 2002 and 2005, can be divided into seven categories:

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<sup>7</sup>

The first legislation in this area was introduced back in 1992, though most of the new rules did not take effect until after 2000.

1. *Conversion of the Federal Employment Office into the Federal Employment Agency*, or from a rule-based administrative body into a "managerial" body driven also by targets and indicators, with the objective of "activating" the unemployed more efficiently, placing job-seekers more quickly and presenting itself to employers as a recognised service partner.
2. *Cutting back unemployment insurance* and stricter application of a "safety net" logic:
  - enforceable obligation to be actively seeking work before the expiry of an existing employment relationship, i.e. when notice is received or three months before the end of a fixed-term employment relationship;
  - shortening from three to two years of the period within which insured employment lasting at least 12 months must be demonstrated to justify a claim for earnings-related unemployment benefit (*Arbeitslosengeld*) (in some cases, people who have not been continuously employed may not be eligible: see Jahn and Stephan 2012 on the implications of this measure);
  - shortening from 32 months to 24 months<sup>9</sup> the maximum period during which unemployment benefit can be claimed by older people, and raising from 45 to 50 the age from which it is possible at all to extend the duration of benefit beyond the normal 12 months, which remained unchanged.

The conditions for claiming unemployment benefit eligibility therefore lie around the middle of the range among the EU 15 (Jahn and Stephan 2012); entitlement periods are at the shorter end of the EU scale (OECD 2013); and the job-seeking and availability requirements are among the strictest in the OECD (Venn 2012, p. 16).

### 3. *"Merging" of unemployment assistance and social assistance*

- The tax-funded and means-tested follow-up benefit known as "unemployment assistance" (*Arbeitslosenhilfe*), also a percentage of previous income and paid after expiry of the entitlement to unemployment benefit (replacing only 53% of earnings<sup>10</sup>, compared with 60% for unemployment benefit), was scrapped. Instead of receiving an earnings replacement benefit<sup>11</sup> based on previous income for an indefinite period, younger and middle-aged workers can now only expect to receive a maximum of 12 months of wage replacement benefits intended to maintain their living standards.

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<sup>8</sup> In fact, the Hartz reforms consisted of four laws, but a number of new rules are mentioned here that were introduced in conjunction with the reforms under other legislative acts.

<sup>9</sup> This was initially shortened to 18 months, but nobody was affected because of the subsequent extension to 24 months.

<sup>10</sup> 57% for claimants with dependent children.

<sup>11</sup> See Knuth 2009 and Knuth 2012a for a discussion of whether it is appropriate to see unemployment assistance as a "tax-funded continuation of unemployment insurance".

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- Unemployment assistance was replaced by a revised form of social assistance for the active population, i.e. a means-tested basic subsistence allowance for all people deemed fit for work<sup>12</sup> between the age of 15 and the prevailing statutory age at which a pension can be drawn, which has been rising progressively since 2012. This allowance is confusingly called "unemployment benefit II" (*Arbeitslosengeld II*, or ALG II)<sup>13</sup>.
  - As with traditional social assistance, the new universal subsistence allowance requires the claimant to reduce or overcome their need for assistance through their own efforts, which may be limited only by personal and family factors, not by the way the labour market is regulated (e.g. collective agreements, customary local wage). Part of the allowance can still be paid out where earned income<sup>14</sup> is inadequate, the aim being to calculate earned income in a way that ensures an incentive.
4. *Fragmentation of public employment services* as an unintended consequence: the original idea was to make the Federal Employment Agency equally responsible for both unemployment benefit and ALG II claimants, but because of the link with traditional social assistance (*Sozialhilfe*), which had always been administered by local authorities, it proved impossible politically and constitutionally to exclude local authorities from implementation of the new benefit (Knuth 2012a). Under the compromise that was eventually found, local authorities are either involved as local partners of the employment agencies or they have sole responsibility (in one quarter of NUTS-3 regions) for implementing the new benefit and activation system. Both these types of "job centre" have developed into a second level of public employment service separate from the employment agencies (which are responsible for unemployed people with insurance and for advising jobseekers not receiving statutory benefits), both organisationally and, for the most part, physically.
5. *Reform of instruments for actively promoting employment*: the reform of these instruments is an ongoing process that has if anything gathered pace since the Hartz reforms. Virtually none of the innovations in the Hartz reform package relating to instruments are still extant. We will therefore mention only three changes, which had some relevance for the long-term development of the labour market:
- increasing support for *new business start-ups* by unemployed people;
  - introduction of the system of *working for the benefit plus expenses*, or "one-euro jobs", and widely extending the use of this instrument for a certain period;

<sup>12</sup> Anybody who is considered medically able to work for three hours a day qualifies as fit for work. This exactly mirrors the definition of unfit for work ("complete incapacity") under German pension law. The basic subsistence allowance is therefore drawn by many people whose capacity is severely impaired for medical reasons.

<sup>13</sup> Hartz IV has become the established popular term for this because the allowance was introduced under the Fourth Act for Modern Services on the Labour Market, or the fourth "Hartz Law".

<sup>14</sup> Workers still claiming the subsistence allowance in addition to their wage are the German equivalent of people claiming *earned-income tax credits* in other countries.

- increasing the *marketisation* of relations between the public employment service and external service providers, i.e. replacing support provided under the law on public grants or through direct commissioning with competitive procurement procedures or issuing of vouchers to job-seekers.

## 6. Employment law deregulation

- The scope of application of statutory *protection against dismissal* was limited to companies with ten or more employees (as opposed to five previously), thus excluding a further 10% of workers from this protection (Koller 2010, p. 313).
- In cases where a contract is *terminated by the company*, the employer was given the option of offering a settlement in its notice of termination for a legally defined amount on condition that the employee refrain from taking legal action against the dismissal.<sup>15</sup> We have no information on how this option has been used in practice. It does not entail any material restriction of rights.
- *Labour leasing (Leiharbeit)*, or temporary agency work, was deregulated by lifting the ban on fixed-term contracts, concurrent contracts and re-employment, as well as the maximum duration of an assignment, and the EU *Temporary Agency Work Directive* was implemented in such a way as to give collective agreements precedence over the EU principle of *equal pay*. Employer-friendly "unions" not belonging to the German Confederation of Trade Unions subsequently agreed low wages for temporary agency workers, and it was only after lengthy legal battles that these organisations and the collective agreements concluded by them were declared unlawful<sup>16</sup>.
- The minimum age at which a *fixed-term employment relationship* may be entered into without an objective reason and without any time limit was lowered from 58 to 52 years. This subsequently had to be restricted, following a judgement of the EU Court of Justice, to people who have been out of work for at least four months, and to a total duration of consecutive fixed-term contracts of five years. No statistically significant effect was observed on the employment prospects of older workers, even for the period before the restriction was imposed (Fertig and Jacobi 2007).

None of these rules have affected the status of employees with open-ended employment relationships in larger companies; instead, the less regulated areas on the margins of the labour market were expanded. The following change, which does not fall within the framework of labour law, is also of this type.

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15 This rule must be seen in the context of there being no legally defined entitlement to a severance payment in Germany up until now. Settlements may be decided under a redundancy arrangement negotiated between the works council and the employer, individually between the employer and the employee, or as the result of a court settlement. In many cases, however, a worker dismissed by their employer receives no compensation (Bielenski et al. 2003).

16 It was not until 2012 that a procedure was introduced for setting a "wage floor" specifically for labour leasing, amounting to a modified form of an *erga omnes* rule (i.e. of general application).

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7. New rules were introduced yet again<sup>17</sup>, from 1 April 2003, for marginal employment, under the new label of *mini jobs*:

- The rule introduced by the first "red-green" (SPD-Green Party) coalition government in 1999 whereby contracts for second jobs had to be aggregated with the primary employment relationship, ruling out the "mini-job privilege" for side jobs, was abolished again by the second red-green coalition.
- Whereas the upper limit for applying the mini-job regime used to be set according to the weekly number of hours worked (15 hours), it is now determined solely on the basis of earnings (EUR 400 since 2003, EUR 450 since 2013), which means that a working week of over 15 hours<sup>18</sup> may count if the hourly wage is low.
- The convention has been that workers are not required to pay social security contributions in such employment relationships, which also means that they acquire no entitlements<sup>19</sup>. Mini jobs are thus attractive above all for people who already have insurance from another source, e.g. through their parents or spouse, or as a pensioner<sup>20</sup>. The employer pays a flat-rate tax, which means that earnings from mini jobs do not have to be included in the household income tax assessment and that they are therefore not affected by tax progression, which represents a tax advantage on the one hand for second jobs and on the other – bearing in mind that the income tax systems "splits" the income of married couples (cf. Dingeldey 2002) – for the spouses of workers with medium to high incomes.

Mini jobs are subject to specific social security and tax rules, but are not treated differently under labour law, so in theory protection against dismissal, fixed-term contract rules, collective agreements and statutory leave entitlement also apply to such "minimally" employed workers. In practice, however, things are different<sup>21</sup>.

### **3.2 Changes in the pension system**

Given that the statutory pension in Germany still covers some 80% of the working-age population and is an important part of people's pension portfolios, even among the better off (Allensbach

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<sup>17</sup> A social security contribution floor has existed since these were introduced in 1893 (cf. Knospe 2007).

<sup>18</sup> The 15-hour limit is relevant because under the official definition, people qualify as unemployed if they are working fewer than 15 hours per week but are seeking work of over 15 hours per week.

<sup>19</sup> The historical background to this system is that "housewives" were brought into the labour market when labour was scarce without disturbing the traditional male breadwinner model, i.e. by continuing to be covered by the social security entitlement of their spouse. These rules were never intended to raise the disposable income of low-paid workers or introduce incentives for unemployed people to accept work.

<sup>20</sup> This must be seen in the context of health insurance being designed as family insurance and of survivor's pensions still playing an important role in pension systems.

<sup>21</sup> In many cases, workers are paid only for the hours worked, and leave entitlement and sick pay do not apply (RWI 2012; Federal Ministry of Family Affairs, Senior Citizens, Women and Youth 2012; Eichhorst et al. 2012).

Institute 2013), it is important to highlight the following aspects of the reforms to the pension insurance system that influence the labour market behaviour of workers:

1. The long-term *fall in the pension level* has a negative effect on the ratio of relative lifetime earnings, expressed in "earnings points", to future anticipated pension payments. Workers can only partially compensate for this by increasing the number of contribution years (i.e. working longer) or by increasing their working hours (i.e. earning more).
2. From 2001, the reform of *disability or invalidity pensions* added to a system that was already restrictive in international terms (cf. Erlinghagen and Knuth 2010; Brussig and Knuth 2013) a safeguard clause preventing the long-term unemployed from "dodging" the "activation system" that was introduced shortly afterwards by taking a disability pension (Brussig 2010c). Disability pensions therefore do not function in any significant way as a labour market buffer in Germany (Brussig 2012a).
3. From 1996, *categories of pension that could be drawn before the statutory retirement age*, including following a period of long-term unemployment, were first reduced in order to discourage people from claiming them; from 2006 the minimum age at which such types of pension could be claimed was raised stepwise up to the statutory pension age, so that each special regime disappeared. This produced a gradually increasing incentive and ultimately an obligation to remain in work longer, since either a pension was no longer available as an alternative source of income or such a pension could only be acquired by accepting reductions (cf. Brussig 2010a).
4. *Gradual retirement for older workers*: this was introduced back in 1996 with the original intention of "smoothing" the transition to retirement, but it was only accepted by employees, companies and the social partners on a "block" model: workers are initially in part-time employment officially but continue to work full-time and are later credited with the extra hours worked while formally still in part-time employment and statistically counted as employees paying social security contributions. This helps companies and workers to bridge the gap with rising pension age ceilings (Brussig et al. 2009).
5. The stepwise *raising of the statutory retirement age to 67* began in 2012 with an annual increase of one month, to rise to two months annually from 2024, so that by 2029 the statutory retirement age will be 67 for people born in or after 1964. The current impact is still limited, but the signal sent to workers and companies is already influencing expectations and behaviour.

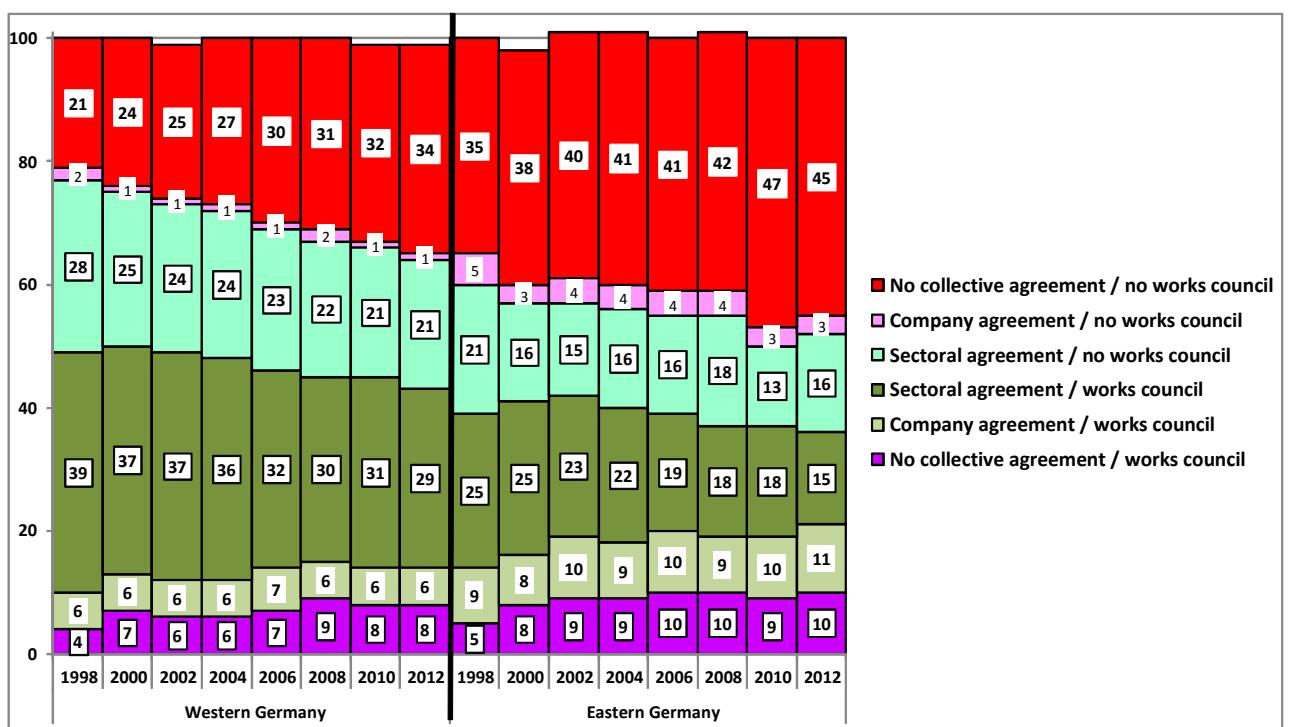
### **3.3 Collective regulation of industrial relations**

The system of collective bargaining did not fall within the scope of the reforms, and the legal position of works councils was actually strengthened in 2001 through a reform of the Workplace Labour Relations Act. There have nevertheless been processes of *de facto* deregulation in this area which may be just as relevant to the situation in Germany's labour market and companies as the reforms under discussion. It is important to remember here that Germany belongs to the minority of EU Member States that do not have a statutory minimum wage (Eurofound 2013).

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The number of workers in companies that are bound by a regional collective agreement has steadily decreased since 1998 when data were first collected, without a substantial rise in the number of company agreements (Figure 4). The number of workers whose employment relationship is not covered by any collective agreement at all thus increased from 25% to 42% in western Germany, and from 40% to 55% in eastern Germany, between 1998 and 2012 (top and bottom segments in Figure 4)<sup>22</sup>. At the same time, the proportion of workers in whose company a works council was elected has decreased, although legally it would have been possible for a works council to be elected in all the companies included here (with more than five employees). The proportion fell from 49% to 43% in western Germany and from 39% to 31% in eastern Germany (bottom three segments in Figure 4). The proportion of workers in companies without a works council and not covered by a collective agreement thus increased from 21% to 34% in western Germany and from 35% to 45% in eastern Germany (top segment in Figure 4).

**Figure 4: Collective agreements and existence of works councils in western and eastern Germany (as a percentage of workers covered in companies with five or more employees)**



Source: Ellguth and Kohaut 2013, data from IAB Establishment Panel

22

These figures have recently been broadly corroborated by the Federal Statistical Office, which reported 41% of workers in companies without a collective agreement in Germany in 2010 (Federal Statistical Office 2013b).

The *de facto* deregulation of labour relations resulting from the weakening force of collective agreements and workplace representation is much more significant than the largely symbolic deregulatory measures implemented on the margins of the labour market under the Hartz reforms (see point 3.1 above). It was therefore necessary to look at this factor, since it affects the labour market trends described in section 2 above and sections 5 and 6 below.

#### **4. Employment services and long-term unemployment**

The Hartz reforms were prefaced by an outcry over the placement statistics of what was then the Federal Employment Office, based on a report of the Federal Court of Auditors. The main objective of the reforms, as a blueprint for "modern labour market services", was to ensure more effective and faster job placement. This raises the question of whether job placement has now become more effective. However, the reforms also entailed changes in statistics, rendering long-term before-and-after comparisons impossible. It is only from 2007 that statistics have been sufficiently consolidated again to allow time-series analysis.

If the 2009 crisis-induced dip is stripped out, the relative performance of placement services overall more than doubled between 2007 and 2011<sup>23</sup>, and improved even more for older people (Figure 5). For the long-term unemployed, on the other hand (data are missing for 2010), the relative improvement was smaller, i.e. their relative disadvantage with respect to placement opportunities increased. This is noteworthy because the reforms were after all supposed to ease long-term unemployment in particular. It is very difficult to find jobs for people who have been out of work for a long time, because only 33% of companies are in principle prepared to hire them (Moertel and Rebien 2013). The number of long-term unemployed as a percentage of total unemployed did fall between 2007 and 2009, but has not dropped any further since.

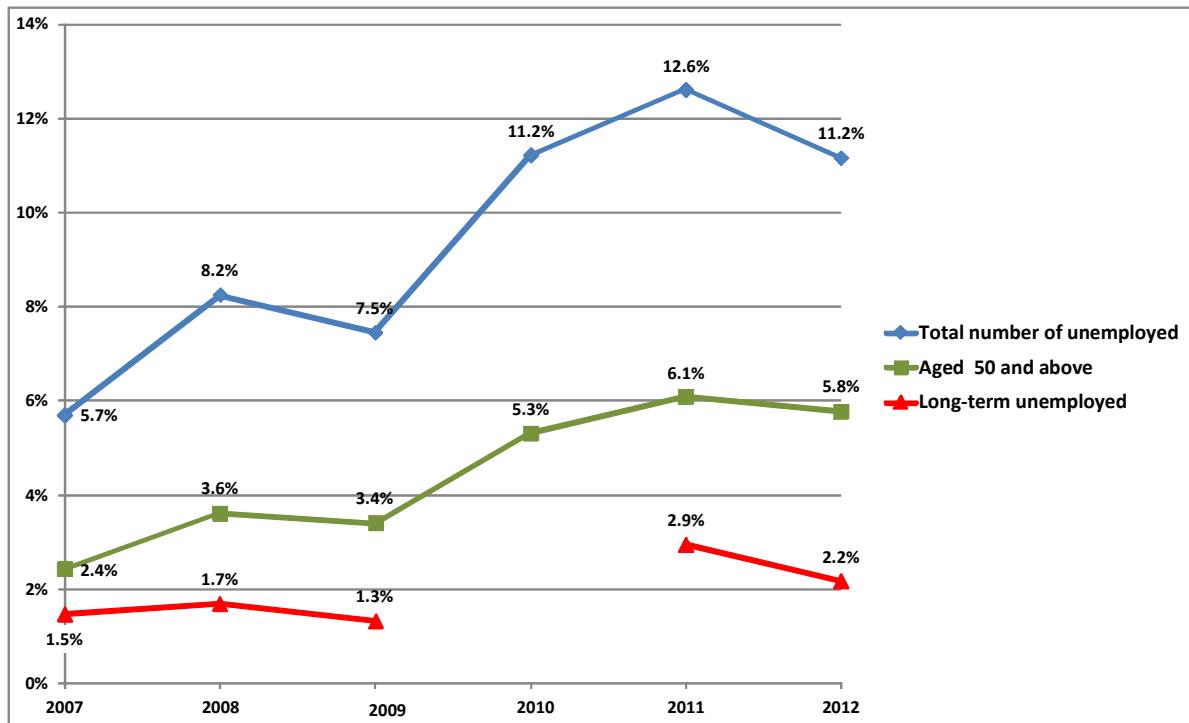
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As shown in Figure 3 (p. 7), placement opportunities decreased in 2012, which should probably be seen as heralding the end of the current cycle.

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**Figure 5: Placement in non-subsidised jobs as a proportion of the average annual number of unemployed, long-term unemployed and older unemployed**



Source: Federal Employment Agency (2007-2012): labour market integration report in accordance with § 11 SGB III and § 54 SGB II (without data from approved local authorities for 2007-2009 and with data from approved local authorities for 2010-2012); author's calculations

An improvement in placement opportunities is to be expected just as a result of employment growth with a shrinking population (see Section 2 above). But there is little conclusive evidence that the reforms had any real impact here.

- Fahr and Sunde (2009) limit their analysis to the impact of the first three reform phases, i.e. before the discontinuation of unemployment assistance, and conclude that those reforms accelerated moves from unemployment into employment. They control for cyclical effects and differentiate between regions and job categories, but not for the duration of prior unemployment.
- Fehr and Vobruba (2011) by contrast focus on unemployed claimants of unemployment assistance or social assistance before the reform and on ALG II after the reform, and find no significant difference with respect to time spent in unemployment, although their model does not control for the more favourable economic situation from 2006.
- Klinger and Rothe (2012) confirm the positive impact of the first three phases of the Hartz reforms on matching of unemployed people with jobs generally, but they find no additional impact for the fourth phase of the reform. Unlike Fehr and Vobruba (2011), they also find a positive effect for the reform overall on the long-term unemployed moving into work.

- Krause and Uhlig (2012) conclude that abolishing unemployment assistance has reduced the unemployment rate by 2.8 percentage points.
- Launov and Wälde (2013) also focus in their analysis on the fourth phase of the Hartz reforms, namely the "merging" of unemployment assistance and social assistance into ALG II, and conclude that this part of the reforms reduced unemployment by only 0.1 percentage points, although it was associated with a reduction in the level of social protection for 76% of workers.
- Krebs and Scheffel (2013), on the other hand, find that the fourth phase of the Hartz reform reduced long-term unemployment by 1.4 percentage points.
- Bauer (2013) does not find any evidence that the Hartz reforms substantially reduced the relative extent of "mismatch" unemployment.

*In summary, these findings can be interpreted as showing that the deterrent effect of impending relegation to the basic subsistence allowance - possibly in combination with advisory and placement services that were genuinely more effective - accelerated moves of "insured" unemployed people (i.e. people drawing unemployment benefit and therefore mainly unemployed for a short period) into employment<sup>24</sup>, whereas generally speaking the activation system of the subsistence allowance had no impact on the many barriers to job placement for ALG II claimants.*

## 5. Employment

The overall positive employment trend since the late 1990s already (not just since the reforms) has been described above (in Section 2). This section will consider more specifically the trend in employment among older workers, the increase in so-called atypical forms of employment, and management of the 2008-2009 financial crisis.

### 5.1 Employment of older workers

If talk of a German "jobs miracle" is to be at all meaningful, then it must be in relation to employment among older workers.

The employment rate has risen steeply for people aged 55 to 64, from around 37% in 2000 to 61.5% in 2012. During this period, Germany experienced the most far-reaching change of all the EU Member States, followed closely by the Netherlands (Figure 6) (Knuth 2012b; Mümken and Brussig 2012). In 2012, there were more people in the 60-65 age group in employment than in retirement for the first time since 1974 (Federal Institute for Population Research, 14.8.2013). A strong contributing factor in western Germany here is the fact that a higher percentage of the female

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<sup>24</sup>

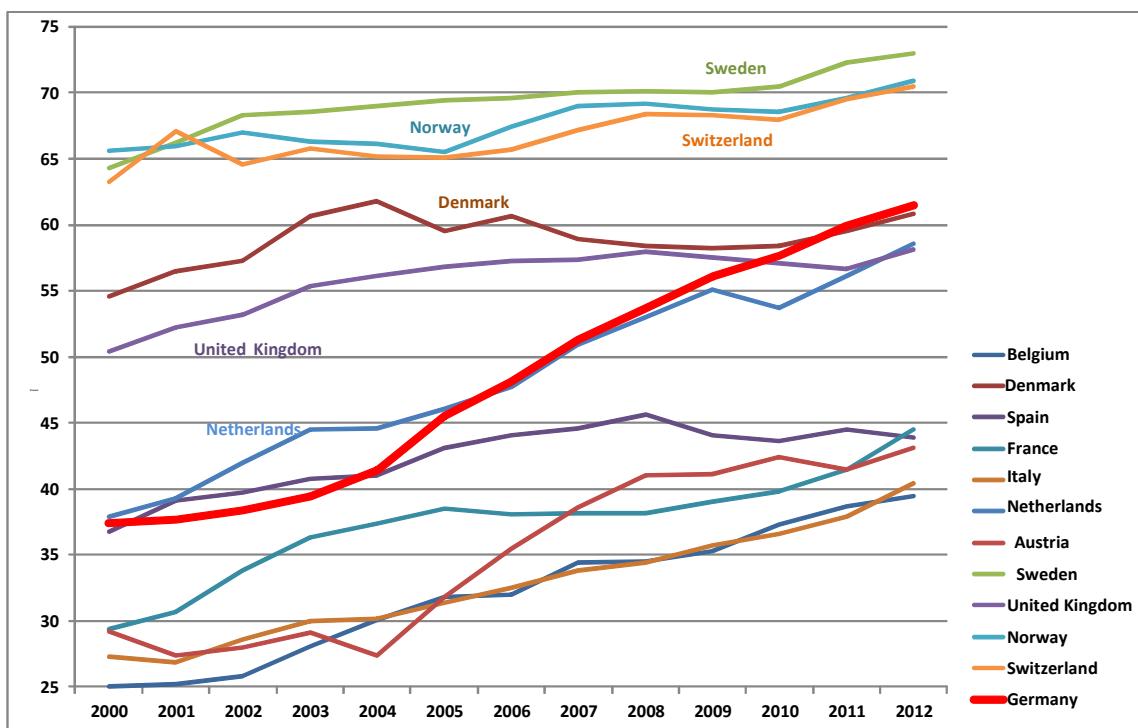
The interaction of labour market and pension reforms has in effect almost stopped unemployment benefit being claimed for the maximum period as a transition to early retirement.

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cohorts now entering this age group than of previous cohorts were already in employment when they were younger<sup>25</sup>.

This trend is often qualified by the reservation that most of the employment in question consists of "bad jobs". However, if atypical types of employment are becoming more common in general (see section 5.2 below), then it is unrealistic to expect older workers to be the exception. In fact, they are disproportionately spared<sup>26</sup>. On the other hand, if rates of insured employment are broken down by age group, then it is above all the two older groups that can be seen to have clearly benefited here (Dietz and Walwei 2011, p. 367)<sup>27</sup>.

**Figure 6:** Employment rates in the 55-64 age group, in selected EU countries



Source: Eurostat database

The employment trend for older people is correspondingly reflected in the decreasing proportion of the population already taking retirement between the ages of 60 and 62; by the increase in people taking retirement at 63, 64 and 65; and by the increase in the average retirement age by almost two years since the end of the 1990s (Brussig 2012b; Deutsche Rentenversicherung Bund 2013). This

25 In East Germany, i.e. under the employment system of the GDR, labour market participation among women was generally high.

26 The proportion of part-time workers is generally lower among older men in Germany than in other European countries, and only markedly higher than for younger men in the case of men over the statutory retirement age of 65. The proportion of part-time female workers among older German women is only slightly higher than among younger women up to the age of 64, although – in line with the gender-specific employment patterns in Germany – it is higher overall than in many other countries (Mümken and Brussig 2012, p. 16).

27 Thus the increase in insured employment shown in Figure 2 concerns almost entirely older workers.

trend is essentially attributable to the fact that older people are remaining in their jobs for longer (Brussig 2010b, 2011b). However, older workers are still less likely to take a new insured job (Brussig 2011a). Only a minority of companies (18%) have age-specific measures to help their staff meet work demands when they are older. Such measures include part-time arrangements for older people, which are more of a defensive response to demographic change and which continue to play an important role, although that role is decreasing and has more recently (2011) been overshadowed by enrolment in further training (Leber et al. 2013).

Unemployment among older people has finally begun to rise again according to official figures (Mümken et al. 2011 and 2013). However, this does not indicate that older people's position on the labour market has weakened, but is rather due to changes in legal classifications and to the fact that it has been made harder for people to move from unemployment into early retirement. Internationally comparable Eurostat data show that unemployment among older workers has fallen to the same extent as unemployment overall, and that it was lower in 2011 than the EU-15 average.

So how do workers see these changes? According to the *European Working Conditions Survey 2010*, the percentage of workers who assume that they will no longer be able to do their current job when they are 60 is very low in Germany, at 18% (lower only in the United Kingdom and Ireland, Balz and Krell 2012). According to the current Good Work index published by DGB, the Confederation of German Trade Unions, however, 47% of respondents believe that they would probably be unable to continue their job up to the statutory retirement age under prevailing conditions (DGB Good Work index GmbH 2013). Depending on the respondent's age, their statutory retirement age in Germany will fall five to seven years after the age of 60, so the findings from the two surveys are not directly comparable. There is thus no reliable estimate at the moment of how far workers will be able to accept a rising statutory retirement age in the future or at which point this reform will only mean a reduction in pension. Until now, at any rate, workers have largely reacted to the organisational changes, meaning that the difference between the average age on leaving the workforce and the statutory retirement age has so far narrowed rather than widened.

## 5.2 Atypical forms of employment

As in most European countries, the prevalence of "atypical" forms of employment has increased in Germany. Figure 7<sup>28</sup> clearly shows that:

- Women are much more concerned by atypical forms of employment, but such employment has increased for both men and women, and now concerns about a quarter of all workers.

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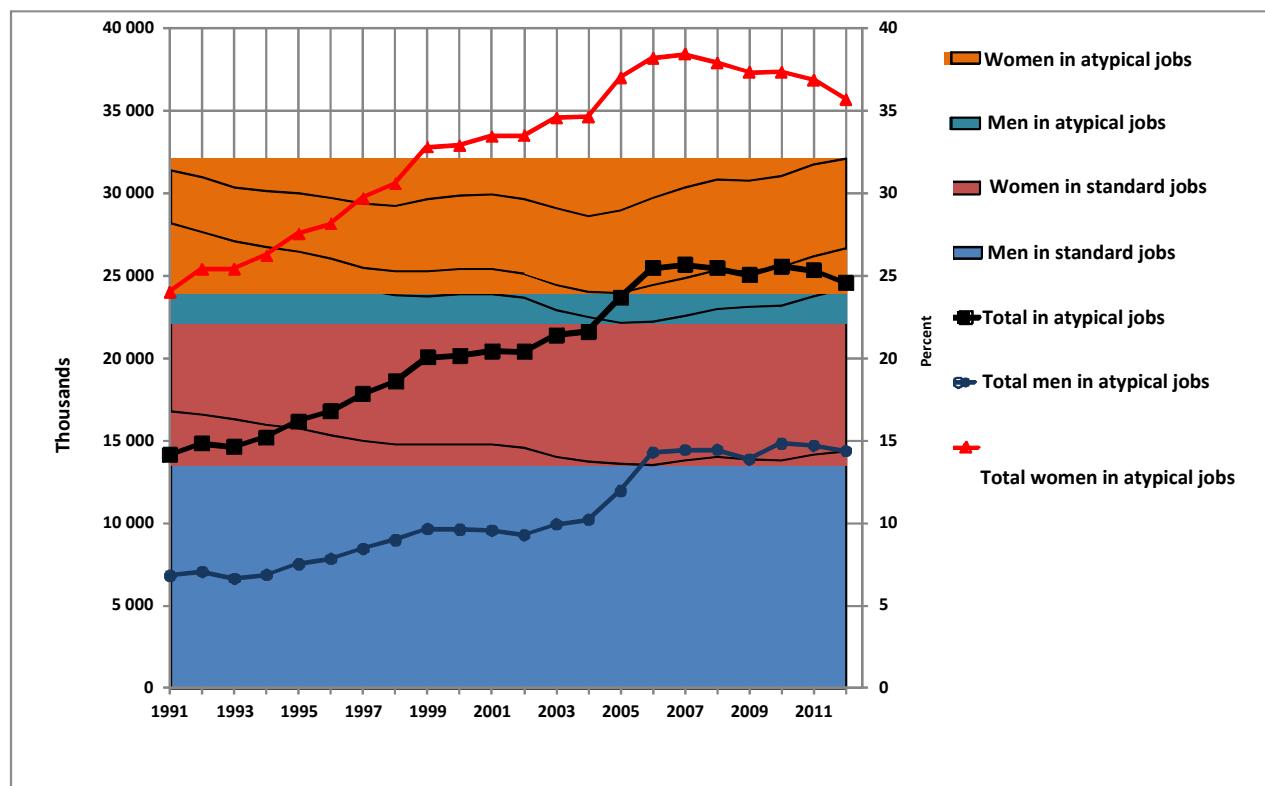
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Workers in standard forms of employment include people in open-ended employment relationships with full social security cover or civil servants who are working at least 21 hours per week and are not temporary agency workers. Those with more than one job are classified according to their main job. People aged over 65, in education or training (trainees, schoolchildren, students), unpaid family workers and self-employed people are excluded; thus the total of people in "standard employment" and "atypical jobs" in Figure 7 is smaller than the total of workers in Figure 2 (p.6).

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- Since around 2007, standard forms of employment have also been increasing again, especially for women. The proportion of women in atypical jobs has therefore dropped again, though it should be noted that jobs of more than 21 hours work a week qualify as standard jobs in these statistics.
- The proportion of people in atypical jobs has decreased slightly overall since 2007.
- The decrease in the proportion of people in atypical jobs in 2009 indicates that these "buffer" jobs were disproportionately affected by the dip in employment<sup>29</sup>.
- The labour market reforms that came into effect in 2002-2003 only caused the proportion of people in atypical jobs to increase during the short period from 2004 to 2006; this was followed by a levelling off, owing primarily to an increase in the amount of standard employment relationships as well.

**Figure 7: Employment of men and women in standard and atypical jobs: absolute figures and percentages, 1991-2012**



Source: Federal Statistical Office, *Kernerwerbstätige nach Erwerbsformen, Ergebnisse des Mikrozensus*: <https://www.destatis.de/DE/ZahlenFakten/GesamtwirtschaftUmwelt/Arbeitsmarkt/Erwerbstätigkeit/Arbeitskräfteerhebung/Tabellen/AtypKernerwerbErwerbsformErwerbstätigeZR.html>, last visited 2.9.2013.

<sup>29</sup>

Closer analysis shows that this obtains for labour leasing and fixed-term contracts, but not for mini jobs.

It is clear from an analysis of specific employment forms which would be too lengthy to present here that:

- The increase in *mini jobs* prompted by the reforms is mainly accounted for – in line with the substance of the reform (see section 3.1) – by jobs that are done as a *side job* (and therefore not shown in Figure 7); an increase in mini jobs as the *sole source* of work was registered only in the period immediately after the reform, between 2003 and 2005.
- The level of 9% for *fixed-term* employment relationships is slightly below the EU average (11%). The labour force survey showed an increase in the share of fixed-term jobs of 3 percentage points over two decades (Federal Statistical Office 2012). However, company surveys indicate a doubling in the share of fixed-term jobs over 16 years (Institute for Employment Research 2013a). At up to 47% (in 2009), the percentage of new recruitments in the form of fixed-term contracts is obviously considerably higher; however, this increase took place before 2005 and not after the reform of the rules governing fixed-term employment contracts, which affected only older workers (see section 3.1).
- Only labour leasing showed a clear upward trend after deregulation (see section 3.1).

Using shift-share analysis, Dietz et al. (2013) showed that structural factors (altered distribution of employment between sectors or population groups) provide only a limited explanation for the increase in atypical employment forms and that *organisational factors* can be assumed to be the main cause. The hope expressed that such employment forms could serve as a *bridge* to standard employment, an argument which was used to justify their deregulation, does not stand up on the whole to scientific analysis (Gensicke et al. 2010; Hohendanner and Walwei 2013; Brüllle 2013)<sup>30</sup>.

Rather than the claimed "bridging" function being proved, there are increasing indications that atypical employment has *excluding effects*. People in atypical types of employment have fallen even further behind over time with respect to their participation in formal further training; this trend is more pronounced in the case of temporary agency workers and people in mini jobs than for workers in fixed-term or insured part-time employment relationships (Bellmann et al. 2013). Temporary agency workers and workers in fixed-term employment relationships may feel better socially integrated than unemployed people, but they feel less well socially integrated than workers with open-ended employment relationships or self-employed people (Gundert and Hohendanner 2011). It should be pointed out here that if the amount of time in employment is below a certain level (and in all cases where mini jobs are concerned) workers may have no more entitlement at all to insurance-based unemployment benefit; also that if earnings are low (see section 6), then unemployment benefit is so low that ALG II has to be claimed to supplement it. In an employment system where ideas about social welfare, inclusion and fairness are still very much shaped by the

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Relatively speaking, workers have the highest probability of moving to normal employment from fixed-term full-time employment, unless the job is in the public sector. However, this does not prove that such people would not have been recruited if they had not been in fixed-term employment.

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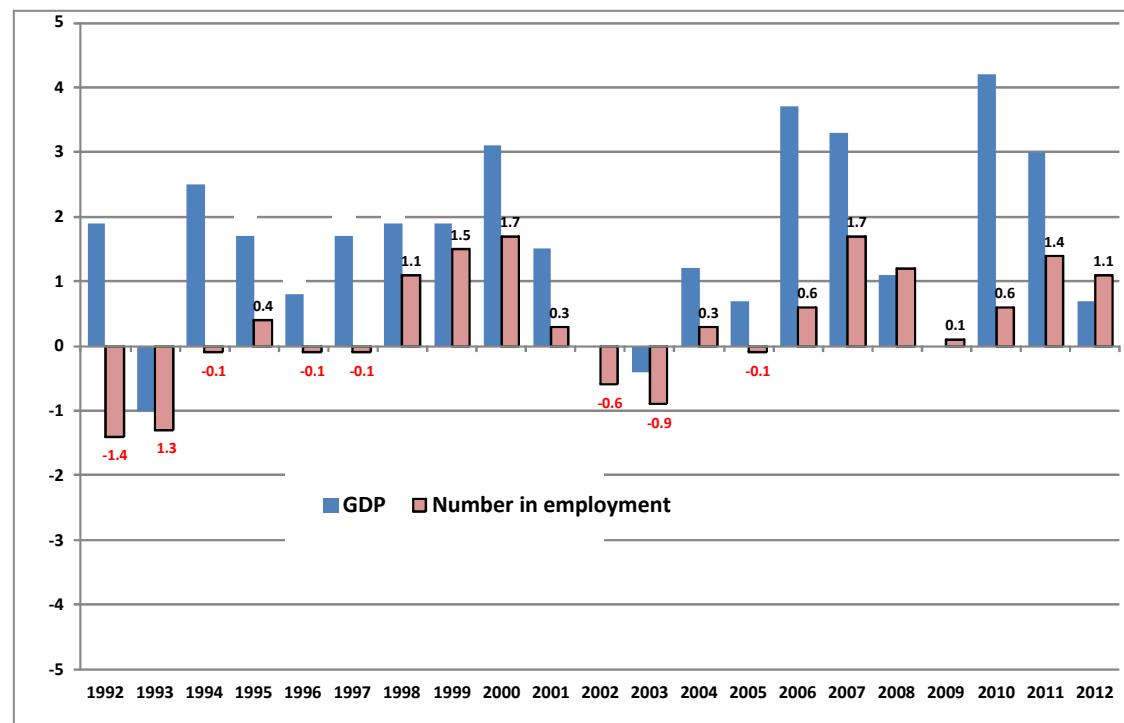
Bismarckian social insurance principle, people feel that dependence on a means-tested subsistence allowance, together with its disciplining elements, excludes them from mainstream society.

*In summary, the disadvantages created for people by atypical employment forms can be said to outweigh any improvement in access to work. There is no evidence that the expansion in these types of employment has increased the total number of hours worked, i.e. that the demand for labour would not be met by standard jobs if atypical types of contracts were not available. But it must be conceded that atypical forms of employment can lead to a fragmentation of the demand for labour and thus help to spread the labour sought over more people, i.e. to increase per capita employment. Unfortunately, efforts to achieve a socially inclusive redistribution of work in the 1980s never really got off the ground, and instead we are now seeing a polarising, non-inclusive redistribution of employment.*

### 5.3 Management of the 2008-2009 crisis

The first talk a German "jobs miracle" was when the German labour market came through the economic slowdown of 2008-2009 virtually unscathed (Krugman 2009). It was curious that employment was affected so little – by comparison with other countries and with earlier cyclical downturns in Germany – by the biggest decline in economic activity since 1929. Whereas in earlier downturns unemployment had already increased when economic growth dipped below 1%, in 2009 employment even increased by 0.1% against the background of a 5.1% fall in GDP (Figure 8).

**Figure 8: GDP and number of people in employment – year-on-year changes, 1992-2012**



Source: Institute for Employment Research, data on short-term economic and employment trends. Figures as at 7.8.2013, downloaded from [http://doku.iab.de/arbeitsmarktdaten/Aktuelle\\_Daten.pdf](http://doku.iab.de/arbeitsmarktdaten/Aktuelle_Daten.pdf)

In 2009, multiple factors coincided that explain the stability of the employment situation:

- There was no property market bubble in Germany to burst, and no loss of domestic demand; only the export-oriented part of the economy was directly affected by the crisis.
- These companies in particular had developed a system of long-term working-time accounts, based on collective agreements, that gave them a level of *flexibility in working hours* that was unprecedented – and unmatched internationally (Gross and Schwarz 2009; Ellguth et al. 2013). After three years of economic upswing, workers had considerable hours in credit that they could use up during the crisis, and companies had financial reserves with which to continue paying compensation (Schneider and Gräf. Bernhard 2010; Bohachova et al. 2011)<sup>31</sup>.
- Once credited working hours had been recuperated, the employment situation was kept stable using a very traditional instrument of labour market policy<sup>32</sup>, namely the partial replacement of wages for hours not worked by a short-time working allowance funded through unemployment insurance, whose scope was temporarily expanded as an emergency response to the crisis. The number of short-time workers reached the second-highest recorded level in 2009. Short-time work nevertheless offset only about one quarter to one third of the decline in production<sup>33</sup>.
- The by now well-advanced overhaul of the retirement system (see section 3.2 above) and shortening of the duration of unemployment benefit for older workers largely prevented companies from responding to cyclical downturns as they generally had previously, namely with more or less "voluntary" redundancy of older workers, whose unemployment would then open the door to an early pension (Rosemann and Kirchmann 2010).
- Employees were put on the defensive by the Hartz reforms and by the public debate surrounding them (Kettner and Rebien 2009). They were prepared to forgo wage components and make other concessions in return for an assurance that there would be no redundancies. After Hartz, any imposition at work seemed preferable to unemployment, and this meant that there was considerable room for negotiation to maintain companies' workforces.
- Many companies evidently expected the economic downturn to be of short duration, and were therefore prepared to pay for hours worked that they could not use as productively as under normal circumstances, in addition to compensating for hours in credit and short-time work (Bellmann et al. 2012; Gerner 2012). In 2009, hourly productivity in the wider economy fell by a long-term record of 2.5% compared with 2008, when a slight dip had already been registered.

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<sup>31</sup> Some working-time accounts were even forced into debit, i.e. companies paid for hours that employees would only work in the future (Zapf and Herzog-Stein 2011). This amounted to a guarantee of work, because anybody who is dismissed is unable to balance their account and is not obliged to do so.

<sup>32</sup> The short-time allowance has existed since the 1924 regulation on unemployment support, and it was also part of the 1927 Law on Employment Services and Unemployment Benefits that introduced unemployment insurance in Germany (Federal Employment Agency, press office).

<sup>33</sup> The number of jobs saved through short-time working is estimated at between 580 000 (Hijzen and Venn 2011) and 250 000 (Herzog-Stein et al. 2013a).

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- The government swiftly put together an economic recovery programme of around EUR 100 billion based on two main pillars: promoting local authority investment to support the construction industry, and the scrappage premium for exchanging old cars for new ones, which steadied the auto industry – in Germany, but also elsewhere.

*To summarise, it is fair to say that the crisis was weathered primarily using conventional strategies such as corporatism, tripartite negotiations and explicitly prioritising internal over external flexibility (Bosch 2011). But the reforms contributed to this outcome indirectly in so far as they made it impossible for companies to adapt their staffing levels through early retirement, while considerably increasing the readiness of workers to make concessions, given that they anticipated poorer social protection in the case of any lengthy period of unemployment.*

## 6. Pay trends

Both collectively agreed and nominal wages had been rising at a very moderate pace from the end of the 1990s already, i.e. before the reforms, and this trend continued after the reforms were introduced<sup>34</sup>. The increase in hourly labour costs was the lowest in the European Union for the period 2000 to 2010, and unit labour costs were markedly below the trend for the euro area as a whole (Niechoj et al. 2011). If national currencies had still existed, the "German euro" would already have been about 23% more expensive in 2011 (Mazier and Petit 2013, p. 516).

There is disagreement as to whether this wage restraint was responsible for German export surpluses and employment growth. It is true that exporting companies pay higher wages than other companies (Hauptmann and Schmerer 2013), and that the gap in unit labour costs is less for industry than for the economy as a whole (Niechoj et al. 2011, p. 14). Wages in the services sector<sup>35</sup> lag further behind those of other countries than in the production sector. It is argued, on the basis of models, that a wages policy geared more to domestic demand would not only have levelled out imbalances in the euro area, but also produced more jobs in Germany (Joebges et al. 2009; Joebges et al. 2010; Herzog-Stein et al. 2013b). During the first six months of 2013, labour costs in Germany increased more quickly than the average for the euro area, however, while the gap between manufacturing industries and the services sector remained the widest in Europe (Herzog-Stein et al. 2013c).

Wage restraint caused real wages to stagnate, so that real household income was no higher in 2012 than in the year 2000 (Brenke and Wagner 2013)<sup>36</sup>. Real wage trends in Germany remained distinctly

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<sup>34</sup> Cf.: Bispinck 2011, supplemented with data from [http://www.boeckler.de/wsi-tarifarchiv\\_4836.htm](http://www.boeckler.de/wsi-tarifarchiv_4836.htm)

<sup>35</sup> The German services sector is not very export-oriented because Germany does not attract large numbers of foreign tourists. Of course, low labour costs in the services sector bring down the cost of inputs for export-oriented companies.

<sup>36</sup> When assessing this trend it is important to bear in mind that structural factors are implicated in addition to the very moderate increase in collectively agreed wages, for instance households that were not on the labour market at all in 2000 entering the labour market on low wages and the proportion of part-time work increasing (Görgens 2013).

below those in the euro area and the United States (Bach et al. 2013). As in many other countries, inequality in household incomes also increased substantially, although this trend was most pronounced between 1999 and 2005, thus before the Hartz reforms were implemented (Schmid and Stein 2013). The at-risk-of-poverty rate rose substantially during the same period (Schmid et al. 2013). The number of workers on low hourly wages<sup>37</sup> has climbed sharply (Kalina and Weinkopf 2013) and is now the second highest in the EU after Lithuania (Rhein 2013). But here, too, the change was greatest in the period before the labour market reforms.

A close correlation can be seen across countries between the proportion of people earning low wages and the number covered by collective agreements (see point 3.3). However, Germany is the furthest "outlier" after Romania: in other words, given the relatively high number of employees still covered by collective agreements compared with other countries, the proportion of people on low wages is particularly high (Bosch 2013). This is probably attributable both to the fact that many collective agreements set a low wage norm, and to the fact that mini jobs (see section 3.1) are often in practice lower paid, even when formally covered by collective agreements.

*To sum up: the inherent logic of the labour market reforms (to lower reservation wages by reducing financial security in the event of unemployment, stepping up activation measures and tightening rules on the acceptability of job offers for people who are marginalised on the labour market) is a very effective way of encouraging wage restraint and increasing the polarisation of wages. In practice, however, the waning power of collective agreements (see point 3.3) seems to be a more significant factor than the reforms in relation to these trends.*

## 7. Labour turnover and duration of employment

High labour turnover is often seen negatively. Employees often regard high labour turnover as a sign of job insecurity and unattractive working conditions. From companies' point of view it is a cost factor. Macroeconomically, the picture is rather the opposite: labour turnover is a sign that labour is in demand and that people have opportunities to improve their wages or working conditions by changing employer. This reallocation improves the match between workforce skills and available jobs. Employees in jobs for which they are overqualified have the possibility of advancing, so that their productive potential provides more benefit to the wider economy. This makes it important to look at labour turnover before and after the reforms (Figure 9).

During the period that the labour market reforms were being implemented, which was a period of economic stagnation, labour turnover sank to the lowest point since relevant statistical records have been available<sup>38</sup>. It then followed the economic cycle in a similar way to before, but at a

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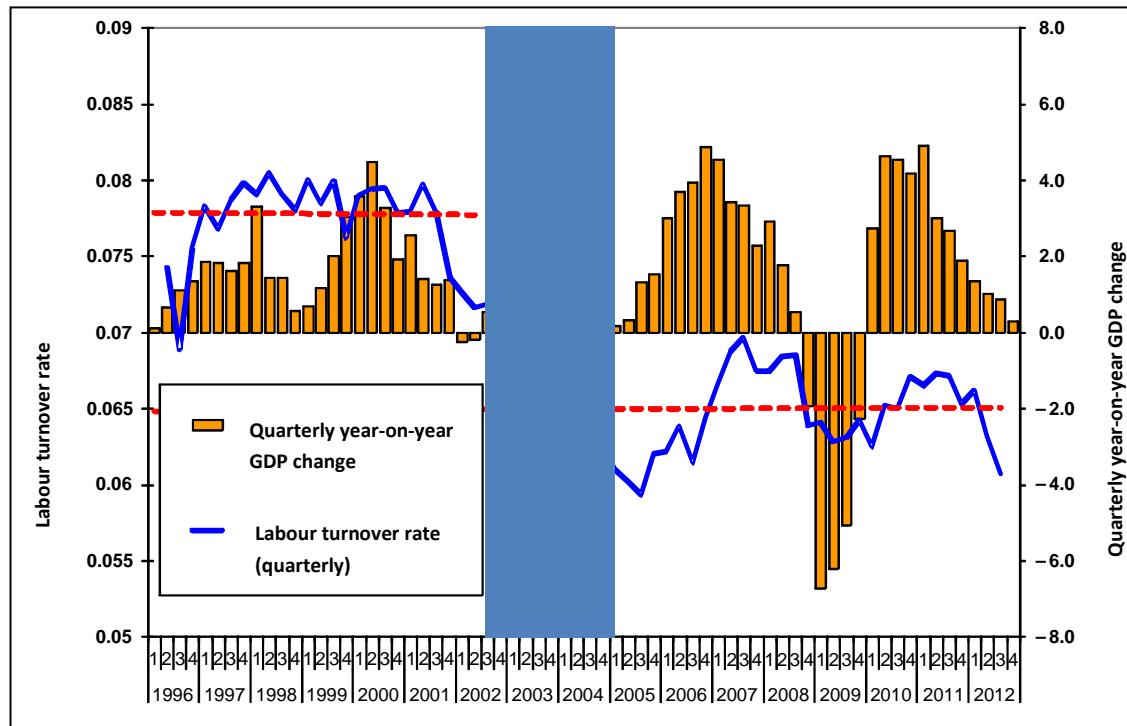
<sup>37</sup> Defined as less than two thirds of the median hourly wage.

<sup>38</sup> To be precise, this applies to western Germany compared with the low point of 1982, before data from East Germany were included (cf. Erlinghagen 2010a, p. 4; Knuth 2011).

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substantially lower level<sup>39</sup>. Decreasing labour turnover was accompanied by an increase in the durability<sup>40</sup> of employment relationships, i.e. the likelihood of a relationship being terminated decreased (Giannelli et al. 2013)<sup>41</sup>.

**Figure 9:** Labour turnover and the economic cycle



Source: Giannelli et al. 2013

A key cause of the downward trend in labour turnover seems to be the decrease in entry-level wages<sup>42</sup>: wages under new employment relationships have been declining since around 2000, the fall being more pronounced at the intermediate and lower levels of the range (Giannelli et al.

<sup>39</sup> The values in Figure 9 are quarterly. On an annualised basis, there was a decrease in labour turnover of around 18%. This trend is consistent with data of the IAB Establishment Panel (Hohendanner 2012).

<sup>40</sup> The concept of "durability" is used rather than "stability" intentionally to avoid confusion with the subjective perception of "employment security", and to reflect the fact that the data on which this observation is based make no distinction between employment relationships terminated by the employee and ones terminated by the employer. Thus "durability" can signify both job security and a lack of alternatives.

<sup>41</sup> This holds after controlling for gender, duration to date of employment relationship, quarter during which a job was started, local labour market conditions, *Land* (region), size of company, sector, age, qualification level and job status before recruitment. Thus the changes observed over time are not attributable to structural changes in the economy or changes in the composition of the workforce, including ageing of the workforce or increased recruitment of previously unemployed workers.

<sup>42</sup> In this case the analysis is limited to full-time jobs, as the data set used contains no information on the exact hours of part-time jobs.

2013)<sup>43</sup>. This means that it is generally not worth voluntarily changing jobs, since there is nothing to be gained by doing so<sup>44</sup>. Thus the increasing durability of employment relationships must essentially be attributable to a lack of alternatives, or absence of incentives to switch employers.

*The big puzzle is then how such a trend is compatible with increasing employment in a context of a shrinking potential labour force (Fuchs et al. 2011) and dwindling "hidden reserve" of labour (Fuchs and Weber 2010, p. 25), growing complaints about skills shortages and increasing actual time-to-hire when recruiting new employees (Brenzel et al. 2013). Surely what is really remarkable about the German job market is that shifts in the ratio of supply to demand favouring workers have not been reflected in wages for such a long time<sup>45</sup>. Is the scare factor effect of the reforms on workers (Erlinghagen 2010b; Kettner and Rebien 2009; Rebien and Kettner 2011) perhaps greater than their activating and mobilising impact on the unemployed? Or are both the subjective and objective barriers to finding employment faced by the long-term unemployed of such a nature that they cannot be overcome through activation and mobilisation? If that is the case, the conclusion would have to be that the Hartz reforms were essentially based on an incorrect diagnosis of the problem.*

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<sup>43</sup> The increase in wage differentiation was seen above (p. 23). Since it is rare for wages to fall in an existing employment relationship, and this would anyway be a reversible emergency measure, the only possible basis for increasing differentiation is entry-level wages. The finding of falling entry-level wages is therefore also plausible against the background of trends in wage structure.

<sup>44</sup> Long-term observation of job changes between 1985 and 2007 using data from the Socio-Economic Panel Study shows a steady decrease in earnings (Trischler and Kistler 2010).

<sup>45</sup> Only recently have employers started reporting increasingly that they have had to make concessions on wages in order to find employees (Brenzel et al. 2013).

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