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Discussion Paper

Combating Precarious employment – the case of Germany

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Outline of the research project ESOPE (*Precarious Employment in Europe: A Comparative Study of Labour Market related Risks in Flexible Economies)*:

The **aim** of the ESOPE project is *to contribute to an improved comparative understanding and evaluation of «precarious employment» as one of the main facets of social and socio-economic insecurity and risks in contemporary European societies*. By thus doing the project expects both to increase knowledge and to inform current policy debates on the interrelations between the modernisation of systems of social protection, the activation of employment policies, and the «quality of employment» in Europe. The **research questions** include:

- How is «precarious employment» understood and appraised in both scientific and policy terms in the five countries of our study (France, Germany, Italy, Spain and the United Kingdom) and also at the European and wider international levels?
- What are the main factors accounting for the actual incidence and forms of «precarious employment» and what is the relative importance of sectoral factors and State-based regulatory frameworks?
- What notion of «precarious employment» could be more appropriate in scientific as well as operational terms for understanding, measurement and policy making?

In order to achieve these purposes, the project is divided into three major **phases**: [1] literature review and comparative policy analysis; [2] two strands of empirical research through case studies of selected services sectors and of local innovative initiatives; and [3] drawing of policy implications and dissemination activities, including an important scientific seminar.

Members of the consortium:

- Departamento de Trabajo Social, Universidad Pública de Navarra (Pamplona, ES)
- ICAS Institute (Barcelona, ES)
- Economix Research and Consulting (Munich, D)
- Centre d'Etude de l'Emploi (Paris, FR)
- Centro di Ricerche Economiche e Sociali (Roma, IT)
- Warwick Institute for Employment Research, University of Warwick (Coventry, UK)

Introduction

Disregarding the recommendations of the OECD, the Worldbank, the EU Commission and other international bodies, Germany refused to liberalise its labour markets for decades. There was no change in wage relations in spite of substantial differences of unemployment rates, no shift of economic risks back to the individuals and no fundamental reduction of the scope of the welfare state. By contrast, the Red-Green Government, elected in 1998 with significant support for the reformist wings of both parties, started to defend the social systems by a series of laws. Re-distributive social policy, which now concentrates of family incomes and child care, plays a central role in the election campaigns in 2002. After seven years, trade unions started a strike for higher wages in the metal industries and other sectors of the economy with the clear target to revise former shifts of the income distribution towards capital incomes.

These few events of the recent past indicate that the German welfare state is not only widely supported by political majorities. Its survival under changing economic and political conditions for half a century needs a deeper explanation which is to be searched in the specific compromise of economic and social priorities. This compromise never was a consensus as every major political reform turned out to be very controversial. Most of the decisions, however, were related to the basic idea of the German model of a “social market economy” ever since. Even against the winds of global change the strength of the German welfare system seems to provide shelter sufficiently broad to refuse the demands for higher flexibility.

This paper tries to identify the characteristics of employment protection in Germany and its economic rationale. It starts from the hypotheses that there is no societal policy standing on its own. Economic efficiency is the condition sufficient for its survival. The interlink between the social and the economic system, therefore, is the central issue to be addressed. Employment decisions of both, workers and employers are highly interlinked with the systems of labour protection, social security, collective agreements and education and training. Thus, the policy combating precarious employment can only be analysed by scrutinizing the whole range of employment and social protection legislation.

Historical roots of employment protection and its economic rationale

The creation of the welfare state

Article 20 of the German constitution writes it down explicitly: "The Federal Republic of Germany is a democratic and social federal state." (Art. 20 GG)[1] All three adjectives of the sentence are of similar importance and the legal reference to extended regulatory systems. While the human and legal rights are defined in detail by the constitution, the social rights are described only rudimentarily. But nevertheless, they constitute the basis of the social state:

The non-discrimination by law (Art. 3 GG)
The legal protection of matrimony, families and mothers (Art. 6 GG)
The freedom of coalition and collective bargaining (Art. 8, 9 GG).
The freedom of movement and the freedom to choose a career (Art. 11, 12 GG)
The freedom and the social responsibility of property (Art. 14 GG)[2]

These constitutional articles create the commitment of legal bodies and public services to pass legislation and to control for public action following these rules. There is no direct obligation for individuals to act along constitutional rules, but nevertheless, they are bound by the legislation.

The fundamental institutions of the social state were largely implemented during the fifties. In particular,

An extensive system of collective agreements was created by the social partners, based on the freedom of coalition and collective bargaining. This system constitutes the core of labour market regulation, covering wage setting and wage negotiation, redundancy regulations and other labour contract elements, minimum standards for working hours, holidays, sickness payments etc.
Based on the social responsibility of property, the democratic rights of workers within their establishments were created by Works Constitution Act.[1]

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[1] Artikel 20, Grundgesetz der Bundesrepublik Deutschland vom 26. Mai 1949 (Art. 20 GG): „Die Bundesrepublik Deutschland ist ein demokratischer und sozialer Bundesstaat".

[2] Art. 14 GG: „Eigentum verpflichtet. Sein Gebrauch soll zugleich dem Wohle der Allgemeinheit dienen." (Property is an obligation. Its use should also be at the advantage of the public.)

Particular legal protection was provided to home workers, disabled workers and pregnant women.
Social insurance of workers was re-established in the field of pensions (age, disability), health care, unemployment and accidents, and the principle of self-administration by social partners were implemented into the institutions of social security.
Minimum social benefits were provided to the population by the Federal Social Benefits Law, which defines the monetary subsistence level of individuals and creates a shadow minimum wage.[2]
Occupational safety and health was protected by a system of security regulation and accident insurance.
The vocational training system was developed and finally regulated by the Federal Vocational Training Law in 1969.

All these institutions were modified through a series of amendments and additional regulations but they and their principles still exist. They constitute the net which every citizen can rely on and which widely affects the individual employment decisions.

The German welfare state is endowed with a comprehensive budget for social policy: Overall expenditure on social policy rose from 21.1 % of GDP in 1960 to 31.9 % in 2000 as the following Table shows. The most puzzling observation coming up with these data is the fact that overall social expenditure did not decrease in relation to overall income in the course of rising per capita incomes. By contrast, there was a continuous relative increase of expenditure during the sixties and seventies, when the systems of health care and pensions were developed extensively. During the seventies the compensation of unemployment risks started to influence many areas of social policy – not only the unemployment insurance system – leading to a continous expansion of expenditure. The efforts by the conservative government to reduce social expenditure during the nineties remained rather limited and were more than offset after German unification.

Social Budget **Table 1**
Germany
Social expenditure as % of GDP

Area	1960	1970	1980	1990	2000*

[1] Betriebliche Mitbestimmung durch das Betriebsverfassungsgesetz von 1952.
[2] Bundessozialhilfegesetz von 1961 preceded by the Bundesversorgungsgesetz (1950).

Matrimony and family	3.6	4.7	4.9	3.7	4.8
Health	5.8	7.3	10.0	9.6	10.9
Employment	0.6	0.8	1.6	2.0	3.1
Aged persons and bereaved	9.2	10.3	11.9	11.2	11.9
Miscellaneous areas	1.9	2.0	2.3	1.3	1.2
Total	21.1	25.1	30.6	27.8	31.9
* Germany; before 2000 western Germany only					

Source: Statistisches Bundesamt.

The growth of the welfare state and its stability during the last fifty years has many justifications but no one which can refer to increasing poverty and economic precariousness. In real terms, average net labour incomes rose by the factor of 4.8 during this period, a growth rate which could have opened a wide scope to individuals to take over the uncertainties of economic life individually. However, the rise of individual incomes and wealth was accompanied by the more than proportional rise of social services and transfers.

The expansion of the welfare state was financed by the workers with non-wage labour costs rising continuously during the last decades. As shown in Table 2 the tax wedge (excluding indirect taxes) increased from 27.4 % of total labour costs in 1960 to 47.6 % in 2000. This substantial re-distribution of private income to public budgets triggered off a long-lasting vicious circle:

- on the labour market, rising total labour costs dampened labour demand and created unemployment,
- on the wage policy side, the relative decrease of net wages pushed the claims for wage increase, and – disregarding the unemployment effects of wages – the responsibility for full-employment was shifted to the government,
- on the social policy side, unemployment reduction became the major target of policy action concentrating on the reduction of labour supply while disregarding the negative employment effects of rising non-wage labour costs.

Non-wage labour costs **Table 2**

Germany

	1960	1970	1980	1990	2000
	% share of total labour costs				
Social security contributions - employers	13,7	14,6	17,9	18,8	19,0
Gross wages	86,3	85,4	82,1	81,2	81,0
Social security contributions - employees	8,1	9,2	10,5	11,6	13,3
Income tax	5,5	10,1	13,0	13,2	15,4
Net wages	72,6	66,2	58,6	56,5	52,4
Total labour costs	100,0	100,0	100,0	100,0	100,0
Tax wedge	27,4	33,8	41,4	43,5	47,6

Source: Statistisches Bundesamt.

Thus, the German welfare state is the result of a specific public perception of the functioning of labour markets and of the optimal burden sharing between different policy areas. This has to be explained in more detail in the following sections.

The idea of the "Soziale Marktwirtschaft"

The historical experience with different economic systems in Germany included both, the free-market systems and its collapse in the world economic crises in the 1920s, and the totalitarian planned economy during the Nazi regime and its destruction at the end of the Second World War. This was the medium for the deeply rooted aspiration or even conviction that a third way between capitalism and socialism must exist. Intellectually, this idea was prepared already during the Hitler dictatorship by the "Freiburger Schule" with Walter Eucken and Wilhelm Röpke as its prominent leaders. Politically, the "Soziale Marktwirtschaft" was implemented under the direction of Ludwig Erhardt as the first Minister of Economics of the Federal Republic of Germany and his State Secretary Alfred Müller-Armack.

The basic concept of the social market economy was to avoid both, the negative phenomena of market concentration and of socialist planning. There were three main targets to be achieved:

- *Competition:* to foster market competition and to counteract the formation of monopolies and trusts in order to find unbiased market prices.
- *Stability:* to achieve continuous growth by a state directed macro-economic policy.
- *Social policy:* to protect the weaker members of the society by income re-distribution, mainly by progressive income taxation, by social security institutions and by regulation of the labour markets.

The freedom of economic activity and property was seen as the engine of growth and welfare. Following the "ordo-liberal" ideas, state intervention had to be restricted to the role of setting and controlling the rules. But which rules and which mechanisms of control? The implementation of the social market economy consequently was more than controversial on both sides, the employers and the workers. The employers objected the stronger rules for an anti-trust policy and the burdens emerging from the general social responsibility of economic activi-

ties. The workers felt to be exposed to exploitation by the employers and to be excluded from increasing wealth. It was not before 1959 that the Social Democratic Party abandoned its ideas of a planned socialist economy, and ten years later the issue was raised again by the young generation in the 1968 revolutions.

In the concept of Walter Eucken, the labour market was one of the important exceptions from anti-trust regulations. Monopolies on the employers' side were perceived to generate unacceptable results on the labour market which had to be corrected by state intervention. In particular the regional demand power of big employers could lead to a downward wage spiral triggering off increasing labour supply by the families. This inverse market reaction was the main justification for minimum wage regulation which was then implemented by a diversified collective bargaining system. In addition, negative external effects on the security and health of workers were seen as justification to restrict the freedom of action for the employers. The regulation of working times, occupational safety and health, and the inspection by public institutions were considered necessary to protect the workers.

The survival of the social compromise

During the first decade of the after-war period the exceptional growth of the economy convinced the majority of Germans that this societal model works. Growth was also what Ludwig Erhard thought to be the core factor to success. In his book "Wohlstand für alle" (prosperity for everybody) which was written for him in 1957 he urged for an undamped growth policy and took little notice of the income and wealth distribution. His credo sounded like this: "It is much easier to share a growing cake than to profit from a struggle on its distribution." (Erhard 1957). Of course, a pareto-optimal solution should be preferred to a non-pareto-optimal. However, the times of continued growth came to an end with the first cyclical crisis in 1967, and consequently the struggle began. The distribution of income and wealth became the central issue of the debate in the late 60s which resulted in extraordinary wage claims. It became clear that the employers did not have the power to refuse those claims and it was the Bundesbank which made an end to the distribution battle by imposing a restrictive monetary policy on the German economy. Together with the effects from the oil crises this caused a second – and for the first time – deep recession from which on low growth and rising unemployment became one of the characteristics of the German model.

The welfare state, however, did not only remain more or less untouched but in contrast continued its expansion even under the conditions of imbalanced labour markets. The question arises why the social market economy could survive under these conditions and why all efforts by the employers to get rid of the social burdens and to establish a free-market economy had only a very limited (and temporary) success. There are three main theses to explain the phenomenon:

- The first thesis argues that – in contrast to other industrialised countries – the wealth and the strength of the economy was widely perceived as the result of common efforts of all the groups of the society. The reconstruction and transition of Germany into a modern economy was discerned as the achievement of the population as a whole, and no group had superior rights to claim for the success. This argument e.g. was the basis for the introduction of a dynamic pension scheme which guaranteed the aged population to share in economic growth. Burden sharing and redistribution, therefore, was realised as one of the success factors by political actors and the public.
- The second thesis is the deeply rooted experience that the social protection of workers and the stability of jobs were positively linked to their economic performance. This went back to the 19th century with a long struggle for workers' rights which was temporarily solved by the first health and safety laws under Bismarck in 1869. From then onwards the social protection of workers was continuously extended by the introduction of health insurance (1883), the freedom of collective bargaining (1918), the introduction of co-determination (1920), the social welfare law (1922) and the foundation of unemployment insurance (1927). While many of these social policy instruments were implemented during the world economic crises, they survived in less critical periods. They were accomplished by the foundation of the vocational training system which also seemed to be necessary to raise industrial productivity. In the after-war period it was no big step to the confirmedness that the economic success of the German manufacturing industries was fundamentally based on the performance of its workers and – contrary to the free-market position – social protection and stable job perspectives were essential conditions to foster this performance.
- The third thesis refers to a public choice argument which considers social policy as the superior instrument to maximize votes. The evidence for this can be drawn from many electoral campaigns, not to mention the present campaign. Neglecting the negative employment effects of rising non-wage labour costs and taxation, public decisions were always in favour of the extension of social services and benefits. Even the conservative government of Helmut Kohl which expressed a clear preference for "lean" social policies introduced nursing care insurance in 1994. The increase of social expenditure which resulted from these decisions opened the vicious circle of rising unemployment and rising wage taxation. The poor employment performance deteriorated the financial status of public social insurance. Rising non-wage labour costs raised the efficiency demands and worsened the job perspectives for less qualified workers. Nevertheless, the rise in unemployment and

non-wage labour costs has been accepted now for 2 ½ decades as a superior solution compared to the reduction of social security and labour protection.

Not surprisingly, the descendents of the social market economy inventors – like Otto Schlecht as the President of the Ludwig-Erhard-Foundation – are more than censorious about its present state (Schlecht 2001). In particular, they criticise that re-distribution is dominating employment creation as a social policy target, that the incentives to expand private activities are seriously limited by high tax rates, and that the widely shared policy assessment of a limited amount of work contradicts with the dynamic character of a market economy. In one sentence, they express their concern that the social element of the "Soziale Marktwirtschaft" has grown too strong as compared to the market element.

Policy instruments to restrict precarious employment

A society with such a strong aversion against class divide consequently developed a long list of policies to avoid and to restrict the various forms of precarious employment. This was done by pro-active measures rather than general anti-discrimination policies, which other countries, the United States in particular, had followed. The government has the constitutional responsibility to consider the creation of equal living conditions in all regions (Art. 106 GG), and political majorities always were in favour of improving the homogeneity of the society. Policy action was developed along six main streams:

- Minimum income provision by social benefits to avoid poverty.
- Improvements of working conditions by and social security of workers to reduce the risks of working life.
- Collective wage bargaining to avoid inverse reactions of labour supply.
- Restriction of labour supply to reduce unemployment and the number of working poor.
- Training policies to improve the competitiveness of workers.
- Group specific policies to reduce discrimination on the labour markets.

Minimum income provision by social benefits

Based on the welfare state principle of the German constitution, the Federal Administrative Court took a ground braking decision in 1954: every person need-

ing help has the legal title to receive public assistance.[1] This was new because until then, public relief was seen as a provision given by the municipal authorities on their own considerations. Now they were obliged to provide help. By tradition, public assistance was the responsibility of the municipalities, an obligation which they objected for a long period during the sixties. Finally, they were bound to provide social benefits by the Constitutional Court in 1967.

Legal history of social benefits regulation **Table 3**

Date	Title	Major innovation
1961	Bundessozialhilfegesetz	Legal title on public assistance
1961	Gesetz für Jugendwohlfahrt	Youth assistance
1970	Wohngeldgesetz	Accommodation allowance
1993	Asylbewerberleistungsgesetz	Social benefits for asylum seekers
1996	Gesetz zur Reform des Sozialhilferechts	Incentives to accept jobs Financial sanctions for refusals

According to the Federal Social Benefits Law (Bundessozialhilfegesetz, BSHG), public aid is provided to persons who are not able to gain the means of subsistence by their own capabilities. This is a legal guarantee to receive at least the subsistence minimum from public budgets without an explicit time limit. The provision is subsidiary to self-help and to the help of third persons. This means that every applicant for assistance has to use his working capacities to earn the means of subsistence for himself and his dependents. He has to search for a job and to accept reasonable jobs. Otherwise he will lose his entitlement. Jobs can also be provided by public authorities in the area of public work. Social benefits are means tested including income and property of first grade relatives. They are complemented by the financial support of housing (Wohngeld) which covers the minimum standards for housing space. Complementary laws are the Youth Welfare Law (Gesetz für Jugendwohlfahrt) which regulates the promotion and integration of young people, and the Benefits Law for Asylum Seekers (Asylbewerberleistungsgesetz) which creates a separate benefit regulation for these persons.

The level of social benefits has to follow the “wage distance rule” (Lohnabstandsgebot), which says that the benefits paid to a household with up to five

[1] Bundesverwaltungsgericht, Entscheidung vom 24.6.1954, 1/159.

persons have to be lower than the average net income of a worker, including child benefits and housing allowance (§ 22 BSHG). The data in Table 4 show, that the wage distance is wide for persons without children. Together with the rising number of children, however, the distance is narrowing rapidly. This is due to the fact that wages are paid as efficiency-oriented remuneration while social benefits are demand-oriented. Moreover, average wages for unskilled workers in manufacturing industries are well above wages in other industries, (the service industries in particular), and are generally above minimum wages in many sectors.

As a consequence, little incentives to work are given to persons in bigger households, to persons in low wage occupations, and to persons with a low individual productivity. It is therefore criticized that the low-wage labour markets are dried up on both, the supply and the demand side and that social benefit regulations create unemployment to a substantial amount (Sinn et al. 2002). Social benefits create a reference for minimum wages as workers – as far as they are eligible for social benefits – will not accept a job without a sufficient premium on non-working income. Collective agreements consider social benefits as a reference for the fixing of the lowest wage levels, and employers take these wages as their reference for minimum productivity standards. Low wage jobs can hardly be created under these conditions.

Social Benefits **Table 4**

Unskilled workers in manufacturing industries, western Germany, 1999

	Average disposable income	Social benefits	Wage distance
	€ per month	€ per month	%
Single person			
no child	1281	604	52,9
1 child	1353	992	26,6
2 children	1496	1307	12,6
Couple			
no child	1578	958	39,3
1 child	1713	1238	27,7
2 children	1870	1499	19,8
3 children	2074	1770	14,6

Source: Bundesministerium für Arbeit.

It is certainly a fact that precarious jobs in the sense of low income jobs only exist to a very limited amount in Germany. On the one side, jobs in the lowest

tariff wage groups are almost not occupied.[1] On the other side there are a high number of unskilled workers being unemployed, and even among the social benefits recipients the number of employable persons is estimated to 800,000 out of 2.7m. Unemployment of unskilled workers rose more rapidly than unemployment in total. The unemployment rate of unskilled workers moved up to 24 % compared to 10 % on average.

The drying up of precarious (low wage) jobs by social benefits is a success at a high price. The number of social benefits recipients continuously rose during the last decades together with unemployment levels and total expenditure for social benefits increased to 23b € annually at the end of the nineties. This was and still is a high financial burden for the municipalities which contributes to the vicious tax-wage-unemployment-circle. Alternative concepts were therefore developed during the last years to overcome the negative employment effects of social benefits. Three approaches are highlighted due to their principle importance to achieve a higher share of low wage employment:

Reform of social benefits system

Taking the US experience – the Wisconsin model in particular – as a an archetype, the Ifo Institute for Economic Research (Munich) recently suggested to reform the social benefits system in order to raise the activity rates of social benefits recipients (Sinn et al. 2002). The starting point of the proposals' rationale is the fact that marginal tax rates for social benefits recipients are close to or at 100 % for all social benefits. This means that there is no monetary incentive to raise the household's income by accepting a job. The Ifo proposal therefore suggests

- to lower social benefits for employable but unemployed persons substantially to levels starting at ⅓ of the prevailing benefits;
- to award persons employed by an earned income tax credit which raises their income above the social benefits level;
- to offer a sufficient number of jobs by public job creation schemes to those persons who are not competitive enough to find a normal job.

In contrast to the existing systems, this mechanism creates continuously rising net incomes for those who work. The present benefit level can be achieved by a

[1] According to the Councel of Economic Advisors, in 1999 less than 3 % of the workers were employed in the lowest tariff groups (Sachverständigenrat 2000, Table 29).

50 % part-time job together with the earned income tax credit. It exceeds the benefit level by approximately 10-15 % if the recipient earns an average low wage income (1,400 € per month). The marginal tax rate still is at a very high level of 70 % but not very far above the marginal tax rate of normal wage earners which is 65 %[1].

The effect of these reforms is expected to be enormous: to create the 2.3m jobs required to employ the social benefits recipients who are employable, a wage cut of ⅓ is necessary at the lower end of the wage hierarchy. This calculation assumes very high wage elasticity of employment close to (negative) unity. The increase in employment creates a positive growth effect on GDP of 1.9 percentage points. Public budgets are disencumbered if more than 60 % of the social benefits recipients can find a normal (unsubsidised) job. Below this margin, additional fiscal burdens will result from the proposal.

The "Kombi-Lohn" and the "Mainz" model

The problem of high non-wage labour costs as one of the high barriers to create low-wage jobs was addressed by the Bundesvereinigung der Deutschen Arbeitgeberverbände (central organisation of the German employers' associations) for many years. The reason for the limited number of low-wage jobs and high unemployment of less skilled workers are identified in the tax wedge which particularly affects the creation of low-productivity jobs, and the "welfare state trap" which keeps persons dependent on social benefits due to very high marginal tax rates. Various "Kombi-Lohn" models were developed which support low-wage jobs by wage subsidies. The most recent statement contains a five-point program to increase employment of unskilled workers and long-term unemployed (Bundesvereinigung der Deutschen Arbeitgeberverbände, 2002). This includes:

- The promotion of low-wage part-time jobs by restricting social security contributions to health and nursing care insurance (15.7 % instead of 42 % of gross wages).
- The dynamic adjustment of the (less taxed) low income bounds (actually € 325) to the tax-free subsistence level.
- The introduction of the "Kombi-Lohn" which reduces the marginal tax rate of wage incomes in combination with social benefits to 75 %.

[1] The calculation of marginal tax rates includes income tax, social security contributions by employees and employers and value added tax.

- A stronger commitment of social benefits recipients to accept less paid or less favourable jobs (Zumutbarkeitsregelung).
- The reduction of the different levels of family subsidies which also are seen as to work as an employment barrier as family subsistence is subsidised significantly higher by social benefit programs than by child benefits paid to working people.
- The simplification of temporary work and fixed-term contracts.

The suggestions were picked up by the Rheinland-Pfalz government with the "Mainz" model which subsidises social security contributions for low-paid jobs. The level of the subsidy is between 15 and 20 % of the gross wage depending on the level of income. The lower income groups receive almost the total amount of social security payments, while the subsidy decreases to the upper income bound which is € 897 for single persons and € 1707 for couples. Families receive additional child benefits between € 25 to 75, depending on income levels. This is to compensate for the high family subsidies of social benefits. The subsidies are not deducted from social benefits.

This program was extended to all regions of Germany in March 2002. Within the given wage limits, it is open to all employees subject to social insurance contribution with a minimum of 15 working hours per week. The subsidies are paid for a maximum period of 36 months. Until now, the response to the program was very limited. The major problem seems to be that the marginal tax rate is above 100 % in some income groups which makes it rational not to raise income by additional work (Sinn et al. 2002).

Without a significant reform of the social benefits system including both, the set-off regulations and the regulation of the commitment to work, significant employment effects cannot be expected from wage subsidies. This is clearly shown by two studies undertaken by the Zentrum für Europäische Wirtschaftsforschung (Buslei, Steiner 1999) and the Institut zur Zukunft der Arbeit (Schneider et al. 2002). Both studies came to the result that the employment effects of such subsidies will be minor. The IZA study simulated several alternatives for wage subsidies compensating for social security contributions. The most comprehensive subsidy which exempts incomes up to € 510 per month from social security contributions and declines until the level of € 1,280 is estimated to have a demand effect of 135,100 additional jobs and 80,800 to 104,000 additional workers supplying labour. The costs of such a wage subsidy program will exceed any reasonable level: € 73,000 annually is calculated per additional job. As these

subsidies are planned to be given to all employees of the low-wage bracket, the relation to the amount of additional jobs is very unfavourable.

These estimates differ significantly from the Ifo calculations. The major reason for this comes from the assumed or estimated elasticities. While the Ifo study assumes very high wage elasticities, the other studies are much more cautious in this point and therefore estimate much lower reactions of both, labour supply and labour demand.

Minimum labour conditions by collective agreements

At the end of 2001 57,595 collective agreements were registered by the Federal Ministry of Labour (Bundeministerium für Arbeit und Sozialordnung 2002) in its public tariff register. Many of these agreements are amendments to earlier treaties but nevertheless 30,361 basic agreements on wages and labour contract regulations were valid at that time. These agreements covered 90 % of the employees in Germany with very few branches left out, like legal and consulting services, religious and political institutions (including employers' associations and trade unions), and parts of the new economy.

Legally, the collective agreements are based on the Collective Agreements Law (Tarifvertragsgesetz) from 1949. It regulates that

- Collective agreements can be stipulated by trade unions and individual employers or employers' associations. (23.158 of the total number of agreements mentioned above are company based).
- The agreements are binding for the members of the tariff partners only, which means that companies without membership of an employers' association and without a company based agreement are excluded. In principle the same is true for non-members of trade unions among the workers. However, companies are obliged not to discriminate between union-members and non-union-members among their employees.
- The legal regulations are compulsory minimum standards for the individual labour contracts and cannot be suspended except by collective agreements. They continue to be valid after the expiration of the collective treaty until they are substituted by a new regulation. Only more favourable arrangements can be fixed.

If a public benefit can be assumed and if more than 50 % of the employees are tariff bound, the Federal Ministry of Labour can declare the collective agreement as generally binding for all companies (Allgemeinverbindlicherklärtung). This

means that all workers and all employers of the sector or regions are bound by the tariff regulation. It is estimated that the 534 generally binding agreements cover approximately 1m employees (Munz, Vogler-Ludwig 1998)

The extended system of labour contract regulations which widely excludes competition from labour markets is justified by three major arguments:

- *Transaction costs:* Collective agreements reduce the costs of negotiation as they stipulate the content of labour contracts for many individual cases. In addition, they reduce the risk of conflicts. The most important issues of contractual arrangements are brought to a general solution. Following the theses, individual negotiations would be more time consuming and costly.
- *Obedience and asymmetric information:* Labour contracts are incomplete contracts as it is impossible to fix the service of work and its reward from the beginning until the end of the contract. In the case of asymmetric information in favour of the employer (e.g. on the economic situation of the company or the competitive situation on the labour market) the risk arises that the employee receives an unfavourable offer already at the beginning of the contract. The disadvantages of asymmetric information continue during the duration of the contract, and can be reduced by consecutive collective negotiations.
- *Inverse supply reactions:* The thesis assumes that individual households increase labour supply if wages are reduced. As all households show the same reaction, a negative wage spiral is triggered off which reduces wages to the subsistence level. Working conditions deteriorate and raise the health risks for workers. To stop this process, collective agreements are required.

Anti-trust legislation in principle accepts these arguments and allows collective agreements as an exemption from the general prohibition. The rationale of collective bargaining, however, is seriously doubted by economic advisors as the Sachverständigenrat (Council of Economic Advisors), the Monopolkommission (Trust Commission) or the Deregulierungskommission (Deregulation Commission). The transaction cost argument is questioned as company based and individual negotiations might be more efficient. The problem of asymmetric information is considered to be solved by legal minimum standards for labour contracts, and the risk of exploitation by employers is assumed to be very limited regarding the experience in many foreign countries. Serious objections are therefore presented against area-wide collective agreements (e.g. Deregulierungskommission 1991, Monopolkommission 1994).

In fact, the justification of collective bargaining assumes the type of everybody's jobs which can be easily filled and where competition among workers is strong. Human-capital accumulation does not arise as an argument of countervailing

power of employees. For large parts of the working force, however, jobs security is based on their knowledge and the resulting efficiency of their work (Vogler-Ludwig 2001). Thus they are able to achieve wages above the levels fixed by collective agreements. At the lower end of the wage and skills hierarchy which is the focus of this analysis, the risks of a liberal labour market are becoming greater, but even there the efficiency wage arguments are working.

Accordingly, collective bargaining in Germany has left the path of a minimum standard policy since decades and has switched to a policy of income distribution and regulation of working conditions. It was during the nineteen fifties when the improvement of minimum standards was dominating collective negotiations, as Table 5 indicates. The defeated controversies on wages and a 16 week strike for sickness payments in Schleswig-Holstein are examples for the efforts to raise minimum standards. This policy was supported by the labour courts which limited the scope for low-wage payments e.g. in the case of low-wage groups for women. At the end of the sixties, the income distribution had become the central matter of debate and spontaneous strikes of the workers in many parts of the country forced the trade union leadership to change their policy. Supported by shrinking unemployment and rising labour shortage a period of rapid re-distribution in favour of wage earners started. In 1974 it took the Public Workers Union (Gewerkschaft Öffentlicher Dienst) only a 3 day strike to achieve an 11 plus on their wages, a success which was corrected afterwards by the anti-inflation policy of the Bundesbank and by a steady re-distribution in favour of capital incomes.

During the seventies and eighties, high and rising unemployment forced the trade unions to lower their wage claims and to stipulate for the re-distribution of labour. Working time reduction became the central instrument of their policy for which they achieved a major break through in 1984 when the target of the 35 hours week was fixed in many agreements. This was amended by early retirement programs and protection agreements against rationalisation.

History of collective bargaining Table 5

Date	Event
1949	Tariff Agreements Law (Tarifvertragsgesetz); Constitutional freedom of collective bargaining (Koalitionsfreiheit, Art. 9 GG)

1954	18 day strike in the Bavarian metal-industries for higher wages ending with a defeat.
1955	Abolition of „Womens' wage groups" by Federal Labour Court
1956	Campaign for working time reduction to 45 hours a week („Samstag gehört Vati mir!")
1957	Successful 16 week strike for sickness payments in Schleswig-Holstein
1965	First agreement on a 40 hours week in the printing industries; First agreement on asset formation for workers
1967	Stability and Growth Law (Stabilitäts- und Wachstumsgesetz); Common negotiations by social partners and government on economic policy "Konzertierte Aktion"
1969	Spontaneous strikes on wages
1974	3 days strike for higher wages: +11%
1978	Protective agreements against rationalisation in the metal and printing industries
1984	Strike for a 35 hours week: Entry into working hours reduction; Early retirement agreements
1990	Transference of the western German tariff system to eastern Germany
1993	Strike in eastern Germany against the termination of tariff agreements by employers; introduction of exemption regulations for vulnerable companies
1994	Employment protection agreements
1996	Law on minimum standards for border crossing services (Arbeitnehmer-Entsendegesetz); Spontaneous strike against reduction of sickness payments; Part-time agreements for ageing workers
1998	Alliance of government and social partners on employment, training and competitiveness ("Bündnis für Arbeit")
1999	Trade unions are entitled to sue against employers who do not apply tariff agreements (Federal Labour Court Decision 20.4.1999; Bundesarbeitsgericht)
2002	Strike in the metal-, printing- and construction industries for higher wages; Tariff Loyalty Law (Tariftreuegesetz)

Source: WSI-Tarifarchiv.

During the nineties the defence of the tariff wage system against various hazards began to determine collective bargaining policy. After German unification, the western system of collective bargaining was transferred to the New Länder without substantial change. However, the system was not fully applicable to the

economic and labour market situation and thus revealed its limitations. The acceptance of the system remained rather low. The share of eastern German companies belonging to the tariff system is estimated to be only ⅓ and the share of workers covered by collective agreements is at ½ (Bellmann 1999). There were some efforts to force employers into collective agreements by strikes. But the trade unions had to confess that the cost burden resulting from the regulations were too heavy for parts of the companies. At the end they allowed for exemptions to vulnerable companies.

Moreover, the system of collective bargaining continued to weaken. The secular trend of decreasing membership at both, trade unions and employers' associations was an alarming sing which forced the organisations to react.

- In 1996 the law on minimum standards for cross-border services (Arbeitnehmer-Entsendegesetz) was passed which forced foreign companies in the construction business to pay minimum wages to their workers at German sites. In the construction sector wage competition with foreign companies had become a serious risk for German companies and German workers. After very controversial debates the central organisations of the employers' associations agreed upon the introduction of generally binding minimum wages in this sector.
- In 1999 the Federal Labour Court (Bundesarbeitsgericht) decided that trade unions can force companies by suit to apply collective agreements. Before this decision such suits could only be submitted by individual workers.
- In 2002 the Law on Tariff Loyalty (Tariftreuegesetz) was passed, which threatens companies in the construction and local traffic sector with penalties, if they do not pay wages customary at place. Moreover, penalties for illegal work and clandestine employment were raised. A register for unreliable companies was established which allows public institutions to exclude these companies from public contracts.

The social partners joined the "Bündnis für Arbeit, Ausbildung und Wettbewerbsfähigkeit" (union for employment, training and competitiveness) proposed by the government in 1998. This was a revival of the "Konzertierte Aktion" of the sixties and concentrated on training issues, placement services, ageing workers and international benchmarking of labour market policies. The important question of collective bargaining and wage policy was excluded.

The system of collective bargaining is highly influential as can be shown by simple regression between the growth rates of tariff wages and virtual wages as paid by the companies. The correlation is highly significant and the correlation coefficients are above 0.7 in all sectors investigated (Vogler-Ludwig 2001). The most

impressive and most important result, however, is the fact that wage policy in Germany achieved the stability of wage relations over decades. The wage relations between different skills groups – as shown in Table 6 – were compressed during the sixties and seventies and remained stable thereafter. Contrasted to the enormous rise of unemployment rates for less skilled workers this result means that wage determination is largely independent from the level of unemployment, internal and external labour markets do not communicate and – most importantly – wage policy is distribution policy for the employees rather than employment policy for the labour force.

Wage relations

Table 6

Virtual wages in manufacturing, construction, trade, banking and insurance
Unskilled women = 100

Employee	Skills group	1960	1970	1980	1990	2000 *
White collar						
Male	High skill level	301	274	252	263	253
	Medium skill level	220	208	190	193	182
	Lower skill level	153	154	143	140	131
	Unskilled	132	134	123	114	111
Female	High skill level	236	215	197	210	204
	Medium skill level	166	161	151	155	149
	Lower skill level	115	116	113	115	114
	Unskilled	100	100	100	100	100
Blue collar						
Male	Skilled	169	158	150	148	147
	Trained	157	143	134	133	125
	Unskilled	136	128	120	120	113
Female	Skilled	114	112	112	115	123
	Trained	108	104	104	104	103
	Unskilled	100	100	100	100	100

* Wester Germany until 1990, Germany afterwards.

Source: Statistisches Bundesamt

Very little scope was left, therefore, to improve the job opportunities of precarious workers. By contrast, they were not allowed to compete by lower wages or less favourable working conditions. This significantly limited their chances to get

a job as they were in general not able to compete by increasing their efficiency of work. In relation to the upper skills groups their relative efficiency wage increased continuously as those skills groups permanently invested into training and human capital formation, thus raising their efficiency and competitiveness on the labour markets. Jammed into the corset of stable wage relations, companies preferred to employ better skilled persons and to substitute simple jobs by machinery and the re-organisation of work.

It would be a misunderstanding to blame the trade unions misusing their power for the struggle on income distribution and enforcing the particular interests of their members. Collective agreements are signed by two parties, and the employers are one of them. In addition, for most of the jobs higher wages were paid by the companies than arranged by wage agreements. Obviously based on economic reasoning, a broad consensus exists on the labour market not to adjust wages to labour market imbalances.
But the question remains, why the imbalances on the labour markets did not force the social partners to react. Here, the government comes in again, which took the responsibility for a high employment level, for active labour market policy and for social security of the population. With the constitutional freedom of collective bargaining guaranteed, the social partners were free to decide on wage issues without being responsible for employment or unemployment levels. The government on the other hand did not have the instruments to solve the structural problem of the labour market which does not create a sufficient number of simple jobs. This, however, is indispensable to solve the unemployment problem. Not surprisingly, the participants at the Bündnis für Arbeit remain rather helpless what to suggest for the reduction of unemployment.

Labour legislation

In principle labour contracts between employees and their employer are individual contracts which can regulate any item according to the results of individual negotiations. In practice, however, the scope for individual solutions is very limited. Federal labour legislation on the one side sets various minimum standards for working hours, vacation, contract duration, minimum lay-off periods etc., and collective agreements set further standards for minimum wages, supplement payments, working time and other elements. While Federal labour legislation is mandatory for every contract, collective agreements are mandatory for members of the social partners' organisations only. For these contracts, however, they

have the same legal status like Federal law. Many individual contracts therefore do not contain much more than a reference to the collective agreement to be applied.

For a long time German labour law differentiated between white-collar workers (Angestellte) and blue-collar workers (Arbeiter). The former differences in payment (white-collar workers were paid on a monthly basis while blue-collar workers get hourly wages), periods of notice for redundancies and other labour regulations are increasingly vanishing – also with the help of the labour courts – the two groups are still registered by different social insurance organisations and collective agreements continue to separate between the groups. Members of the managing staffs are given a special status.

As all efforts to develop a single labour code failed until today, German labour legislation still is much diversified. The legal sources are ranked in the following order:

- Mandatory labour law
  - EU labour law
  - German constitution
  - Federal law
- Mandatory collective agreements
  - Tariff agreements
  - Works council agreements
- Single labour contracts
- Disposable collective agreements
- Disposable labour law

Higher ranking regulations always have priority which means that lower ranking regulation has to consider higher ranking regulation as minimum standards. From this follows the optimal solution principle (Günstigkeitsprinzip) which means that employees can claim for the best regulation whatever the rank of the legal source. Legislation by the courts is very important, the legislation by the European courts in particular.

During the after-war period German labour law was developed in three main streams (the details of legislative output are given in Table 7):

- Extension of individual rights of workers, including the protection of vulnerable groups
- Development of the collective rights of workers by co-determination legislation

- Extension of labour market services and implementation of active labour market policies, including macro-economic employment policy.

Workers' individual rights and the protection of vulnerable goups

During this period the basic instruments of employment protection were created by the dismissal protection law (Kündigungsschutzgesetz) in 1951 and the introduction of sickness payments in 1957. In addition, several laws were passed to protect specific groups of workers, like mothers, home workers, disabled persons and young workers.

The dismissal protection law brought a fundamental change to the protection of labour contracts as it allowed workers to claim for the continuation of the labour contract rather than to obtain severance payments. According to the law, which is still valid in principle, every dismissal has to be "socially justified" by the employer. This means that the lay-off has to be substantiated by facts which are connected to the worker's ability or behaviour (e.g. the inability to work, continuous tardiness etc.), or by urgent economic requirements (e.g. lack of orders). Moreover, it has to be proved that the dismissal cannot be avoided by re-training or transfer to another job.

The works councils have the right to veto against the dismissal if the social justification seems not to be given. The final decision is taken by the labour courts. In any case, the labour contract can be terminated by the employer if the continuation of the labour contract must be expected to be counter-productive. Mass-dismissals – defined in relation to the size of the work force[1] – have to be announced to the labour office and can only be exerted with its approval. Members of the works councils, disabled persons, pregnant women and persons in temporary military duty cannot be dismissed.

History of labour legislation Table 7

Date	Title	Major innovation
1951	Kündigungsschutzgesetz Heimarbeitsgesetz	Dismissals protection Protection of home workers
1952	Mutterschutzgesetz	Motherhood protection

[1] E.g. dismissal of 30 employees out of a work force of 500.

1953	Schwerbehindertengesetz	Protection of disabled persons
1957	Entgeltfortzahlungsgesetz	Sickness payments
1960	Jugendarbeitsschutzgesetz	Protection of young workers
1961	Vermögensbildungsgesetz	Promotion of private asset accumulation
1963	Bundesurlaubsgesetz	Federal vacation law
1967	Stabilitäts- und Wachstumsgesetz	Law on economic stability and growth
1969	Arbeitsförderungsgesetz Berufsbildungsgesetz	Labour promotion law Vocational training law
1972	Betriebsverfassungsgesetz	Co-determination law
1974	Gesetz zur Verbesserung der betrieblichen Altersversogung Gesetz über Konkursausfallgeld	Company based pensions Insolvency shortfall payments
1982	Abeitsförderungs-Konsolidierungsgesetz	Consolidation of labour promotion law
1984	Vorruhestandsgesetz	Early retirement law
1985	Beschäftigungsförderungsgesetz	Employment promotion law
1994	Arbeitszeitgesetz	Working time law
1995	Arbeitsrechtliches Beschäftigungsförderungsgesetz	Reform of the employment promotion law
1996	Altersteilzeitgesetz	Part-time for ageing workers
1997	Arbeitsförderungs-Reformgesetz	Reform of labour promotion law
1999	Gesetz zur Neuregelung geringfügiger Beschäftigungsverhältnisse Gesetz zum Schutz der Arbeitnehmerrechte	New regulation of minor employment contracts Law on protection of workers' rights
2001	Gesetz über Teilzeitarbeit und befristete Arbeitsverträge	Part-time and fixed-term contract law
2002	Job-Aqtiv-Gesetz	

Lay-off or quitting has to be announced with a four week period at the minimum. For employers lay-off periods are rising with job tenure up to the maximum of seven months for employees engaged for twenty and more years (§ 622 BGB; Civil Code). In general longer periods are fixed by collective agreements, increasing with job tenure. Workers must never have longer terms of notice than employers.

The application of the law was continuously under debate. It is applied to companies with more than five employees are subject to the law and employees with more than 6 months job tenure are protected. Between 1996 and 1999 the threshold for application was shifted to 10 employees.

The dismissal protection law does not avoid separations but raise the barriers against a hire-and-fire practice by forcing the employer to present revisable evidence for the lay-off. This is enforced by the rights of the works councils to veto and to influence the selection of workers to be dismissed according to social considerations. The law is effective in extending employments duration and lowering the short-term employment reactions of employers as regards fluctuations of production volumes. As shown by Abraham and Houseman with a US-German comparison, production elasticities of employment in German manufacturing firms were significantly less in the short-run, however, within a two years period, elasticities reached the same level as at US-firms (Abraham/Houseman ...). This indicates the decelerating effects of dismissals protection laws.

In addition to dismissals protection, specific groups of workers were protected by labour law:

- *Motherhood:* Women must not be employed 6 weeks before and 8 weeks after birth, and they cannot be dismissed within 4 months after birth.
- *Home workers:* Wages of classical home-workers are controlled by a home works council. Tele-work generally is considered as re-located dependent work rather than home work.
- *Disabled persons:* Companies with more than 15 employees have to employ at least 5 % disabled workers. Firms not achieving the quotas have to pay a levy between € 100 and 250 for every working place not filled with a disabled worker.
- *Young workers:* In general only children aged 15 and over are allowed to work, however, for agricultural work and news paper delivery the age limit is 13. The maximum working time is 40 hours a week, with 25 to 30 days vacation per year for workers younger than 18.

The social protection of workers has two economic effects, increasing the (shadow) price of labour on the one hand and raising productivity on the other. In reality, both effects are much more complex that expressed by these stylized facts. Nevertheless, they describe the double windmill by which the employers were caught. Beyond social considerations, the employers accepted restrictive regulations on labour contracts as they were aware of the negative economic impacts of a hire-and-fire policy. High flexibility was connected to high risks of

poaching. In addition to the loss of initial training investments into workers, the loss of company-based knowledge was assessed to have negative effects on the economic performance of companies. Pay-off periods for training investments were reduced with shortening job tenure and thus the volume of training was expected to shrink in general. The human-capital basis for future efficiency seemed to be in danger. The dependency of company profits on human capital was evident and repeatedly verified by the export success of German manufacturing industries. And finally, job security worked as a non-pecuniary premium for workers in face of the risk of unemployment.

Of course, these considerations did not have the same importance for all groups of employees. Higher skills groups were more valuable for the companies than lower skills groups. The labour law, however, did not allow for discriminating regulations and the trade unions tried to protect vulnerable workers. The arguments based on the rising shadow price of labour regulation, therefore, became more important with rising unemployment of low skills groups. Being aware of these effects, the conservative government undertook a major step into a deregulation policy for the labour market and passed an Employment Promotion Law in 1985 (Beschäftigungsförderungsgesetz). This law introduced a new regulation of fixed-term contracts, eased dismissals protection and stepped into a part-time policy. From that time onwards, fixed-term contracts were allowed for a period of 18 months, and the former justification of the limitation was no longer required. Contract work was allowed for 6 month (3 months longer). In addition, marginal employment was set tax-free up to the income level of 12.5 % of average wages (actually € 325) and less than 15 working hours per week.

The partial liberalisation of labour law gradually opened the watergates for an unprotected peripheral labour market with increasing marginal employment and (dependent) self-employment (Düll/Düll 2002). This was seen as both, endangering the legal position of dependent employees and undermining the financial basis of the social security system. Marginal employment was therefore taxed with a 20 % tax rate already by the conservative government.

The Red-Green coalition passed a series of laws to restrict the disbanding of the labour market: In the year 1999 a new regulation of marginal employment was passed, imposing a 22 % social security contribution instead of the flat tax rate (which meanwhile was raised to 23 %). This had the effect that marginal employment in second jobs decreased significantly while it increased as primary job. Moreover, the law to restrict dependent self-employment (Gesetz zum

Schutz der Arbeitnehmerrechte) was passed which assumes dependent employment (submitted to social security contributions) if two out of four criteria are fulfilled:

- Regular work for one employer
- No employees
- Typical activities of employees
- No appearance on markets

The burden of proof was reversed. Dependent employment is assumed as long as the employee and the employer cannot confute the assumption, and the agreed remuneration is taken as net wage for which the employer has to pay social security contributions.

In the year 2000 the Beschäftigungsförderungsgesetz was substituted by the law on part-time work and fixed-term contracts (Gesetz über Teilzeitarbeit und befristete Arbeitsverträge) which is related to the EU directive 99/70/EG. This law returned to the requirement of an explicit justification by enumerated reasons for the limitation of employment duration (nature of the job, training, substitution of other workers etc.). For contracts of less than two years, however, an explicit justification is not required. Fixed-term contracts can be prolonged for three times at the maximum.

As regards part-time work, the new law introduced the legal right of full-time workers to reduce their working hours. Part-time workers must not be discriminated concerning wages and supplementary payments. Capacity oriented working hours (labour on demand) were newly regulated, requiring a fixed minimum working time per week and per day, and the announcement of changes in working hours four days in advance. Job-sharing contracts are allowed for workers who have to share the risk of substituting the other part in case of sickness or other absence from work.

Development of the collective rights of workers by co-determination legislation

The enforcement of workers' rights was implemented by workers' representatives in the companies rather than litigation before the courts. This approach has a long tradition in Germany going back to the 1920s when the idea of a "Rätere-publik" (republic of councils) was developed. With their claim for exclusive representation of workers, the idea of works councils initially was in fundamental

contradiction to the big political parties (the Social Democratic Party in particular) and the trade unions. This ambiguity accompanied the debate on works councils for a long time.

The first law on co-determination was passed in 1952 against the resistance of the trade unions. The works councils were obliged by this law to co-operate with the employers on a loyal basis without receiving extended rights of co-determination. The trade unions perceived this to be imbalanced. In 1972 a fundamental reform of the Works Constitution Act (Betriebsverfassungsgesetz) was passed, allowing the election of works councils in all companies with a minimum of five employees to represent the interests of the workers. In 1976 the Co-Determination Act was passed, giving workers' representatives half of the seats of the supervisory boards of corporations with more than 2000 employees.[1]

Works councils have the task to

- monitor the application of laws, directives, collective agreements, and works council agreements,
- submit measures in favour of the employees and the company to the employer,
- promote young workers, disabled persons, aged workers, foreigners, and to foster equal opportunities for women.

Three types of co-determination rights were created to fulfil the tasks: the right on information, on consultation, and on co-determination. The most extensive right on co-determination is limited to social issues (e.g. the order of the company, the behaviour of employees, the regulation of working hours, the principles of remuneration, the application of monitoring techniques etc.). The works council can veto against enlistment, transfer, or regrouping if the personnel measure is at the disadvantage of the employee. In addition, a veto against a dismissal can be based on the arguments that social considerations were not assessed adequately, employment is possible by re-location or re-training, or the principles for personnel measures as agreed with the company management were violated. The right on consultation refers to issues of occupational safety and health, staff planning, training, and changes of the companies' principles. In these cases, the employer has to inform the works council about the measures

[1] There is no full parity of votes as the capital owners are empowered to nominate the chairman of the supervisory board in case of conflict, and the chairman has two votes in case of equal votes by capital owners and workers.

and to consider the arguments by mutual exchange. The right on information includes the plans of the management concerning new facilities, technical equipment, changes in the organisation of production or working places etc. In bigger companies with more than 100 employees, an economic council is established which has the right to be informed about the economic situation and planning of the company. The employer has to provide the necessary materials to the works council.

This description of co-determination shows that the works councils have effective legal instruments to control the implementation of labour law and collective agreements in the companies. They are the long arm of the law. However, they are more than a controlling institution. As the representation of the workers of a company they can develop their own policy on basic workers' interests, as the sustainment of the working capabilities and health of workers, the dignity of individuals, the equal treatment of all workers, the freedom from arbitrariness, fair remuneration and the safety at work. These are interests which can hardly be guaranteed by labour law, as in general the barrier to sue against the employer is very high. Works councils therefore have the important function to solve conflicts between workers and the management by negotiation, and the management is forced to enter into these negotiations by the Works Constitution Act. In this sense the co-operation of works councils and management are the continuation of social partnership on the company level.

Paragraph 2 of the Works Constitution Act gives a general clause for the co-operation of works councils and management: "Employer and works council co-operate truthfully at the welfare of workers, respecting applicable collective agreements and co-acting with the trade unions represented at the company." The result of these negotiations can be both, individual measures or works council agreements, which are legally binding for the staff of the company. Works councils are independent from the trade unions; however, they have to respect the results of collective bargaining. The dominance of collective bargaining is fixed by the explicit exclusion for works councils to negotiate on issues regulated by collective agreements (paragraph 77). In fact, works councils are not allowed to negotiate on wages and many other elements of labour contracts which are regulated by collective agreements. This leads to conflicts with trade unions in cases where the works councils try to contribute to job security by accepting conditions inferior to collective agreements. There were some cases concerning working hours and wages in the construction industries. Generally, there is a

close partnership with trade unions as the majority of works council members are also members of a trade union.

Being very controversial at the times of implementation, co-determination was integrated into the management and decision process and therefore not questioned for long by the employers. Co-determination proved to be a workable instrument to reduce conflicts with the workers and to improve social integration. The claim for truthful co-operation is assessed to promote the introduction of co-operative management concepts and the reduction of hierarchical structures. Due to the information provided to the works councils and the inclusion into the decision process, the rationale of decisions by the management could be transferred to the workers and the solutions worked out were adjusted to the interests of the employees. As a result, changes in technology or working processes could be implemented with little resistance, and works councils in general even accepted staff reductions if this appeared to be necessary for the survival of the company.

Co-determination is guided by the idea of long-term employment of core staffs which reach an optimum of productivity and which makes human-capital investments profitable. This coincides with the expectations of the majority of workers, and companies made use of the willingness of workers to take responsibilities and to engage in strategic thinking. New and peripheral forms of employment, however, were perceived as a hazard to the dominating employment model. Marginal employment, (dependent) self-employment and even part-time employment were not or only reluctantly integrated into the works councils' policies. Thus, the low degree of flexibility on the German labour market is also linked to co-determination.

Forced by structural transition and the feedbacks of international competition on labour markets (e.g. by multinational benchmarking of working processes) there was a continuous fallback of the standard German employment model and, in parallel, the decline of works councils representation. This was supported by the decline of employment in manufacturing where many job were re-located to foreign countries. Growing employment in the service industries mainly happened in small businesses with low trade union membership and a preference for flexible forms of employment. Therefore, the zone free of co-determination grew from 50.6 % of all workers in 1985 to 60.5 % in 1995 (Kommission Mitbestimmung 1998).

Co-determination regulation remained more or less unchanged for three decades. The recent reform of 2001 simplified the election procedures and the working structures of works councils, increased the number of works council members, and extended the rights concerning new types of employment and equal treatment of workers. This was a partial answer to the declining representation of workers by works councils. On the employers' side the reform was criticised as extending the duration of decision taking, raising the cost of co-determination, and increasing the power of works councils (BDA 2000). The principles of co-determination, however, were not questioned, notwithstanding the unique position of German co-determination among the industrialised countries.

Active labour market policy and macro-economic governance

The first severe cyclical downturn in Germany at the end of the nineteen sixties pointed out that full-employment is nothing guaranteed by the social market economy, and at that time a broad consensus existed that macro-economic policy and further state intervention will be able to bring the labour market back to the balance. The first Labour Promotion Act (Arbeitsförderungsgesetz) was passed in 1969, defining three policy areas:

- *Unemployment insurance:* In addition to regular unemployment benefits, unemployment aid was provided to long-term unemployed not eligible for unemployment benefits.
- *Active labour market policy:* This included placement services, training, mobility promotion, and group-specific labour market policies.
- *Macro-economic labour market governance,* including cyclical interventions, restriction of labour supply, and long-term growth policies.

During the 27 years the Labour Promotion Act existed, more than 100 amendments were undertaken with 15 substantial reforms. In 2001 the law was included into the Social Code (Book III) together with a fundamental revision. Most importantly, the public responsibility for a high number of jobs, for the improvement of the structure of jobs, and for high growth was skipped in favour of a market-oriented approach urging for the consistency of labour market policy with social, economic, and fiscal policy, leaving the responsibility for job creation to the markets, and committing labour market policy not to endanger the creation of competitive jobs (Social Code III, § 1). This switch to a market-oriented labour market policy which was debated for a long time before, however, did not prevent the Chancellors of both the conservative and the red-green government to promise a substantial reduction of unemployment through their policies. Ig-

noring the change of policy already noted by the legislation, both promises failed.

The regulatory elements of the new law are differentiated:

- Unemployment benefits
  - Benefit payments of 60 % (minimum) of net wage for 6 to 32 months depending on age if a minimum insurance period of 12 months is given.
  - Obligation to job search activities and to accept of jobs of any kind providing 70 to 80 % of the previous wage level.
  - Unemployment aid for long-term unemployed not eligible for unemployment benefits.
  - Insolvency payments for the last three months of employment at an insolvent employer.
- Employment security
  - Short-time employment benefits, a subsidy for reduced hours of work during an economic slack period (24 months at the maximum), according to unemployment benefits.
  - Promotion of year-round employment in the construction industry, similar to short-time employment benefits.
  - Financial support of social compensation plans which enter into re-employment measures.
  - Training of unemployed or redundant persons, with a focus on continuing training of employees, training of disabled persons, and training of young workers in the dual system (Auszubildende).
- Employment promotion
  - Consultation and job placement services are not longer a monopoly of public employment services. Private placement services are controlled by the public labour offices.
  - Financial support for employees by subsidies concerning the costs of job application, mobility, short-term employment and the foundation of new businesses by unemployed persons.
  - Wage subsidies to employers for long-term unemployed and aged workers, and to newly founded companies (2 employees at maximum are subsidised with 50 % of the means tested wage income).
  - Integration treaties for unemployed persons, which cover the cost of sickness payments and other absence from work
  - Training subsidies for disabled persons
  - Job creation programs and measures for structural adjustment which normally cover 75 % of wage costs. These programs concentrate on environmental improvement, social and youth services.

Due to the heterogeneity of the law, evaluation is a difficult task. Fritzenberger and Speckesser (2000) however summarise in their review of evaluation studies that most of the studies do not show significant effects of active labour market policy. The results of all studies remain very uncertain which means on the one

hand that the great number of measures makes it difficult to identify the specific effects, but on the other hand that the effects were not strong enough to outweigh the white noise of other impacts. In particular, no positive effects of the training measures could be identified, in eastern Germany where large programs were implemented, as well as in western Germany where even negative effects were measures for public training programs. Similar results were obtained for job creation programs and wage subsidies.

There was a long debate on a "secondary labour markets" subsidised by public programs, in order to provide jobs rather than benefits to unemployed persons. This should help to sustain the working capacities and the return of these people to the "primary" labour market. In particular, for eastern Germany such programs were established with big volumes. The expectation, however, that job creation programs could be an entry ticket to a normal job was not fulfilled. In contrast, participants of these programs entered a dead end street and working capacities deteriorated in the non-competitive environment of these jobs.

The other main approach to reduce unemployment was on labour supply restrictions. During the nineteen seventies already it became evident that macroeconomic employment policy was not effective due to inflation risks and increasing budgetary problems. The expectation of the Stability and Growth Act (Stabilitäts- und Wachstumsgesetz) from 1967 which designed a major public role for the achievement of growth and market balances was wrong, as Germany had to suffer from unemployment increasing during every recession. Full employment, sliding out of rational expectations, should therefore be achieved by labour supply restrictions. On the public side, various early retirement programs were implemented with broad acceptance but high costs. On the trade union side, the reduction of working hours was already proposed during the nineteen seventies. The great break through was achieved in 1984 after a long strike in the metal industries. This was the entry into the reduction of weekly working hours from 40 to 35 hours which is now the standard for most of the sectors (excluding the public sector and eastern Germany). While the reduction of working hours had positive effects on the number of workers employed, about half of the calculated effect vanished in rising labour productivity. Most of the changes in working hours were associated with cost effects which limited the scope for additional employment. As a result, the volume of hours worked in the German economy continued to decrease (ifo Institut, Stille ...).

Conclusions

With its long tradition of a social consensus, Germany established a complex legal construction to avoid rising divergence, marginal existence and heterogeneity. The society was willing to pay more than one third of its total income for redistributive purposes. In a close link between legislation, social partnership and co-determination a narrow network of regulations was created, restricting almost all risks of dependent work. Precarious individuals in Germany are therefore not to be found on the labour market. They are unemployed, retired, in training or other forms of public sponsorship.

Simultaneously to the development of the welfare state, the economy chose a strategy of high productivity and efficiency, switching to high-price product markets and selecting the most efficient workers on the labour market. The alternative to downgrade the productivity level was never considered seriously, neither by the companies nor by the actors of public policy. It seemed as downgrading derogates the income basis of the welfare state. This, however, was one of the fundamental misjudgements during the last three decades. The high-productivity strategy improved the income levels of workers but raised unemployment. Increasing social taxes afforded to finance different types of unemployment and non-employment were associated with negative employment effects, thus propelling the labour-cost-unemployment circle.

Even with the expectation of full-employment – which was the pride of the "Wirtschaftswunder" generation – a policy of diverging income levels, rising numbers of working-poor, poverty and insecure employment was never accepted. The economic target of full-employment was abandoned in favour of the welfare state achievements. In this sense, unemployment in Germany appears as the solution which was not only accepted but wanted by the society as the better outcome. Similarly, high social taxes are preferred against rising economic risks of individuals.

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