

Discussion paper

**EUROPEAN EMPLOYMENT OBSERVATORY
GERMANY**

Fighting the crisis

**Quarterly review of labour market trend and policies
3rd Quarter 2008**

by

Kurt Vogler-Ludwig

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Glossary

Business Foundation Allowance	<i>Gründungszuschuss</i> : New regulation of business foundation support for unemployed UB-I recipients for a period of 15 months at maximum (valid since 1 August 2006). During the first nine months, a lump sum of EUR 300 is paid in addition to UB-I as a contribution to social insurance costs. During the following six months the lump sum is continued to be paid only if the business became the main entrepreneurial activity.
Hartz reform	Reform of unemployment insurance under the Federal Employment Service (<i>Bundesagentur für Arbeit</i>) and active labour market policies, named after Peter Hartz, principal staff manager of Volkswagen and the president of the "Hartz Commission" established by the German government in 2002. The reform has four parts: Hartz I (2002): introduction of public temporary work agencies (Personnel Service Agencies – PSA) Hartz II (2002): reorganisation of public employment services; mini-jobs, ICH-AG Hartz III (2004): restructuring of public employment services to the Federal Employment Agency Hartz IV (2005): merger of unemployment aid and social assistance to UB-II
Midi-Jobs	<i>Midi-Jobs</i> : Registered employment with monthly wages between 401 and 800 € and reduced social insurance premiums.
Mini Jobs	<i>Geringfügige Beschäftigung</i> : Jobs with monthly incomes up to EUR 400. These can be regular or occasional jobs and jobs in addition to regular employment. Employers pay 30 % of wages to social insurance.
National Training Pact	<i>Nationaler Ausbildungspakt</i> : Agreement between the Federal Government and the employers associations to offer additional dual training places. The pact started in 2004.
Registered employment	<i>Sozialversicherungspflichtige Beschäftigung</i> : Employment contracts subject to public social insurance, i.e. dependent employment with salaries above 400 EURO per month.
Rehabilitation benefit	<i>Eingliederungszuschuss</i> : a wage subsidy for employers who employ long-term or disabled unemployed. Subsidies are limited to 50 % of wages for 12 months. For disabled or older workers the limits are 70 % of wages for a maximum period of 24 months.
Short-term work	<i>Kurzarbeit</i> : following articles 169 ff. SGB III, companies can apply for short-term work in the case of a considerable but temporary lack of work. At least one third of the work force must be endangered to loose at least 1/10 of the income. According to unemployment benefits workers receive 60 to 67 % of the omitting income. Social insurance premiums are continued to be paid at the former levels.
Social benefits	<i>Sozialgeld</i> : non-employable persons in a subsistence-based partnership with at least one employable person receive social benefits. Above the age of 16 rates are equivalent to UB-II.
Subsistence-based partnerships	<i>Bedarfgemeinschaft</i> : These partnerships are defined by the Hartz-IV act as the private income and property units obliged to individual transfers among its members.
UB-I	<i>Arbeitslosengeld I</i> : Regular unemployment benefits for singles provide 60 % of the last net income for 12 months. For parents the rate is 67 %. The regulation is included in Social Code Book III (SGB III).
UB-II	<i>Arbeitslosengeld II</i> : Means-tested basic income for job seekers, paid after expiration of regular unemployment benefit. The basic rate is 351 EURO per month. The regulation is included in Social Code Book II (SGB II).
1 €Jobs Auxiliary public jobs	<i>Ein-Euro-Jobs</i> : Temporary jobs for UB-II recipients in the field of social and public services. They are remunerated by EUR 1 or 2 in addition to UB-II benefits. Jobs need to be for the public benefit and have to be additional to jobs in the premier labour market.

Executive Summary

While the German labour market still shows an excellent performance with employment growth of 1.4 % against the previous year and a long-term low of three million unemployed, the prospects for the next year are deteriorating rapidly. Like other countries Germany now is in recession with two subsequent quarters of decreasing GDP. All macro-indicators are on negative trends actually, and major industries face rapid decline of demand – the car industry in particular.

Official forecasts see a job reduction between 0.1 and 0.3 % in 2009. This appears as optimistic view as it assumes a recovery of the German economy during the next year. The analysis of previous financial crisis however reveals that the burst of such bubbles takes years. Moreover the duration of crisis strongly depends on the adequacy of policy reactions.

Germany was hit by the financial crisis due to its strong links with international capital markets rather than a home-made downturn of housing markets and mortgages. The financial sector and the economy in total are strongly affected by the shockwaves of this crisis which are amplified by the cyclical downturn in the US and some European countries. Moreover, the German banking sector was underperforming already before the shock as it preserved its heterogeneous structure of private and public banks. The German financial sector is said to be “on intensive care”.

The adjustment pressure on banking industries is bigger than ever and will lead to the reform of public banking with accelerating concentration. The least performing savings and mutual banks will be forced to reduce their administrative departments and use the substantial economies of scale on banking markets. Private banks will be limited in their expansion by stronger supervision. Overall, an acceleration of job cuts can be expected for the next years.

Due to the unequal distribution of employment risks on the German labour market, agency workers, free-lancers, workers with fixed-term contracts and mini-jobs will be affected first. The recession however will also affect the core of the German labour market with workers in unlimited full-time jobs: banking employees, financial professionals, and the traditional group of blue-collar workers in manufacturing and construction. The comparatively better economic performance of the Asian countries will attract German producers and thus reinforce previous relocation trends.

The German Federal Government quickly reacted to the appearance of the crisis with a rescue program of 480 billion EURO, a business cycle stabilisation program, and various other measures. While the economic effects of these programs still have to be awaited, they were able to efficiently embank the panic attacks of investors and consumers.

1. Introduction

This quarterly report is dominated by the present financial and business crisis which arrived in Germany with full power. Much of the information usually presented under the heading of "public debate" therefore is now included in the special Chapter 5 on the "impact of the financial crisis". The cyclical forecasts normally reviewed in Section 2.2 were also transferred to this Chapter.

At present state of knowledge, the report can only give preliminary answers to the question of how the crisis will affect the German labour market. There is too little information available on undiscovered risks, and there is only little experience from the past. In principle, however, this report expresses its concern that the expectation of a rapid recovery from the crisis might be wrong.

2. Update on economic and labour market trends

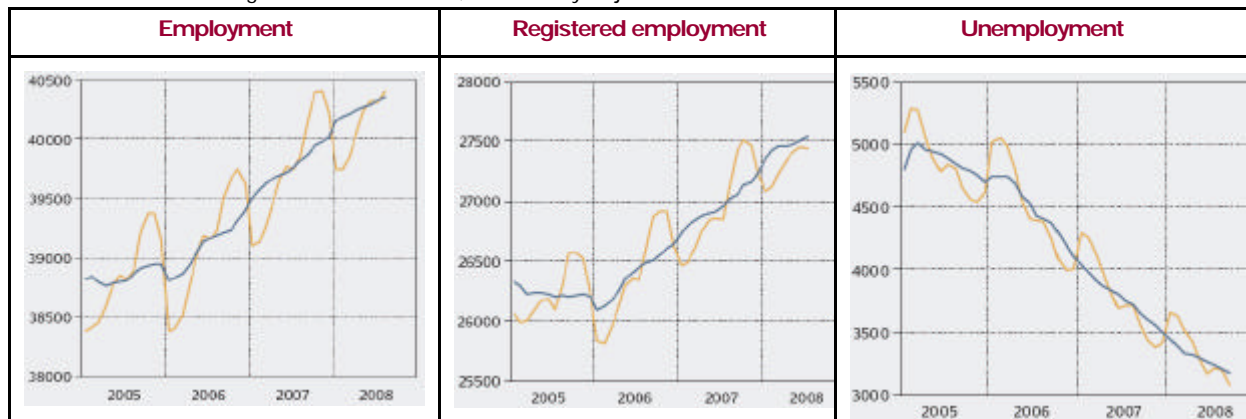
2.1. Recent labour market trends

Macro trends

Employment still grew until recently, however, the increase decelerated: a seasonally adjusted plus of 20,000 jobs was counted in September 2008, compared to an average monthly increase of 50,000 from January to June. In relation to the previous year, 552,000 new jobs were created (+1.4 %). Registered jobs continued to increase by 2 % while self-employment, mini-jobs, and 1 EURO jobs stagnated or declined.

Chart 1 **Employment trends**

Germany
Original values in 1000; seasonally adjusted values



Source: Bundesministerium für Wirtschaft und Technologie (November 2008).

Unemployment

A new record of low unemployment was achieved in October with 2.99 million and an unemployment rate of 7.2 %. This was 1 percentage point less than a year before. By ILO standards the unemployment rate was 6.2 %.

While Western Germany saw a decline of the number of unemployed by 12 % compared to the previous year, Eastern Germany achieved a 14 % reduction.

Long-term unemployment decreased by 20 % against the previous year. The share of long-term unemployed in total unemployment now is 36.6 %.

10.2 % of the population up to the age of 65 received public support through UB-II benefits. In comparison to the previous year the quota declined by 0.6 percentage points. The average subsistence-based partnership with 1.9 persons received 818 EURO per month as public benefit, including UB-II benefits, social insurance premiums and accommodation allowance.

Vacancies

In the third quarter the number of vacancies declined by 130,000 against the second quarter to around 1 million. In comparison to the previous year, a significant reduction by 250,000 vacancies was observed (-20 %). This decline was particularly visible in Eastern Germany but the Western part was also affected. While the number of vacancies for immediate hirings stagnated, future hiring declined by more than 50 %.

Dual training

As already reported in the Post-Assessment of the National Reform Programme (*Vogler-Ludwig 2008*) the dual vocational training system showed a positive balance for the training year 2007/08 with a slight surplus of training places over applications. This couldn't be observed for many years and can be attributed to the upswing of labour demand but also to the policy initiative under the National Training Pact.

At the end of the training year, 14,500 applicants still had no training place. This was less than half of the number counted one year before.

Active labour market policy

Public employment services expanded their activities considerably. Compared to the previous year, the number of participants in active labour market policy measures increased by 1.7 % (Table 1). In particular, support of job seekers expanded by 61 %, in combination with training measures (+ 10.6 %). Support for people on the job however declined due to the reduction of self-employment programmes. Employment creation increased slightly, and other support measures were reduced by one third.

Table 1 **Active labour market policy**
Germany

	October 2008 (1000 participants)	% change to previous year
Improving chances on primary labour markets	739,0	16,3
Counselling and support to job seekers	152,6	61,1
Training and qualification	248,9	10,6
Preparatory measures to training*	337,5	7,0
Support of people on jobs	366,8	-6,4
Support of employees	203,0	30,0
Support of self-employment	163,8	-30,5
Employment creation	378,9	2,9
Employment opportunities for UB-II recipients	332,6	2,0
Job creation measures	46,3	9,7
Other support measures (free selection)	123,1	-33,9
Total (estimated)	1607,8	1,7
<i>ESF-BA-Programme**</i>	20,2	-25,3

*April 2008; ** September 2008

Source: Bundesagentur für Arbeit (October 2008)

2.2. Economic forecasts

See Section 5

3. Labour market policy developments

3.1. Policy actions

Stabilisation programme

With a series of measures the Federal Government tries to combat the negative effects of the financial crisis and the cyclical downturn. The programme "Safeguarding Employment by Strengthening Growth" (*Beschäftigungssicherung durch Wachstumsstärkung, BMWI/BMF 2008*) includes measures to support investments, private consumption and active labour market policy. In combination with the package "Measures to lower tax burden, stabilise social insurance expenditures and investments into families" – decided by 7 October 2008 – 32 billion EURO will be provided until 2010. Investment volumes of 50 to 70 billion EURO are expected. In detail, the following measures are planned:

- In addition to the 480 billion EURO stabilisation programme for the financial sector, the public *Kreditanstalt für Wiederaufbau (KfW)* will offer an additional credit programme of 15 billion EURO.
- Special depreciation will be allowed to SMEs and degressive depreciation will be introduced for two years.
- Additional investment into CO₂ reduction will be supported by a housing sanitation programme and an investment programme for schools, kindergarten, and other social infrastructure. The KfW will contribute to that by special programmes.
- Investments into rail and road infrastructure will be promoted by one billion EURO and regional economies will be supported.
- The crafts business will be supported by doubling the tax deductibility of crafts services.
- Car sales will be promoted by an exemption from car tax for one to two years, depending on environmental standards of the new car. Car tax will be based on CO₂ emissions however EU standards should be introduced gradually. In addition, an innovation programme for modern automotive technologies and other areas of innovation will be launched.
- Finally, older workers will be supported by a qualification programme (*WegeBau*), 1000 additional jobs for placement officers will be created, and the maximum payment period for short-time work will be extended from 12 to 18 months.

Skills initiative

The Prime Ministers of the German Länder and the Federal Government signed a skills initiative (*Aufstieg durch Bildung – Die Qualifizierungsinitiative für Deutschland*) on 22 October 2008 in Dresden. The purpose was to agree on the priorities of education and training reforms in Germany and to define the appropriate measures for achieving the targets. The outcome is a paper with an impressive list of objectives and actions. Financial issues however were delegated to a strategy group which will suggest a solution with one year.

The programme is divided into eight chapters:

- *Highest priority for education:* Germany wants to raise investments into education and research to the level of 10 % of GDP until 2015. It wants to develop common educational standards for A-level examinations and establish an Institute for Quality Development in Education (IQB).
- *Optimal starting conditions for children:* In addition to the improvement of child care

facilities until 2013 (which was already decided earlier), integration of children with migration background will be promoted and 80,000 additional educators and day care staff will be trained. More men will be recruited for child care jobs. Disabled children will be promoted as early as possible.

- *Certified education and training for everyone:* The share of school leavers without certificate will be lowered from 8 to 4 % until 2015, and the share of adults without certified training from 17 to 8.5 %. Schools will better prepare for later jobs, profiling for different types of training will be introduced and training modules will help adjusting training to the needs of disadvantaged youth and adults without training.
- *Improving career prospects:* connectivity of training sequences will be improved; universities will be opened for crafts master, technicians and other intermediary professionals; universities will be motivated to introduce life-long learning schemes.
- *More university students:* 40 % of school leavers should start university studies; "dual studies" with practical work in companies will be extended; more study grants will be provided; tutorials will be extended and capacities of universities will be used more efficiently. Universities will have to imply adequate measures which allow studies within the regular time horizon. Quality management practices will be introduced.
- *More students in natural science:* special incentives will be given for studies in mathematics, informatics, natural science and engineering.
- *More opportunities for life-long learning:* in cooperation with social partners, participation in life-long learning should increase from 43 to 50 %. A campaign for life-long learning will be initiated, and an alliance for life-long learning will be established. Consulting services will be improved and a training allowance will be introduced.

The programme addresses many key issues of the present debate of education and training reforms in Germany. In particular, improvements of pre-school education, the reduction of upward barriers in the training system, and the development of a life-long learning scheme can help reducing the strong status orientation of education and training in Germany. The decision to extend education and training budgets is also a necessary precondition for a better performance. However, financial burden sharing still is unclear.

Working time value accounts

Almost one third of German companies are keeping working time value accounts for their employees. These accounts are part of flexible working time management. With the recently enacted "Flexible Working Time Security Act" (*Gesetz zur sozialrechtlichen Absicherung flexibler Arbeitszeiten, FlexiG*) the Federal Government suggested to improve the security of financial claims resulting from overtime and other forms of flexible working hours. In contrast to working hour accounts, working time value account will have to be kept in money value. They allow transferring the claims over years, are guaranteed by insolvency protection, and are not due to taxes and social security contributions until they are disbursed. They are therefore used for longer-term time management rather than short-term working time flexibility. They can be used for off-times resulting from parent times, care times, or early retirement. The act is planned to come into effect at 1 January 2009.

Collective bargaining

The IG Metall, representing 3.6 million metal workers agreed on a wage increase of 4.2 % within 18 months. The compromise is remarkable not only because the trade union started from an 8 % claim but conceded that wage increase payments might be postponed by up to seven months depending on the financial situation of the company.

Similarly, wage negotiations in the banking sector were revived by VER.DI by abandoning the initial 8 % and reformulating the target to "a considerable wage increase". The banking crisis forced the trade union to adjust their policy.

3.2. Policy actions

See Section 5

4. Recent labour market reports

Die Finanzkrise meistern – Wachstumskräfte stärken. Jahresgutachten 2008/09. Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung. 12 November 2008.

(Mastering the financial crisis – strengthening growth. Annual report 2008/09. Expert Advisory Board. 12 November 2008);

<http://www.sachverstaendigenrat-wirtschaft.de/gutacht/ga-content.php?gaid=53>

In addition to the usual cyclical forecast and the debate on macro-economic policy, the 45th annual report of the Expert Advisory Board (*Sachverständigenrat*) concentrates on two issues: the financial crisis and labour market development. While the analysis of the financial crisis will be included in Section 5 of this quarterly report, this review puts the focus on labour market developments and income distribution. This comprehends the main outlines of the present discussion in Germany.

The experts state a continuous reduction of structural unemployment since 2005. Measured by the NAIRU concept¹, the inflexibilities on both product and labour markets declined significantly. This is taken as indication that the labour market reforms of recent years were successful. The assessment is underlined by the observation that – in contrast to other boom periods – job growth was associated with a parallel increase of the volume of hours worked. Moreover, the numbers of registered employment and full-time jobs increased. This is seen as an exceptionally positive performance compared to previous upswing phases. Finally, the labour market in Eastern Germany was able to profit from the positive trends.

Collective bargaining contributed substantially to the improvements. Since 2005 collective wages increased between 0.9 and 1.3 % annually. Only 2008 saw a stronger increase of 2.5 % on average. Real wage costs fluctuated between -0.8 and +0.7 % per annum. Real net wages however declined in all years between 0.6 and 1.7 %. In 2008 the decline was 1.0 % due to rising social insurance rates. Parts of the workers' contribution to lower wage costs and rising employment therefore was absorbed by public budgets which – apart from unemployment insurance – were unable to restrict expenditures.

The Expert Advisory Board points to the fact that the German labour market is increasingly characterised by an uneven distribution of chances and risks, speaking of a two-class labour market. Atypical forms of employment (agency work, fixed-term contracts, mini-jobs etc.) bear the major burden of cyclical adjustments while core staffs still are effectively protected. A broader dissemination of risks is suggested. With this analysis the board underlines the arguments which were accentuated by several quarterly reports and the recent assessment of the German NRP (*Vogler-Ludwig 2008*).

As policy reactions the board suggests

- dismissals by employers should be principally allowed if a compensation was agreed in advance
- unemployment insurance premiums should be differentiated by companies as far as

¹ Non accelerating inflation rate of unemployment – an econometric measure for of the Phillips curve relation between inflation and unemployment. A low level indicates highly flexible adjustments of both product and labour markets while high levels indicate “structural” unemployment due to market inflexibilities.

the dismissed receive unemployment benefits

- the extension of unemployment benefits for aged workers (from 12 to 15 months for 50+, and up to 24 months for 58+) should be cancelled and unemployment benefits should be degressive with the length of unemployment spells.

Two members of the board, however, expressed their objection of an experience rating of companies regarding unemployment insurance premiums. They argue that the solidarity principle of unemployment insurance will be abandoned and incentives created not to employ workers with high unemployment risks.

Moreover, the board suggests

- introduce a combi-wage model as integrated part of UB-II benefits: only half of the additional labour income should only be deducted from benefits (compared to the present 80 %).
- abandoning preferences for atypical forms of employment
- reform collective bargaining

Most of the measures suggested, however, were rather controversial among board members, which means that the report did not come to common recommendations in a series of labour market related issues.

Flexibilisierungspotentiale bei heterogenen Arbeitsmärkten. Zeitschrift für Arbeitsmarktforschung 2/3 2008. 41. Jahrgang.

(Flexibility potentials of heterogeneous labour markets. Journal for Labour Market Research 2/3 2008. Volume 41);

With this volume, the Institute for Employment Research, Nürnberg, presents the result of a four year research project on the flexibility of heterogeneous labour markets. The two terms are seen as antagonisms where flexibility is limited by heterogeneity and leads to various types of mismatches. The twelve articles refer to labour markets for older workers, gender and occupational segregation, the role of SMEs for labour market dynamics, atypical employment, wage issues and job protection. They summarise the present state of dynamic labour market research in Germany.

- Regarding wage remuneration, the research came to the conclusion that intergenerational earnings mobility in Germany appears to be high compared to the US. Earnings differences between fathers and sons seem to be higher than e.g. in the US. In parallel, no significant effects of job tenure on wages were found.
- Following the results, marginal employment does not affect the time spent in regular employment, reduces future unemployment, and slightly increases future earnings. Only older workers are negatively affected by marginal jobs.
- Company reorganisation is associated with positive wage effects and higher job stability for middle and high skills groups, while the results for un- or less qualified workers remain unclear. Negative wage effects are rarer than positive wage effects.
- Minimum wages in the construction industry brought positive wage effects but negative employment effects in Eastern Germany. Western Germany saw (insignificant) positive job effects (a result which was disproved in the subsequent debate).
- The occupational segregation of men and women slightly decreased between 1996 and 2005. This is mainly explained by the change of occupational structures.

5. Impact of the current financial crisis

5.1. The financial crisis in Germany

Rescue programs with a total of 3.2 trillion EURO saved the world financial system from its collapse. The worst case scenario of a world depression thus has been avoided until now. Financial institutions are operating normally more or less but are strongly hurt by the loss of equity capital, the presence of unrealised risks in their portfolios, and the lack of trust among financial actors – banks, companies and private clients. The Expert Advisory Board (*Sachverständigenrat 2008*) characterised the situation with the title “Financial Systems on Intensive Care”.

The German financial sector was hit by the shockwaves of the financial crisis due to its strong international links rather than a home-made downturn of housing markets and the rising insecurity of mortgages. German banks – Federal States Banks in particular – were strongly involved in the business of “structured” credits and thus were strongly affected by the US mortgages crisis. Private Banks could escape from these risks early enough but were then affected by the loss of trust and the devaluation of stocks. Meanwhile many of the banks are applying for support by the public rescue programme.

The financial crisis appears in combination with the cyclical downturn of a series of important countries – the USA first, and the UK and other European countries second. Germany is in recession too and the only question is how deep it will be.

Finally, the German banking system has been underperforming by international standards long before the financial crisis appeared. The main reason is that it preserved its heterogeneous structure of private and public banks until now (Section 5.2). It is said to be costly, with a low level of standardisation and innovation. International competitiveness appears to be poor. Consumer banks therefore were under strong competition from internationally operating direct banks.

5.2. Structure of the financial sector

The German banking system is a universal banking system engaged in all types of financial services and investments. In 2007, 2,012 banks operated with 37,976 local branches (*Deutsche Bundesbank 2008*). The private banking sector is dominated by four big banks (*Deutsche Bank, Dresdner Bank, Commerzbank, HypoVereinsbank*) but also includes 270 smaller and more specialised banks. The public banking sector comprehends around 450 saving banks (*Sparkassen*) with the federal states banks (*Landesbanken*) as their central institutions, and 1,200 mutual banks (*Volksbanken, Raiffeisenbanken*) also with various central organisations.

The sector employed 1.2 million workers in 2007. 58 % were engaged by the banking sector, 20 % by insurance companies and 22 % by financial intermediaries. Real value added decreased in recent years and employment followed this trend: since 2002 there was a decline of 13 % in the number of jobs in the banking sector, 8 % were lost in the insurance business. Only intermediaries could expand employment by 25 %. In total the number of jobs in the sector declined by 5 %.

A strong labour saving concentration process is dominating the sector: while overall value added declined, the top ten German banks were able to expand their balance sums by 50 % since 2002 with only 5 % additional workforce. This indicates the tremendous economies of scale which were available on banking markets.

The average profitability of equities was 6.6 % in 2007, only half of the rate in 2005 (Deutsche Bundesbank 2008). While private banks were performing much better with an average profitability of 19.1 %, saving banks and mutual banks were close to the average and the profit rates of Landesbanken and the central banks of the cooperative sector were close to zero or even negative.

5.3. Prospects

The large depreciation needs which appeared in 2008 will further reduce profitability and force various banks into mergers. Private banks will have to pay for their foreign "adventures". Savings banks will have to bear parts of the high losses among the federal states banks, and mutual banks are burdened by losses of their central banks.

The outcome of this crisis can hardly be forecasted at the state of present knowledge. Too many unknown risks still have to be suspected as information on these points is less than incomplete. Another "Lehman Brother" case would be able to radically change the situation again and thus hopes concentrate on the stability of public rescue programmes. Hopefully they are.

In Germany the banking crisis will reinforce restructuring trends which were already visible since years. In particular it will change the landscape of public banking. The consolidation process will be reinforced. The sector will reduce the number of central banks and force savings and mutual banks to get rid of their extensive administrative departments². Local banks will be transformed into sales points rather than banks. Bank management, innovation and marketing activities will be strongly concentrated in central holdings. Public banking will nevertheless remain a strong part of German banking as it can provide high security for private deposits. This will remain their great advantage in comparison to private banks.

Private banks are already highly concentrated on the four top players. The concentration process can be expected to continue as losses become visible.

The German insurance sector will remain less affected by the financial crisis but nevertheless has to cope with the downturn of stock prices. Profit margins are squeezed.

Taken together, the trends will lead into a phase of accelerated employment decline during the next decade.

5.4. Real economy effects

Actually all economic indicators are on negative trends:

- GDP was decreasing by -0.5 % in the third quarter 2008 after -0.4 % in the second quarter.³
- Incoming orders: -11 % against January 2008
- Industrial production: -4 %
- Business climate: -13 %
- Consumer climate: -21 %

The majority of consumers expect a recession during the next year. By international com-

² In November, saving banks agreed on the merger of seven federal states banks to three central institutions (north, middle, south). The re-organisation will be associated with job losses of yet unknown extent. Moreover, saving banks will close less profitable activities and transfer high risks to newly founded „bad banks“.

³ If this trend will continue during the fourth quarter 2008, overall GDP growth will be at 0.5 % against the previous year. This also indicates the optimism included in present cyclical forecasts.

parisons however, consumers in Germany are less pessimistic than in other countries.

Industrial sectors are particularly hurt by these developments:

- *Car industry:* Demand on important export markets in the US and Western Europe declined at unprecedented extent. A recovery is not expected before 2010. Big producers like Daimler and BMW are or will be on short-term work. The volume of 865,000 directly employed workers can be expected to decline as will the indirectly employed.
- *Steel industry:* After a boom phase of ten years, the sector is declining again. A minus of 2 % is expected for 2009. The recovery might not happen before 2010. 260,000 workers are employed by the sector and 10,000 can be expected to lose their jobs during the next year.
- *Mechanical engineering:* Production still is at a high level due to the order stocks from the boom phase. Incoming orders however are decreasing and first job cuts can be discerned in production of textiles, construction and printing machines. The sector employs around 1 million workers which might be happy to keep their jobs at least during the first half of the next year.
- *Construction:* The crisis has not yet arrived in the order books but forecasts appear to be gloomy. 2.2 million workers are engaged by the sector. The cyclical downturn and a disfunctioning banking sector will affect employment negatively.
- *Chemical industry:* Export markets are shrinking rapidly as do supplies to car industry and construction. As a major supplier of world markets the sector will not be able to keep its actual level of 450,000 jobs.
- *Retail trade:* Real turnover is expected to decline by 0.5 % due to the deterioration of consumer sentiments. The strong concentration process will continue and demand for further cuts of the presently 3.3 million jobs.

Cyclical forecasts are on the downturn. The most recent annual report of the Expert Advisory Board (*Sachverständigenrat*) sees the German economy stagnating in 2009 while the Federal Government still expected a minor GDP growth of 0.2 %. This was also the forecast of the Project Group Business Cycle Forecasts. However, they also provided a worse case scenario with a decrease of GDP by 0.8 %. This is what the IMF expected for the next year (Table 2). Employment will decline in all scenarios at rates between -0.1 and -0.3 %. Unemployment rates will slightly increase.

The stagnation forecasts of the Expert Advisory Board and others appear as optimistic views on the short-term future, in particular as a rapid recovery of the German economy is expected in the course of 2009. Considering the strength of the downturn in Germany and abroad and the spread of the shockwaves in the economy, a rapid recovery does not appear as the most probable outcome. In contrast the economy will have to bear the financial burdens of the crisis and will be limited as far as its investment capacities are concerned.

This view point is particularly supported by investigations of the real economy effects of former financial bubbles in various countries. The examples of Sweden and Japan showed that the effects of these crises were long-lasting. The financial crisis in Sweden in 1992 – which is said to have been managed perfectly – resulted in a 5 % reduction of capacity utilisation two years after the start of the crisis. In Japan (1994) the economy was 18 % below its trend four years later. This reveals that long-term negative effects could hardly be avoided even if adequate policy reactions were employed. Studies on the macro-effects of property bubbles over the last 30 years come to the conclusion that the devaluation of housing and stock prices in bust phases resulted in a significant underperformance of the real economy (*Hülsewig, Wollemshäuser 2006*). There is hardly any reason why this should be different in the present world financial crisis.

Table 2 Economic forecast for 2008 and 2009
Germany

Institution	Date of publication	GDP (% change to previous year)		Employment (% change to previous year)		Unemployment rate (%)	
		2008	2009	2008	2009	2008	2009
Expert Advisory Board (<i>Sachverständigenrat</i>)	November 08	1.7	0.0	1.3	-0.2	7.8	7.9
European Commission	November 08	1.7	0.0	1.2	-0.3	7.3	7.5
International Monetary Fund	November 08	1.7	-0.8				
Federal Government	October 08	1.7	0.2	1.3	-0.1		
Project Group Business Cycle Forecasts (former Association of Economic Institutes)	October 08	1.8	0.2	1.3	-0.2	7.5	7.5
DIW (Deutsches Institut für Wirtschaftsforschung)	October 08	1.9	1.0	1.3	0.5	7.5	7.2
Institut für Wirtschaftsforschung, Halle	July 08	2.3	1.3	1.3	0.0	7.5	7.2
Ifo Institut für Wirtschaftsforschung	June 08	2.4	1.0	1.5	0.3	7.5	7.1
Deutsche Bundesbank	June 08	2.3	1.5	1.5	0.5	7.8	7.6

Source: IAB/Economix

5.5. Labour market effects

In this early phase of the cyclical downturn, the labour market profits from various lags of labour demand compared to economic developments. High order stocks still require a high level of employment in order to fulfil all contracts. Business expectations might not fully consider the seriousness of the crisis and – like the economic experts – calculate with a rapid recovery. Labour capacities therefore are not yet adjusted to decreasing economic growth – and the longer this takes the stronger will be the downturn of employment in the future.

Until recently employment continued to grow with only a minor reduction of growth rates. In the second quarter 2008 overall employment increased by 1.4 % against the previous year. Registered employment grew by 1.9 %. However, it appears as very unlikely that this trend will continue. For the third and fourth quarter of 2008 job growth will be considerably lower and 2009 will see job cuts significantly exceeding the expected -0.2 %.

The unequal distribution of job risks in the German labour market puts certain groups of workers at particular risks:

- The first group which is affected by declining labour demand is agency work – a trend which was already reported by various press statements. Agency work has been widely used by manufacturing and construction companies in order to manage production peaks. The size of agency work is 1.8 % of total employment. Substantial parts of these workers can be expected to become unemployed during the next year.
- The second vulnerable group are free-lancers. Both the contraction of business and consumer markets will reduce demand for the services provided by these self-employed professionals. In particular the great number of business founders pro-

moted by the business foundation programme of the Federal Labour Agency will now face deteriorating market conditions. While foundations proved to be rather stable in economic terms, this observation was made during the recent boom phase. As economic conditions will change considerably, parts of the 4.4 million self-employed will lose their economic basis.

- As further groups, workers with fixed-term contracts and marginally employed workers will lose their jobs before others. These groups accounts for 18 % of the workforce (fixed-term contracts 7 %; marginally employed 11 %).

While workers in these “atypical” jobs can be expected to be hit at first place, the recession will nevertheless affect the core labour market of those with unlimited full-time contracts. The financial crisis will reduce the number of jobs in the banking and insurance sector, and the cyclical downturn will mainly affect manufacturing and construction.

In financial services, administrative jobs can be expected to be particularly reduced due to the big potentials from labour saving organisation and important economies of scale. However, professional services in investment banking, stock trading and international business might also be affected.

In manufacturing and construction the burden will again be taken by skilled blue collar workers (*Facharbeiter*) who will not only be affected by the decline of product markets but by the relocation of production to growth areas. The comparatively better economic performance of the Asian countries will attract German producers and thus reinforce previous relocation trends.

5.6. Policy measures

Within short reaction times, the Federal Government reacted to the appearance of the crisis since September:

- A guarantee fund was established with 480 billion EURO which can be used by financial institutions as guarantees for their credit business (400 billion EURO) and the improvement of their equity capital (80 billion EURO). This also includes the take-over of dubious papers. The usage of the programme is linked with the check of business plans, the cut of dividends, the revision of bonus systems and the restriction of annual management salaries to 500,000 EURO.
- A business cycle stabilisation program which should reduce present market slumps in manufacturing and construction in particular (see Section 3.1). This includes the extension of public export guarantees as banks are actually too risk averse.
- The reduction of unemployment insurance premiums from 3.3 to 2.8 % by 2009. This however will be compensated by the increase of health insurance premiums to 15.5 % by the beginning of next year.
- The Federal Ministry of Labour and Social Affairs actually intends to extend short-term work benefits from 12 to 18 months.

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