

Discussion paper

EUROPEAN EMPLOYMENT OBSERVATORY  
GERMANY

A divided labour market

Quarterly review of labour market trends and policies  
2<sup>nd</sup> Quarter 2006

by

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## Glossary

Subsistence-based partnerships	<i>Bedarfsgemeinschaft</i> : These partnerships are defined by the Hartz-IV act as the private income and property units obliged to individual transfers among its members.
Business Foundation Allowance	<i>Gründungszuschuss</i> : New regulation of business foundation support for unemployed, valid since August 1 2006. For a period of 15 months at maximum, UB-I recipients. During the first nine months, a lump sum of EUR 300 is paid in addition to unemployment benefit I for the cost of social insurance. During the following six months only the lump sum can be paid if the business became the main entrepreneurial activity.
Hartz reform	Reform of unemployment insurance under the Federal Employment Service ( <i>Bundesagentur für Arbeit</i> ) and active labour market policies, named after Peter Hartz, principal staff manager of Volkswagen and the president of “Hartz Commission” established by the German government in 2002. The reform has four parts: Hartz I (2002): introduction of public temporary work agencies (Personnel Service Agencies – PSA) Hartz II (2002): reorganisation of public employment services; mini-jobs, ICH-AG Hartz III (2004): restructuring of public employment services to the Federal Employment Agency Hartz IV (2005): merging of unemployment aid and social assistance to UB-II
ICH-AG	<i>Existenzgründungszuschuss (§ 421 I SGB III)</i> : Business foundation grant for UB-I recipients, which supports unemployed becoming self-employed for up to three years (1 <sup>st</sup> year: EUR 600 per month, 2 <sup>nd</sup> year EUR 360, 3 <sup>rd</sup> year EUR 240)
Mini Jobs	<i>Geringfügige Beschäftigung</i> : Jobs with monthly incomes up to EUR 400. These can be regular or occasional jobs and jobs in addition to regular employment. Employers pay 25 % of wages to social insurance.
Midi-Jobs	Registered employment with monthly wages between 401 and 800 € and reduced social insurance premiums.
National Training Pact	Agreement between the Federal Government and the employers associations to offer 60,000 additional dual training places in 2004, and another 30,000 in 2005.
1 € Jobs Auxiliary public jobs	Temporary jobs in the area of social and public services for UB-II recipients. They are remunerated by EUR 1 or 2 in addition to UB-II benefits. Jobs need to be for the public benefit and have to be additional to jobs in the premier labour market.
Rehabilitation benefit	<i>Eingliederungszuschuss</i> : a wage subsidy for employers who employ long-term or disabled unemployed. Subsidies are limited to 50 % of wages for 12 months. For disabled or older workers the limits are 70 % of wages for a maximum period of 24 months.
UB-I	<i>Arbeitslosengeld I</i> : Regular unemployment benefit
UB-II	<i>Arbeitslosengeld II</i> : Means-tested basic income for job seekers, paid after expiration of regular unemployment benefit

## Executive Summary

The long awaited upswing has presently reached the German labour market. Job vacancies are strongly increasing, employment is growing and unemployment is decreasing. Beyond seasonal factors this can predominantly be attributed to the acceleration of cyclical dynamics. As far as the present Middle East crisis will not curb positive GDP growth forecasted for 2007, the improvement of the labour market situation will continue. Registered unemployment, however, will remain above 10 %.

Besides the positive macro-development, two principle imbalances remain on the German labour market:

- A substantial lack of training places appears on dual training markets, with a gap higher than in previous years. Considerable difficulties can be discerned in providing vocational training to the youth, migrants, and disadvantaged people in particular.
- Economic performance in Eastern Germany remains weak. Employment is expected to decline further and the improvement of unemployment has to be addressed to emigration rather than rising labour demand. This indicates severe structural problems of the Eastern German economy – despite some positive signs in the manufacturing sector – and the risk of a vicious circle triggered off by a continuous brain drain.

The Hartz reform opened the potential to cut non-wage labour costs considerably as unemployment insurance (paying UB-I) shows a rising budget surplus. Total savings against planning figures amounted to EUR 3.2 billion during the first half of 2006. This however will probably be counteracted by increasing tax expenditures for UB-II recipients (+ EUR 3 billion in 2006), and rising contribution rates for public pensions and health insurance. The target to contribute to employment growth through lower non-wage labour costs appears to be far away – as it was under the previous government.

Regarding the Hartz reform, the Ombudsrat confirmed the principle effectiveness of the reforms, but strongly argued for the decentralisation of programme administration. Presently the organisation lacks clear management structures and legal regulations. Largely independent organisations are required at the local level, and Länder governments should be involved in labour market politics.

While a governmental working group is preparing a report on low-wage sector approaches, the debate on combined wages continues with suggestions to subsidise employment of older workers. Research evidence from international comparisons, however, identified substantial impediments to transfer welfare-to-work programmes from liberal to socially protected labour markets like the German system.

Industrial relations were characterised by continued strikes regarding working hours in the public sector. The dispute was solved in May with a compromise that was significantly below the employers' targets. The strikes were continued by clinical doctors who are partly combating for a substantial pay increase and regular working hours. After the strike of airplane pilots this is the second group of professionals which successfully tried to force open traditional wage structures.

Following the recommendations of the European Commission in the NRP assessment, Germany started a debate regarding the low-skill sector and migrants. Policy approaches are in development but cannot be expected before the end of 2006 or mid 2007. Regarding child care, some progress can be discerned in Western Germany. Day-care however remains underdeveloped in the Western regions.

## 1. Introduction

After its implementation in autumn 2006, the government now has the complicated issues of social reform on the political agenda. The second quarterly report for 2006 therefore cannot refer to a long list of active labour market measures. It concentrates on the presentation of recent economic and labour market trends, on amendments in the area of labour market politics – the Hartz reform in particular – and on the preparation of further policy decisions in the area of low-skill employment, health reform, and migration.

## 2. Update on economic and labour market trends

### *Recent labour market trends*

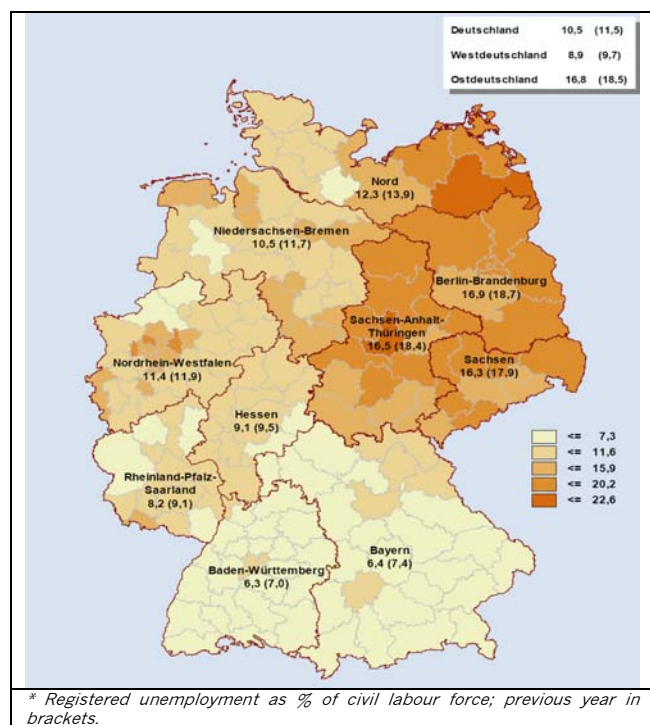
The latest figures for June 2006 show positive trends on the German labour market: Employment grew by 0.1 % compared to the previous year, vacancies rapidly increased by 32 %, and unemployment declined by 9.5 %. The only negative results appeared on dual training markets where the number of youth without training places increased by 10 %, and in Eastern Germany where employment continued to decline.

*Employment:* The number of persons employed is now estimated to 38.77 million (Federal Statistical Office, May 2006). Seasonally adjusted, an increase of 36,000 was measured in May 2006. Even registered employment increased in the second quarter of 2006 by 0.1 % in comparison to the previous year. This stopped the long decline of social insurance premium payers.

*Unemployment:* Beyond the spring upswing in labour demand, cyclical factors considerably contributed to the decline of unemployment figures. Since June 2005 seasonally adjusted unemployment declined on average by 29,000 per month. In June 2006 it dropped by 49,000. This indicates a considerable acceleration of business cycle dynamics on the German labour market. The unemployment rate was 10.5 % in June 2006 (-1 % to previous year) but with a wide variance among regions (Chart 1). Eastern Germany continues to show the highest rates – 16.8 % on average. Some areas in Mecklenburg-Vorpommern and Sachsen-Anhalt had rates above 22 %. However, the decline of unemployment rates was more expressed in Eastern than in Western Germany. During the last 12 months the unemployment rate declined by 0.8 percentage points in West-German regions but 1.7 points in Eastern Germany.

*Dual training:* With the end of the school year, the transition of school leavers to dual training becomes relevant. As the latest statistics reveal the number of applicants without a training place increased to 315,000 (+10 %) compared to the previous year. In parallel, the number of unfilled training places rose to 120,400 (+17 %). Currently, no final assessment of the situation is possible as chambers and public authorities are trying hard to enhance the number of training places offered. Nevertheless, the situation is even worse

Chart 1 Regional unemployment rates\*



than in the previous year. A considerable group of youths stands in waiting loops of preparatory measures to enter dual training. Thus the presently difficult situation on dual training markets appears as the accumulation of former shortfalls.

*Unemployment insurance and Hartz IV:* The 2006 surplus in the unemployment insurance budget is expected to exceed earlier calculations by the Federal Labour Agency. Rising revenues and declining expenditures from a bigger number of jobs and – in addition – declining expenditures through savings from the Hartz reform contributed to the positive financial development. Total savings will amount EUR 3.2 billion during the first half of 2006 (11.4 % of total revenues). The most important contribution was provided through lower unemployment benefit payments (EUR -0.9 b) and lower transition payments for UB-II recipients (EUR -0.8 b). On average 1.6 million UB-I recipients were counted during the first half of 2006 – 100,000 less than expected.

Counteract to cost savings for UB-I recipients, the cost for UB-II are overshooting the expectations. The number of subsistence-based partnerships (*Bedarfsgemeinschaften*) climbed to 3.9 million in April 2006, a plus of 600,000 since the introduction of Hartz IV in January 2005. Since 1 July 2006, UB-II benefits are equal in Eastern and Western Germany. Standard benefits amount EUR 345 per month (+14 € compared to the former regulation). The budgetary line of EUR 24.4 billion in 2006 will be exceeded by approximately EUR 3 billion.

### Economic forecasts

Economic prospects continued to improve during the second quarter of 2006. The majority of research institutes expect GDP to grow by 1.6 to 1.9 % in 2006 and 1.0 to 1.7 % in 2007 (Table 1). The growing optimism is based on rising production activity and consumer spending as well as positive impacts from foreign trade in the first two quarters of 2006. Public institutions as the Federal Government and the EU Commission are still more cautious expecting 1.7 or 1.6 % GDP growth for 2006 and 1 % for 2007.

**Table 1 Economic forecast for 2006 and 2007– Germany**

Institution	Date of publication	GDP (% change to previous year)		Employment (% change to previous year)		Unemployment Rate (%)	
		2006	2007	2006	2007	2006	2007
IMK (Institut für Makroökonomie und Konjunktur)	July 06	1.9	1.1	0.3	0.3	10.5	10.2
DIW (Deutsches Institut für Wirtschaftsforschung)	July 06	1.8	1.4	-	-	10.2	10.1
IWH (Institut für Wirtschaftsforschung Halle)	June 06	1.7	1.2	0.2	0.3	10.5	10.2
Ifo Institute for Economic Research	June 06	1.8	1.7	0.1	0.5	10.6	10.3
IfW (Institut für Weltwirtschaft)	June 06	2.1	1.2	0.4	0.2	8.5 <sup>1</sup>	8.0 <sup>1</sup>
OECD	May 06	1.8	1.6	-	-	-	-
European Commission	Spring 06	1.7	1.0	0.3	0.3	9.4 <sup>1</sup>	9.2 <sup>1</sup>
Federal Government	April 06	1.6	1.0	0.1	-	-	-
RWI (Rheinisch-Westfälisches Institut für Wirtschaftsforschung)	April 06	1.8	1.3	0.4	0.4	10.6	10.4
Association of Economic Institutes (ARGE-Institute)	April 06	1.8	1.2	0.3	0.5	10.6	10.2

<sup>1</sup>Standardised unemployment rate

Source: Economix

Different to recent years the growth rate is strengthened through positive cyclical trends at the domestic market. These positive developments accrue mainly through rising capital formation and consumer spending. These aggregate components account for approximately 1.1 percentage points of the growth rate (ARGE-Institute). Consumer spending is increasing, particularly because the labour market situation is improving. Moreover, the forthcoming VAT increase will shift private consumption and housing expenditures into the year 2006 at the expense of 2007. According to the institutes, the VAT reform will increase private consumption approximately by three percentage points and lead to higher overall growth of 0.2 percentage points in 2006. Despite higher energy prices, which cut real incomes, consumers became more optimistic.

The research institutes expect a reduction of the unemployment rate by 0.6 to 1 percentage point during the current year and a further decline by 0.1 to 0.5 percentage points next year. Due to the deceleration of growth the current positive trend will slow down. Employment is expected to increase by 0.1 to 0.4 % in 2006 with slightly better prospects for 2007.

Economic forecast are more heterogeneous for 2007 than for 2006 because the consequences of policy measures of the federal government are rated in different ways. While the majority expects that the economic policy programme will reduce growth by 0.5 percentage points, the Ifo-Institute – with a stronger believe in endogenous growth forces – considers a continuing high-level growth rate. The majority of the research institutes, however, assume that the economic situation will noticeably degrade because of the additional burdens and the gradual slow down of the expansion of the world economy. The present Middle-East crisis is not yet considered by the forecasts. Fiscal policy will be less stimulating and potential cuts in social security contributions (AGEF assumes 1.3 percentage points) will not compensate the negative impacts of the tax reform.

Eastern Germany is expected to continue at a slower growth path compared to the West. The recent forecast by the Institut für Wirtschaftsforschung Halle (IWH) calculated GDP growth of 1.4 % in 2006 and 0.6 % for 2007. Employment in Eastern Germany will prolong the negative trend of the past with -0.5 % in 2006 and -0.3 % in 2007. Unemployment rates are expected to decline slowly to 18.3 % and 17.9 % until 2007. Emigration and low birth rates after unification are the main reasons for this development. While manufacturing companies are on an upswing, the structural burdens still lie in oversized construction industries and public services.

### 3. Labour market policy developments

#### 3.1. Policy actions

##### *Support of business foundations of unemployed*

From 1 August 2006 the “Business Foundation Allowance” (*Gründungszuschuss*) substitutes the former “ICH-AG” (*Existenzgründungszuschuss*) and the “Transition Allowance” (*Überbrückungsgeld*). The new regulation supports recipients of unemployment benefit I for a maximum period of 15 months. During the first nine months, a lump sum of EUR 300 is paid in addition to unemployment benefit I (UB I) for the cost of social insurance. During the following six months only the lump sum can be paid if the business became the main entrepreneurial activity of recipients. Self-employed activities must be the main income source and afford a working input of 15 hours per week. Applications must be approved by a competent institution (banks, chambers of commerce e.g.) certifying economic sustainability of the business plan. Moreover, applicants must convince local labour offices of their abilities. In dubious cases additional screening tests and/or training might be arranged. UB-II recipients will receive the existing “Entrance Allowance”.



### *Hartz IV development act*

As described in the last quarterly report, the Federal Government updated the Hartz IV act by August 1 2006 through the acceleration of job offers to entrants into UB II, through sanctions to unemployed refusing job proposals, through stronger controls and in particular through the reversal of the burden of proof for applications. The government expects to save 1.2 billion EURO annually through these measures. For 2006 savings of 400 million EURO are calculated.

### *Health reform*

After a long debate on the health insurance reform, the government coalition decided to introduce a centralised “Health Fund” by 2008 which should replace the existing financial balancing system among the 250 health insurances. The health fund will fix contribution rates to public health insurance uniformly and distribute resources to the individual insurance organisations based on per capita rates. Insurance companies with deficits will have to raise a capitation fee. The government plans are fixed in a white paper (*Eckpunkte der Gesundheitsreform 2006*).

The plans are strongly opposed from all sides, insurance organisations, trade unions, and experts. The representatives of public health insurance argue that competition among insurance organisations will be further restricted, services will have to be cut, and tremendous costs of reorganisation will be created. Trade unions criticise that private health insurance is not included in the system and 30,000 to 40,000 jobs will be affected. Experts argued that the financial problems of health insurance will not be solved by this approach. The start into tax funding with a tax contribution of EUR 1.5 billion in 2008 and EUR 3 billion in 2009 will be counteracted by cancelling the former tobacco tax funds of EUR 4.2 billion. Moreover, health insurance contribution rates are planned to rise by 0.5 percentage points to 14.7 % by 2007. This means reinforcing the job problem in Germany.

### *Industrial relations*

On the 18<sup>th</sup> trade union congress in May 2006 it was decided to postulate the introduction of a general minimum wage in Germany amounting to EUR 7.5 per hour. Moreover the represented trade unions raised the demand for a constitutional right on vocational training, the promotion of European collective bargaining systems, and a European constitution including the regulation of national and international financial markets.

(Source: <http://www.bundeskongress2006.dgb.de/aktuelles/news/querschnitt.htm/>)

After a several months strike in the public sector, the trade union VER.DI and the collective union of Länder governments concluded a new wage agreement for public employees in May 2006. The agreement was signed by Länder governments and the representatives of municipalities. It includes a series of issues:

- Weekly working hours will range between 38.5 hours in Schleswig-Holstein and 39.7 hour in Bavaria. In Eastern Germany the 40 hours working week remains unchanged. The initial target of the Länder governments to raise working hours above 40 hours thus was not achieved. However, opening clauses were agreed which allow Länder governments to negotiate working hours from 2008 onwards.
- A new wage scheme will be introduced by November 2006 which unifies the remuneration of blue and white collar workers to 15 skills groups.
- Wages will be adjusted in 2006 and 2007 through single payments ranging between 60 and EUR 450 differentiated by skills groups. In 2008 the first linear adjustment since 2004 will be undertaken through a mark-up by 2.9 %.



- Fringe benefits will be joined to a single payment. In Western Germany this will amount to 95 % of a monthly wage for low-wage groups (71.5 % in Eastern Germany), and 35 % for high-wage groups (30 % in Eastern Germany).
- From 2007 onwards performance premiums will be introduced as part of public wages.

The representation of clinical doctors (Marburger Bund) did not accept the Länder agreement and continued striking. In a special treaty with Länder governments which was signed in July a wage increase of 20 % was decided. Weekly working hours are 42 hours up to a maximum of 58 hours if stand-by time is included. The 2008 wage increase will also be valid for clinical doctors. As municipalities did not follow this agreement, strikes in municipal clinics are actually continued.

The wage movement of clinical doctors can be seen as an outstanding event which reveals that the traditional consensus on wage relations is becoming weak. Similar to the movement among German pilots, clinical doctors refer to significant wage disadvantages by international standards. The success of these initiatives against financial restrictions of public budgets indicates that the dependence on qualified labour even affects labour relations in the public sector. The great importance of a highly skilled work force is changing wage relations effectively.

### 3.2. Public and scientific debate

#### *The implementation of Hartz IV – the Ombudsrat conclusions*

After 18 months of work the appeal council for Hartz IV (*Ombudsrat*) published its final report in June 2006 (<http://www.ombudsrat.de/>). The council was chaired by Kurt Biedenkopf, former Prime Minister of Saxony, Christine Bergman, former Federal Minister for Family Affairs, and Horst Rappe, former Chairman of the Trade Union “Chemistry, Paper, Ceramics”. In its conclusions, the Ombudsrat stated that the combination of social aid and the former unemployment aid to a basic income support system is the adequate instrument for those who need support. The principles of the Social Code II (*SGB II*) are widely supported by the public, and the staff in the job centres performed with strong commitment. The creation of a second labour market for UB-II recipients (*soziale Zusatzjobs*) appears to be necessary in the face of a dynamic labour market with rising skills requirements. Hartz IV essentially created a system of combined wages which brought positive results for the group of disadvantaged workers. It should be further developed.

The appeal council nevertheless strongly argues for organisational reforms of programme administration. The present co-operation between local labour agencies (belonging to the Federal Labour Agency) and municipalities is located between central allegations of the Federal Ministry of Labour and Social Affairs (and the Federal Labour Agency), and the interests of municipalities. The organisation lacks clear management structures and legal regulations. The 2005 agreement between the representation of municipalities (*Deutscher Städtetag, Deutscher Städte- und Gemeindebund*) and the Federal authorities to improve the co-operation was not effective, and the new Hartz IV development act (*Fortentwicklungsgesetz*) is also not expected to change the situation. The council concludes that an effective organisation requires a decided decentralisation through largely independent organisations at the local level. Financial controlling should be guaranteed by the audit courts. Moreover, Länder governments should be involved in labour markets politics of Hartz IV.

#### *Continued debate on combined wages*

Anticipating the final report of the governmental working group on low-wage employment, being expected for autumn 2006, the government coalition agreed on the introduction of combined wages for older workers. The “Initiative 50+” intends to raise the employment

rate of older workers over 55 from 45 to 50 % by 2010. Following the Federal Ministry of Labour and Social Affairs (BMAS), this should be achieved through two instruments:

- a wage compensation programme (*Entgeltsicherung*) which supports UB-I recipients who accept jobs with lower wages than in the previous employment through a wage compensation of 50 % of the difference during the first year and 30 % in the second.
- an integration allowance (*Eingliederungshilfe*) for UB-II recipients providing a wage subsidy for employers who employ older long-term unemployed.

The government calculates jobs for 100,000 unemployed through these instruments.

The Institute for Employment Research (IAB) undertook an international review of combined wages which states that the welfare to work programmes in the United States and Great Britain created considerable employment effects among social aid recipients. These effects are however linked to the existence of a liberal labour market with low social incomes. Moreover, social benefits were restricted to a five year period in the USA. Following the study, such a system can hardly be transferred to a country where social minimum standards are guaranteed by law. Without a consequent activation policy and the creation of low-skill jobs the implementation of this approach in Germany will have limited effects.

### *Integration summit*

18 % of the German population have a migration background, as recent statistics from the Labour Force Survey revealed. The number of companies with foreign owners almost doubled during the last 10 years to meanwhile 300,000 (15 % of all companies). Against this background the Federal government held an integration summit with the plan to establish a national integration plan until mid 2007.

Beyond the controversial debate on integration standards (language, cultural and historical knowledge etc.), the most severe problem is skills development among the population with migration background. 17 % of foreign youth have no school certificate, and one third has no vocational training. Foreign-owned companies do not participate in dual training at comparable level. Various initiatives by the Chambers of Commerce and Trades are undertaken to raise training participation of these companies.

## **4. Recent labour market reports**

*Konsortium Bildungsberichterstattung (2006): Bildung in Deutschland. (Education in Germany)*, published by the Federal Ministry for Education and Research.

The common publication by the Permanent Conference of the Länder Ministers of Education (*Ständige Konferenz der Kultusminister der Länder*) and the Federal Ministry of Education and Research provides the first official assessment of the education and training system in Germany. It was prepared by the German Institute for International Pedagogic Research (*Deutsches Institut für Internationale Pädagogische Forschung, DIPF*), the German Youth Institute (*Deutsches Jugendinstitut, DJI*), the University Information System (*Hochschul-Informationssystem, HIS*), and the Sociological Research Institute of the University of Göttingen (*Soziologisches Forschungsinstitut an der Universität Göttingen, SOFI*) in cooperation with the Statistical Offices. The report contains an analytical assessment of education trends in Germany, starting with pre-school education, general education and non-formal training. In addition, it covers vocational training, university education and continuing training and includes basic information on education trends with a comprehensive statistical annex. A special focus is given to education and training of migrant youth. It is planned updating the report in a two years sequence.

Beyond demographic changes, the report identifies the impacts of globalisation and the trends toward a service economy as the major challenges for education and training politics. It states

that rising training participation was associated with declining GDP shares of public training expenditures. The share of youth without training stagnated over many years at a high level. In the section on migrants, language training is particularly suggested to improve skills levels.

Regarding child care, the situation improved in recent years in Western Germany in particular. These services are now used for 90 % of the children. A major problem is day-care service which is available for one third of the children in Eastern Germany but only 3 % in Western Germany. The section on vocational training states that 40 % of the youth is in preparatory measures for dual training. This is seen as an important risk for disadvantaged youth. A major concern of the report is the efficiency of the education and training system which appears to be weak regarding the long training periods of German students.