International Labour Organization

INTERNATIONAL INSTITUTE FOR LABOUR STUDIES

STUDIES ON GROWTH WITH EQUITY

GERMANY

A JOB-CENTRED APPROACH

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The International Institute for Labour Studies (IILS) was established in 1960 as an autonomous facility of the International Labour Organization (ILO) to further policy research, public debate and the sharing of knowledge on emerging labour and social issues of concern to the ILO and its constituents — labour, business and government.

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FOREWORD

The ILO's Declaration on Social Justice for a Fair Globalization provides scope for assisting Members in strengthening their research capacity, empirical knowledge and understanding of how the strategic objectives of employment, social protection, social dialogue and rights at work interact with each other and contribute to social progress, sustainable enterprises, sustainable development and the eradication of poverty in the global economy.

In accordance with this plan of action, the 304th Session of the Governing Body set in motion a plan to strengthen the ILO's knowledge base through a series of pilot country studies conducted under the aegis of the International Institute for Labour Studies. The purpose of these studies is to (i) document examples where employment and social policies have successfully contributed toward mitigating the impact of the global financial crisis; (ii) extract policy lessons which could be useful to other countries; and (iii) examine country-specific challenges in the context of the crisis and moving forward.

This report on Germany has been prepared by Verónica Escudero, Byung-jin Ha, Sameer Khatiwada and Steven Tobin of the International Institute for Labour Studies. The report has benefited greatly from a background paper prepared by Martin Dietz, Michael Stops and Ulrich Walwei. The authors are also grateful for valuable comments received from Wolfgang Schmidt, Director for the ILO Country Office for Germany. The study has been coordinated by Steven Tobin under the supervision of the Director of the Institute, Raymond Torres.

A draft of the report was presented at a seminar organized by the ILO Country Office for Germany in Berlin on 6 December 2010. The final report takes into consideration many of the comments received from national authorities, the social partners and other stakeholders during the seminar.

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CDO	collateralized debt obligation
DIW	Deutsches Institut für Wirtschaftsforschung
EAPE	Economically Active Population Estimates
ECB	European Central Bank
FMSA	Federal Agency for Financial Market Stabilization (= SoFFin)
FSP	Fiscal Stimulus Package
GEL	The Global Economic Linkages model
IKB	Deutsche Industriebank
KfW	Kreditanstalt für Wiederaufbau
LTU	long-term unemployment
PES	Public Employment Service
SMEs	small and medium-sized enterprises
SoFFin	Bundesanstalt für Finanzmarktstabilisierung (= FMSA)
UB	Unemployment Benefit
ULC	unit labour costs

EXECUTIVE SUMMARY AND POLICY RECOMMENDATIONS

Germany experienced one of the most dramatic declines in output as a result of the 2008 crisis...

The crisis had a significant impact on growth in Germany in terms of both magnitude and duration. GDP fell 4.7 per cent in 2009; in comparison, growth in advanced economies fell by just over 3 per cent in the same period. The recession also persisted over five consecutive quarters, starting in the last quarter of 2008. In 2010, however, growth returned to positive territory, first moderately – 2.1 per cent in the first quarter – but then more prominently as GDP expanded by 3.9 per cent in the second quarter, almost double the EU-27 average of 2.2 per cent.

Underlying the steep declines in output were Germany's exposure to both the US financial system where the financial crisis originated, and the ensuing decline in aggregate demand. The German financial system was directly affected by the sub-prime mortgage crisis and the fall of Lehman Brothers, as a number of financial institutions had invested heavily in collateralized debt obligations and related asset-backed securities. The losses incurred by the German financial system spread quickly through the real economy. In addition, as the financial crisis escalated to an economic crisis, external demand dried up. Global trade fell 12 per cent in 2009, and with over 40 per cent of GDP in Germany dependent on exports, the export-oriented manufacturing sector was hit hardest – output in manufacturing fell by more than 25 per cent between the third quarter of 2008 and the first quarter of 2009.

However with the rebound in trade activity taking place in the second half of 2009, German exporters benefited considerably from the the strong recoveries and demand from emerging markets, notably in Asia.

...and yet employment fell marginally.

Despite the steep declines in output, employment levels remained relatively stable, falling only 0.2 per cent in 2009. Among advanced economies, where the fall in GDP was much lower than in Germany, employment fell by 1 percent, i.e. five times more than in Germany. The unemployment rate, which reached a peak of 8.1 per cent in February 2009, fell to 6.6 per cent by the end of 2010 – one of the lowest rates in the EU.

Even youth, who are often more vulnerable to downturns, fared reasonably well. Despite rising to nearly 11 per cent in the second quarter of 2009, the youth unemployment increase was short-lived and the rate has since fallen by more than 2 percentage points – as of September 2010, Germany had the lowest youth unemployment rate in Europe at 8.5 per cent.

The remarkable employment performance reflects, first, adjustments through lower working hours instead of layoffs...

One of the main mechanisms with which firms adjusted to the downturn was by reducing the volume of hours worked. Between 2007 and 2009 average work hours per salaried worker fell by 3.3 per cent (8 per cent in manufacturing). A key factor behind increased recourse to working-time reductions is the fact that, before the crisis, many workers had accumulated significant overtime. More fundamentally, the relatively high costs associated with dismissals of regular workers make working time reductions cheaper than layoffs. In addition, given the uncertainty of the length of the crisis, firms did not want to lose high-skiled workers – who had been relatively scarce before the onset of the crisis.

...second, well-designed government support of short-time work...

Germany's short-time work programme (Kurzarbeit) was the most widely used means by which firms were able to stabilize employment through working-time reductions – the programme accounted for one-third of the reduction in hours. The programme was widely promoted by the Government through a series of public relation activities – which proved crucial to promote awareness and facilitate implementation. Under the programme, the Federal Employment Agency covers a portion (up to 67 per cent) of the wage losses incurred through reduced working hours and compensates between 50 and 100 per cent of the social security contributions of employers. In the years preceding the crisis the programme had fewer than 100,000 recipients on average, but as the crisis worsened the Government stepped up its efforts and made a series of amendments to the programme, notably (i) relaxing criteria to access the programme; (ii) extending its duration (up to 24 months); and (iii) adding training provisions. The programme has led to a number of successes:

- *Employment stability*: Over the period of the crisis, labour productivity per worker and per hour declined significantly, especially in the manufacturing sector, which is an indication of labour hoarding. Indeed, on average 1 million workers in 2009 – at its peak in April 2009 1.4 million workers – were participating in the programme. A wide spectrum of firms took advantage of reduced working time, including many SMEs, with those most affected by the crisis being over-represented (i.e. manufacturing in western regions).
- *Income support*: Although wage levels fell per employee with the reduction in hours worked, overall aggregate income levels were higher than if employment levels had been adjusted instead of working hours. This provided an important boost to aggregate domestic demand and overall confidence.
- *Limited deadweight losses*: An analysis of enterprises benefiting from the short-time work arrangements reveals that only one-third of firms expecting demand increases took advantage of the short-time work programme, suggesting limited deadweight effects (i.e. firms that did not need the programme used it less). Additionally, up to two-thirds of firms using the programme expected steady or rising employment levels for the forthcoming year, which suggests that the programme may have had some influence on stabilizing employment.
- *Tripartite solutions*: A unique feature of the programme is that the costs and benefits are shared among workers, employers and government: (i) while firms are still responsible for wage-related expenses, they avoid the unnecessary costs associated with employee turnover and can draw on

existing labour and skills when demand returns; (ii) the Government incurs the direct costs associated with the compensation provided to workers and employers, but the social and economic costs of higher unemployment are avoided, while instilling a sense of confidence in the economy; and (iii) workers are able to maintain their jobs but, as a result of reduced hours worked, have lower earnings.

...third, strengthened support to the most vulnerable...

The Government reinforced existing labour market and social programmes to mitigate the impact of the crisis on the most vulnerable. This also helped strengthen their automatic stabilizing effect:

- *Improved unemployment benefits*: The monthly benefit for Unemployment Benefits Part II (UB II) was increased from €351 to €359 per month, benefiting 4.9 million people on average over the course of 2009.
- *Reduced social security contributions*: As part of the second stimulus package, social security contributions for Unemployment Benefits Part I (UB I) were reduced temporarily from 3.3 per cent in 2008 to 2.8 per cent for 2009 and 2010 (rising to 3.0 per cent in January 2011).
- *Reinforced Public Employment Service*: In an attempt to improve the ratio of unemployed persons to caseworkers, the first two stimulus packages announced measures to recruit on a short-term basis 1,000 and 4,000 additional staff. The PES also allocated €1.12 billion in 2009 for training purposes – of which €200 million was targeted to reemployed temporary workers (in the same firm) and another €770 million for the extension of a reeducation programme for elderly and low-skilled workers. Moreover, the Federal Government through loan provisions and grants has ensured that the PES can run a deficit during times of crisis. This means the PES can function as an automatic stabilizer, i.e. there is no disruption in benefits and programmes or increases in contribution rates during downturns.

- *Pension guarantee*: In June 2009 the Government guaranteed that pension benefits would not decline. Given that pensions are indexed to wage developments, pensions would have fallen (due to the effective wage reduction resulting from lower hours worked). Without the measure it is estimated that in 2009 pensions would have declined by roughly 2 per cent in west German states and by 0.54 per cent in the east German states. Over 20 million pensioners have benefited from the guarantee.
- *Other social benefits*: Although previously announced , the social assistance benefit (Heizkostenzuschuss) to cover heating costs was increased from €91 to €142 per month – benefiting approximately 800,000 households in 2008. In addition, the Child Benefit (Kindergeld) was increased, benefiting some 15 million recipients in 2009.

... fourth, broader macroeconomic support measures...

The Government also introduced a series of new initiatives to stimulate economic activity in a number of sector-specific areas, including direct credit support to enterprises:

- *Credit to sustainable enterprise*: In March 2009 the Government established a €115 billion fund (Wirtschaftsfonds Deutschland) for credit guarantees and other support for enterprises, of which €15 billion was reserved for SMEs. In addition, export guarantees worth €22.4 billion were issued in 2009, constituting an 8.2 per cent increase over 2008 and the largest increase in six decades.
- *Green-oriented initiatives*: The Government introduced a "cash for clunkers" programme, which made available a €2,500 premium to individuals who owned a car more than nine years old and were willing to purchase a new car that complied with the EU's Euro4 emission standard. The total budget for this measure was initially planned to be €1.5 billion, but as a result of the popularity and widespread uptake of the measure

an additional €3.5 billion was allocated. Additional financing and credit guarantees were targeted at enterprises which engage in the development of electro- and hybrid cars and fuel cell technologies.

- *Other measures*: The automotive sector also benefited from a temporary, one-year exemption from motor tax for new cars purchased between November 2008 and June 2009. In addition, €10 billion was earmarked until December 2010 for infrastructure investment projects. The aim of the initiative was to promote investments in universities, schools, child care, hospitals, and information technologies. Additionally, the Federal Government designated €2 billion for transportation infrastructure.

...finally, social dialogue played a big role.

Success of the above measures is grounded in effective social dialogue. Employment-oriented measures are often a product of negotiated worker–employer agreements or firm-level pacts. The government also undertook discussions with employers and working council representatives of DAX 30 companies in relation to fiscal measures.

The importance of social dialogue at the macroeconomic level is highlighted through the Global Economic Linkages Model (GEL) developed at the International Institute for Labour Studies. The model demonstrates that effective collective bargaining can cushion the fall in both output and employment. In particular, the output and employment multipliers of fiscal measures are larger when firms and workers negotiate both wages and hours than in the absence of such bargaining.

Looking ahead, the immediate challenge will be to ensure that, first, jobseekers get benefits and well-designed job-search services...

As the economy enters the recovery phase, the Government has now adopted a strategy of fiscal consolidation. Of the €11.2 billion to be saved in

2011, more than a third is expected to come from changes to policies and programmes delivered by the Ministry of Labour and Social Affairs. This is being undertaken with the objective of achieving a balanced budget by 2016.

Such retrenchment, if badly designed, could affect the pace of job recovery. There are currently close to three million unemployed workers receiving some form of unemployment benefit and job-search support. A continuation of a number of policies and programmes is needed to keep workers in contact with the labour market and avoid skills erosion:

- *Continue to improve client/unemployed ratio within PES*: The efforts to recruit additional staff in an attempt to improve the effectiveness of service delivery to unemployed persons was a welcome step, as is the new law to reduce the ratio to 1:75 (for persons under 25) and 1:150 (persons 25 and over) for UB II recipients. It will be important to ensure that fiscal retrenchment measures do not compromise these crucial targets.
- *Reinvigorate training initiatives*: Despite improvements in recent years, 1.4 million people or 48 per cent of the unemployed in Germany have been without work for more than a year – one of the highest figures in advanced economies. More than 900,000 have been without work for over 24 months. Skill requirements have changed over the past two years, at the same time as unemployment has caused the erosion of skill sets. Close to one-third of the unemployed have only primary education and no more than 56 per cent has secondary education. Greater utilization of training support for unemployed workers is urgently needed. Importantly, over the course of the crisis the Government allocated a significant amount of resources for training, much of which went unused. For example, of the €150 million additional resources to PES for training, only €35 million was used. Efforts are also needed to improve the delivery and effectiveness of training programmes, perhaps by leveraging private–public partnerships.

...second, that employment prospects of vulnerable groups improve, as the workforce is expected to decline…

While the urgent challenge will be to absorb all the current labour market slack, in the medium term Germany is confronted with a declining labour force which could affect overall growth patterns and productivity. Growth in the working-age population has been flat over the past five years and in 2009 it was negative. Among the G20 countries, Germany has the third highest ratio of the population aged 65 and over to the working-age population aged 15–64 (behind Japan and Italy). Already before the crisis, firms were beginning to be confronted with the challenge of labour shortages. Policy-makers do have a number of options, but no one option in isolation will be sufficient. Over the coming decades, a comprehensive strategy to improve labour market participation of key groups is needed.

- *Older workers*: In Germany, there is steep decline in participation rates for the age group 60–64: participation rates among this group are 45 percentage points lower compared to those aged 50–54. Germany's Perspektive 50 plus programme, which focuses on long-term unemployed older workers, is a welcome step. But a more comprehensive strategy is required that (i) ensures that the pensions and benefit systems do not harm decisions to continue working; and (ii) improves the employability and working conditions of older workers such that they are willing and able to extend their working lives.
- *Women*: the participation rate of women in the labour market is considerably lower than in many advanced economies and significantly lower than the participation rate of men. In 2009, only 53 per cent of women were active, compared to close to 66 per cent among men. In this context, a number of policy levers merit consideration, including an increase in the number of childcare establishments, especially for young children (1–2 years old). A recent Government initiative to improve the provision of childcare for children less than 3 years old will be effective from 2013 and should help increase the day-care coverage and encourage an earlier labour market return of parents – especially mothers and single parents. However, more efforts may be needed to raise women's participation rates. For example, measures to de-penalize the tax situation of joint and single parents could help. Currently, low-income single parents are confronted

with an effective tax rate in the order of 80 per cent, the highest among OECD countries. Likewise, joint parents face a "splitting rule" that acts as a disincentive to the participation in the labour market of the lower earner.

…third, it is crucial that wages grow in line with productivity gains…

Real hourly wages in the private sector declined in the years preceding the crisis (2003–2006). Only the United States had lower wage growth over this period among selected advanced economies with available information (Australia, France, Germany, United Kingdom and United States). With the onset of the crisis, real household disposable income actually fell in the first three quarters of 2010. Part of the challenge lies in the fact that real wages in Germany have been growing slower than productivity since the 1990s, with the gap widening in recent years. Interestingly, the gap has narrowed during the crisis, given that declines in labour productivity have outpaced declines in real wages per hour. Employers and workers should seize the opportunity to ensure that the gap does not widen further and that future gains in productivity are rewarded with wage improvements. If properly designed through effective social dialogue at the enterprise level, this could provide a boost to disposable income that could have positive spillover effects without compromising competitiveness.

…and firms, especially SMEs, will need better access to finance for investment purposes.

German firms tend to rely heavily on bank financing for external funds, but equity financing is limited except for large firms – a situation which is exacerbated by weak competition, higher user costs of capital (and likely to rise with higher capital requirements under the Basel III framework) and limited access to venture capital. For example, the lending rates charged by German banks to firms have hovered around 10 per cent in the past decade, while for all major European economies and the United States it has been lower than 6 per cent. A comparison of capital structures illustrates that German SMEs tend to rely heavily on bank debt – around 50 per cent, while for other European economies it is around 30 per cent. But while the equity ratio for Germany SMEs has edged up since the early 1990s, it is still considerably lower than in its European counterparts.

As such, pre-crisis investment trends show that Germany has seen one of the largest declines in real investment among advanced economies. Between 1980 and 2006, investment as a percentage of GDP in Germany declined by more than 6 percentage points – more than double the decline in other high-income countries. As a result, in 2006 investment as a percentage of GDP was two percentage points lower than the high-income OECD average.

In order to stimulate investment activity and promote the creation and sustainability of viable enterprises, a number of reform options exist:

- *Promoting innovation and entrepreneurship*: Germany lags behind in entrepreneurship development, as small and medium-sized start-up firms face numerous difficulties in succeeding. But Germany can learn from the experience of other advanced economies that have successfully managed to facilitate start-ups. For example, countries such as Republic of Korea and the United States have programmes that encourage and facilitate the commercialization of new technology, products, and services.
- *Improving funding conditions for SMEs*: The credit fund (Wirtschaftsfonds Deutschland) established by the Government has proved to be very popular among medium-sized firms – over 95 per cent of the applications for financing have come from medium-sized enterprises. The fund, which was closed in December 2010, benefited nearly 20,000 companies. Conditional on evaluating the success of this initiative, the Government could consider launching similar initiatives until some of the more structural weaknesses of the German financial system have been addressed. The government should also consider ways to encourage medium-sized and small firms to tap into equity financing, e.g. by giving tax incentives to list themselves publicly. This has the potential of offering firms a new source of finance.
- *Boosting employment and labour incomes in line with productivity*: Promoting employment prospects of represented group and ensuring

closer connection between wages and productivity, in line with the above recommendations, would help stimulate the domestic engines of economic growth and investment. This would also support a more dynamic Euro-zone economy, thus improving the prospects for German exports to other Euro-zone countries.

Socially-inclusive policies were key to Germany's success in responding to the crisis and should serve as the foundation for future action.

In comparison with other advanced economies, Germany's response to the crisis was rather comprehensive in nature. Several initiatives were introduced to stabilize employment by leveraging the use of social benefits – while being mindful of labour market objectives and work incentives. Germany also made concerted efforts to reinforce social safety nets that were accompanied by support at the enterprise level to sustain the viability of businesses. This had the double dividend of focusing on jobs and providing support to domestic demand and business through income growth. In many instances this was supported by effective social dialogue.

Moving forward, it is essential that such a socially-inclusive approach – which proved so successful for overcoming the crisis – be pursued. Germany would be rewarded with further significant gains, both economic and social.

CHAPTER 1
ECONOMIC AND LABOUR MARKET PERFORMANCE

INTRODUCTION

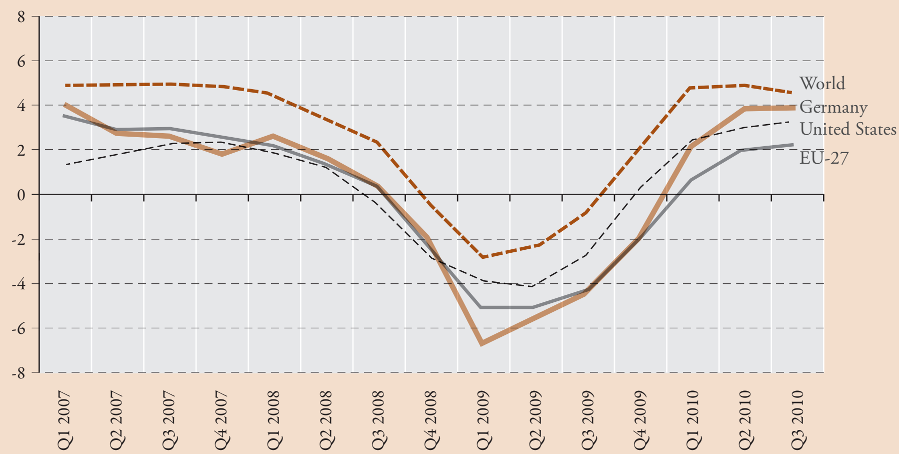
The global financial and economic crisis had a significant impact on output in Germany: in the first quarter of 2009, GDP fell by nearly 7 per cent (on an annual basis) – far more than in most other advanced economies. Export-oriented firms, notably manufacturing, were particularly hard hit as external demand shrank considerably. However, despite the dramatic fall in GDP, the German labour market has performed exceptionally well. Indeed, in relation to the sharp decline in output, job losses were marginal and thus the unemployment rate rose moderately in comparison with other countries where output fell less. There are nevertheless some concerns regarding the distribution of employment losses. The purpose of this chapter is to shed light on the macroeconomic effects and transmission mechanisms of the crisis on the German economy (section A) and review in more detail the labour market impacts stemming from the dramatic decline in GDP (section B). The final section will conclude by discussing a number of policy considerations and introducing the rest of the report.

A MACROECONOMIC DEVELOPMENTS

Germany was affected by the crisis both through finance and trade...

The onset of the crisis has affected countries in a variety of ways. In the case of Germany, the crisis was transmitted through both the trade and finance channels. In particular, given that nearly half of GDP in 2008 was attributed to exports, demand for German goods and services collapsed as global demand shrank and world trade fell more than 12 per cent at the end of 2008. In addition, when the sub-prime market in the United States crashed in the summer of 2007, various German banks, including state-owned banks that had heavily invested in collateralized debt obligations (CDOs), were confronted with significant financial losses. The first bank to receive financial support was Deutsche Industriebank (IKB) which, at that time, received a €8 billion guarantee from the government-owned Kreditanstalt für Wiederaufbau (KfW). This, in turn, affected credit supply which dampened overall business activities.

Figure 1.1 GDP growth, quarterly real GDP rate, 2007–2010 (percentage change from one year earlier)



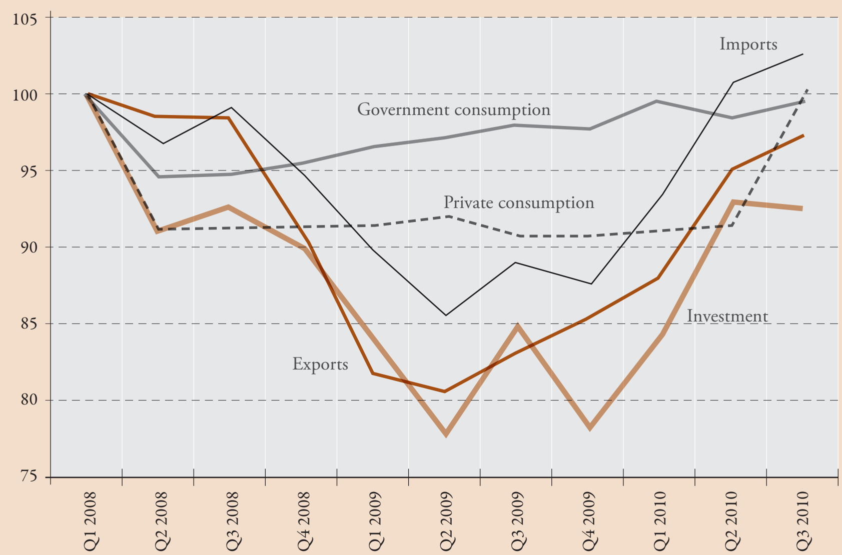
Note: Data are seasonally adjusted.
Source: IMF(2010a); Eurostat database.

As a consequence, the fall in GDP was dramatic – both in terms of magnitude and, to a lesser extent, duration. GDP growth had started a downwards trend in early 2008, dipping into negative territory in the last quarter. The impact was felt however in the first quarter of 2009, when compared with the same period in 2008, GDP fell by 6.6 per cent. In comparison, growth in the EU-27 and the United States fell by 5.1 and 3.8 per cent respectively (Figure 1.1). The recession persisted for some time – growth remained negative through the whole of 2009 – turning positive only in the first quarter of 2010. Throughout 2010, improvements in the growth rates have continued.

… as a result, external demand fell dramatically.

In light of the transmission mechanisms, imports, exports and investment not surprisingly suffered the steepest declines. Indeed, exports and imports, declined by 18 and 12 per cent, respectively, in the second quarter of 2009. Likewise, investment declined by around 18 per cent in the same period (Figure 1.2). However, with the rebound in trade activity takingplace in

Figure 1.2 Real GDP growth by main components, Q1 2008–Q3 2010
(percentage change from one year earlier)



Source: EUROSTAT.

the second half of 2009, German exporters benefited considerably from the strong recoveries and demand from emerging markets, notably in Asia.[1] And given the strong import content of exports, import growth also recovered to a similar extent.[2] Private consumption held up well during the recession against a background of surprisingly stable employment (see section B). Given the relative dominance of the manufacturing industry within the export sector, manufacturing was hit hardest, with sectoral real output falling over 21 per cent between the second quarters of 2008 and 2009. However, since that time the sector has been recovering – albeit at a moderate pace. The financial sector was also impacted, although less strongly, and remained relatively stagnant over early 2009.

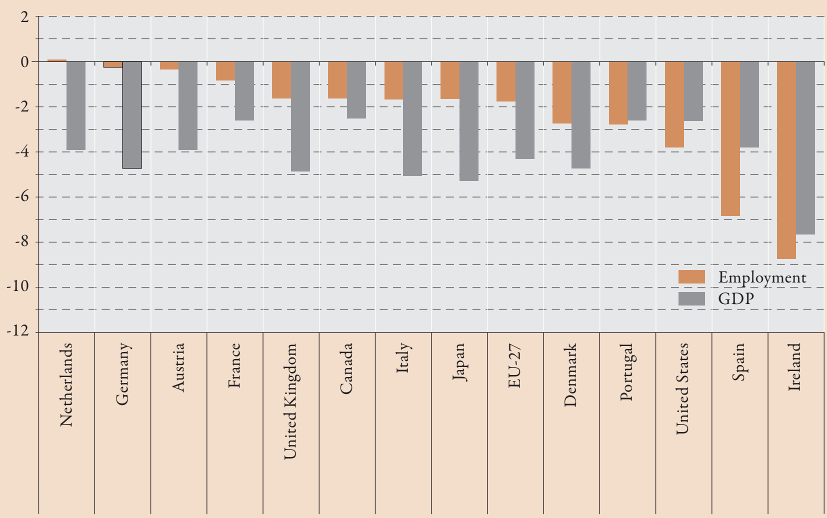
[1] UNCTAD (2010). Germany benefited considerably from the depreciation of the euro against the US dollar and major currencies, which occurred as a result of the self-inflicted internal divergences in the euro area and its related debt problems in the course of the global crisis.
[2] OECD (2010).

B LABOUR MARKET IMPACTS OF THE CRISIS

Employment fell much less steeply in comparison to GDP declines…

The impact of the global financial and economic crisis on employment and growth varied considerably across both developing and emerging economies. In the case of Germany, given the magnitude of the decline in GDP, employment displayed considerable resistance (Figure 1.3). Among advanced economies over 2009, employment losses in Germany were among the lowest. In other countries where the fall in GDP was similar in 2009, for instance in Italy, Spain and the United Kingdom, employment fell much more heavily. Most advanced countries, especially in Europe, are also confronted with the dual challenge of creating enough jobs for new labour market entrants. As a result, in most countries employment rates (that is, the employment to working-age population) fell.[3] In the case of Germany, the employment rates have actually improved over the course of crisis due to weak population growth – an issue to be discussed in more detail in Chapter 5.

Figure 1.3 GDP and employment in selected countries, change in 2009 compared to 2008 (percentages)



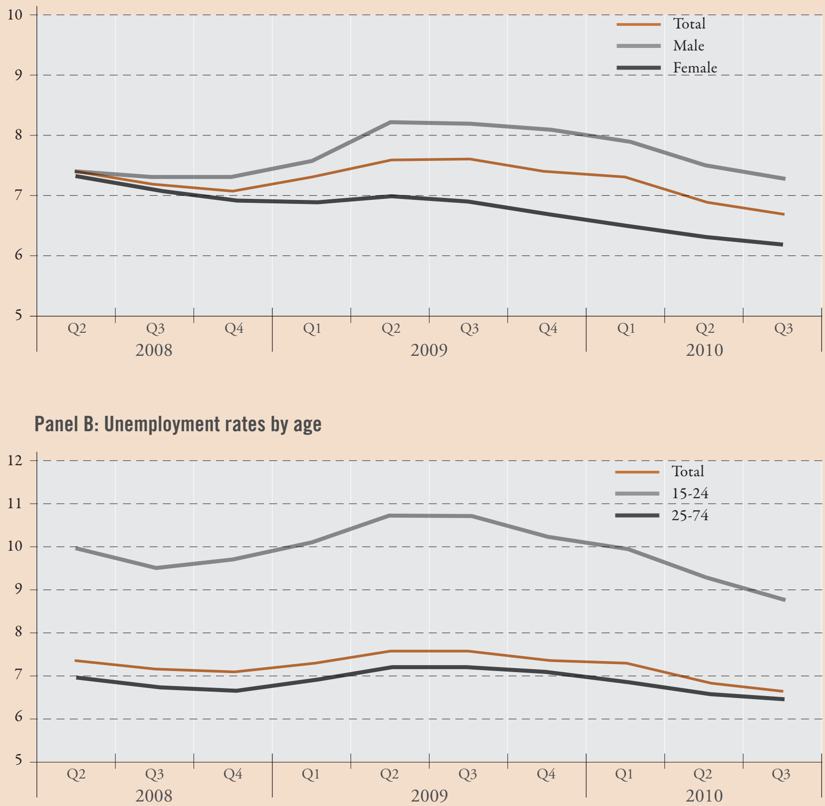
Source: EUROSTAT; OECD database; ILO Global job crisis observatory.

[3] IILS (2009).

Figure 1.4 Unemployment rates by sex and age, Q2 2008–Q3 2010 (seasonally adjusted)

Panel A: Unemployment rates by sex

Panel B: Unemployment rates by age



Source: EUROSTAT.

…and has already begun to recover in the middle of 2009.

As a result, total unemployment continued its downward trend until the end of 2008 – at which point the unemployment rate began to rise, reaching 7.6 per cent in the second and third quarters 2009 but then declining again. Much of the increase in overall unemployment rates was due to the rise in unemployment rates among men and youth. As in many advanced economies, the impact on men was due to the sectoral distributions of employment – that is, men are concentrated more in the sectors that were worst hit by the crisis, such as manufacturing (see below). For youth, employment tends to be more sensitive to fluctuations in growth. Youth unemployment rates rose to 10.7 per cent in the second quarter 2009, but the increase was short-lived; the ratio of youth to adult unemployment rates – at 1.4 – remains unchanged and is comparably low by international standards where the ratio is between 2 and 3.[4]

Likewise, sectoral distributions of employment explain why the impacts of the economic crisis were felt harder in southern and western Germany than in the northern and eastern parts of the country. Indeed, since southern and western Germany are highly specialized regions in the export-oriented industry (specially manufacturing), the crisis effects hit these regions directly and profoundly. In northern and eastern Germany, the economic and labour slump was far less important due to the greater dedication of this region to the services sector. In fact, between the third quarter of 2008 and 2009, employment fell in western Germany by approximately 185,000 compared to only 11,000 in eastern Germany.[5] Interestingly, export-oriented firms in manufacturing were highly competitive prior to the crisis and had lower unemployment rates than service-oriented firms located in eastern Germany. Therefore, the crisis triggered a certain convergence of unemployment rates in Germany – which will more likely be only a transitional phenomenon.[6]

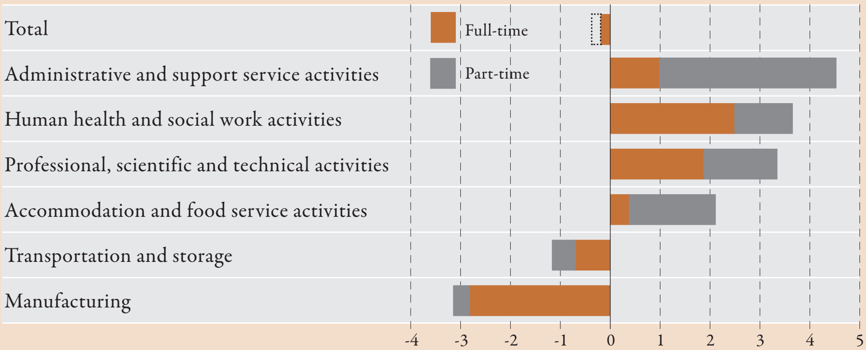
Nevertheless, manufacturing and temporary employment fell considerably….

Despite the aggregate stability in employment – total employment fell 0.2 per cent in 2009 – there were some still some important sectoral developments as well as some compositional adjustments. In terms of the sectors, the significant job losses in manufacturing were compensated by jobs in services, notably health, hotels and restaurants and other service activities (Figure 1.5):

[4] Ha et al (2010).
[5] Bundesministerium für Arbeit und Soziales (2010).
[6] Dietz et al (2011).

- The manufacturing sector – which accounts for nearly one-quarter of total employment – lost 3 per cent of employment in 2009. In particular, more than 539,000 jobs were lost between the last quarter of 2008 and the third quarter of 2009.
- Employment also fell considerably in the transportation and storage sector (22,000 jobs or 1.2 per cent) but this sector accounts for only 5 per cent of total employment.
- These losses were offset by significant job gains in the human health and social work activities sector: in 2009 the sector added 159,000 jobs. Similarly, jobs within the administrative and support service activities sector grew by 4.5 per cent (84,000), and combined with growth in the professional, scientific and technical activities sector (61,000), the job gains in these sectors helped to offset nearly all the declines in manufacturing.

Figure 1.5 Changes in employment by sector, 2008–2009
(percentages)



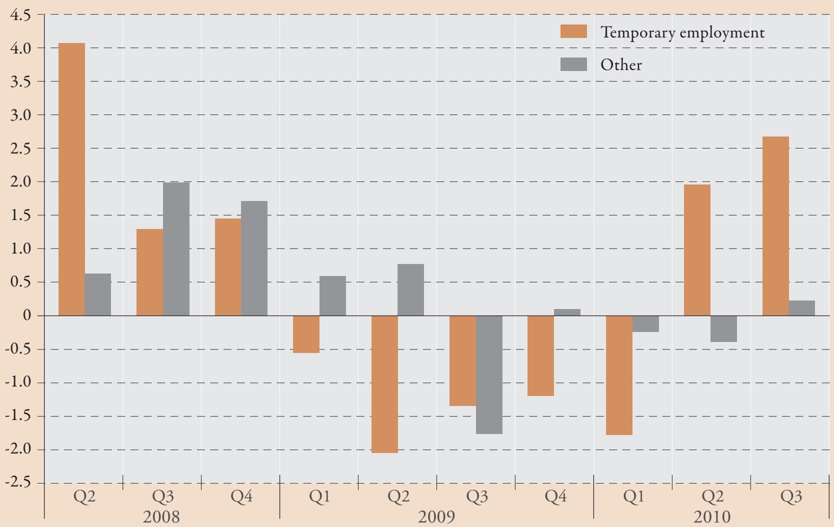
Note: The white area for total employment indicates the fall in full-time employment. That is to say, in overall employment, growth in part-time jobs helped partially offset the declines in full-time employment.
Source: IILS estimates based on EUROSTAT.

...and job quality fell ...

However, there was an important shift in terms of the quality of jobs. In particular, the vast majority of jobs (over 90 per cent) lost in manufacturing were full-time jobs, and this was also the case for transportation and storage. But over half the gains in the other sectors were part-time in nature. Indeed, in 2009 part-time employment actually grew (133,000), offsetting the declines in full-time employment (332,000).

In addition, firms were able to stabilize overall employment by using temporary employment as a buffer (Figure 1.6). In comparison to the same quarter a year earlier, temporary employment fell in five consecutive quarters – in the first two quarters of 2009, over 320,000 jobs were lost in temporary employment. Among temporary employment, agency work declined significantly at the onset of the crisis (Box 1.1). This represents close to half the decline in employment over this period, yet temporary employment as a share of the total is only 12 per cent. With the recovery, however, temporary employment has also begun to rebound growing strongly in the second and third quarters of 2010.

Figure 1.6 Changes in employment by type, from same quarter in previous year, Q2 2008–Q3 2010
(percentage change from one year earlier)

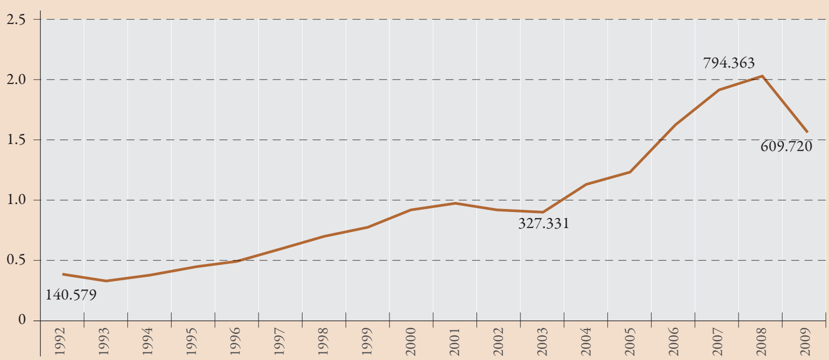


Note: 'Other' refers to the difference between total employment and temporary employment. This calculation is made given that permanent employment as a category is not available.
Source: IILS estimates based on EUROSTAT.

Box 1.1 Development of agency work in Germany

Since the 1990s there have been a number of efforts to modify employment regulations to encourage agency work (Antoni and Jahn, 2009). Indeed, as part of the Hartz-reforms a major change was implemented in 2004. Against this backdrop, the incidence of agency work has increased significantly since the early 1990s – the number of agency workers reached a peak in 2008 at nearly 800,000 or over 2 per cent of total employment (Figure 1.7). However, with the onset of the crisis, agency work fell dramatically – by nearly 23 per cent or 185,000 – in 2009. In this respect, agency workers bore a disproportionate share of the job losses in Germany.

Figure 1.7 Agency work in Germany, 1992-2009



Source: Dietz et al (2011).

Table 1.1 Average working hours per salaried worker, various sectors, 2007–2009

	Total	Primary sector	Manufacturing	Construction	Trade, hotel, restaurants and transport	Finance, housing and business-related services	Public and private services
2007	1 353.8	1 452.9	1 430.0	1 532.9	1 300.2	1 357.3	1 309.1
2008	1 350.6	1 452.5	1 415.3	1 550.7	1 301.7	1 359.2	1 304.3
2009	1 309.3	1 410.7	1 315.9	1 512.8	1 270.2	1 323.4	1 292.6
% changes, 2007–2009	-1.4	-0.3	-9.0	-0.7	-1.2	0.8	2.2

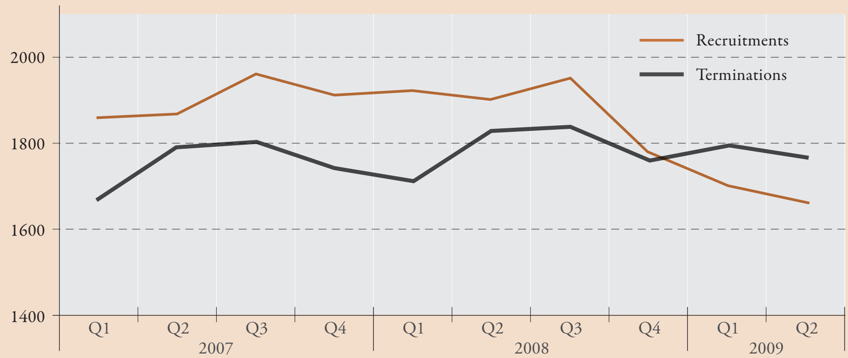
Source: Dietz et al (2011).

…with overall employment stability possible through adjustments in hours worked.

Perhaps the largest adjustment to employment came in terms of intensity, i.e. hours worked, rather than volume, i.e. jobs. Indeed, the decline in hours of work has been the key mechanism of adjustment in the German labour market – between 2007 and 2009 average work hours per salaried worker fell by 3.3 per cent. The decline was particularly prominent in manufacturing where average hours worked fell by 8 per cent,[7] but there were steep falls across all sectors, as shown in Table 1.1.[8]

The issue of how the reduction of hours was achieved is discussed in greater detail in Chapter 3, especially as regards its effect on employment. But an analysis of employment flow data confirms that changes in employment are principally a reflection of a reduction in the hiring rates, rather than terminations (Figure 1.8).[9] Leading up to the crisis, recruitments and terminations were rather stable despite some fluctuations – with the former consistently above the latter. In the last quarter of 2008, though, recruitments fell sharply.

Figure 1.8 Recruitments and terminations, Q1 2007–Q2 2009
(thousands per quarter)



Source: Statistics of the Federal Employment Office.

[7] In the 2nd quarter of 2009, average hours per salaried worker in the manufacturing sector decreased by 12.4 per cent.
[8] The reduction in average working hours per full-time employed was much higher than for part-time employed.
[9] See also Heckmann et al (2009), Möller (2009) and Rothe (2010).

C CONCLUDING REMARKS

The financial and economic crisis had a profound impact on growth in Germany, with GDP falling by 6.6 per cent in the first quarter of 2009 (compared to the previous year) – the steepest decline in over five decades. The impacts were most felt – both in terms of output and employment – in the manufacturing and financial sectors, given Germany's relatively high exposure to external demand and interconnectedness with the US financial system via collateralized debt obligations.

And while some sectors experienced significant job losses, overall employment remained relatively stable during the crisis – due predominantly to a number of internal flexibility mechanisms. First, firms were able to adjust employment levels rather quickly by laying off workers with temporary contracts. Indeed, temporary employment bore the brunt of the job losses (notably within the manufacturing sector). Second, firms were able to adjust, principally through modifying working times. Finally, the job losses in certain sectors such as construction and manufacturing were offset by gains in a number of service-related activities. However, it is important to note that many of the job losses were full-time in nature, whereas most of the gains were part-time; there was thus a considerable shift in job quality.

These issues will be further discussed in the chapters that follow. In particular, Chapter 2 presents a brief overview of Germany's response to the global financial and economic crisis, while Chapters 3 and 4 examine in more detail the role that employment and social policies have played in mitigating the effects of the crisis. Chapter 5 will conclude by examining briefly a number of lessons and challenges in moving forward.

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CHAPTER 2
GERMANY'S POLICY RESPONSE TO THE CRISIS

INTRODUCTION

The purpose of this chapter is to document and examine in more detail the measures adopted by Germany to mitigate the impact of the crisis. The chapter is divided into two main sections. The first looks at measures taken to stabilize financial markets, maintain liquidity, and improve access to credit for firms. Section B will discuss the fiscal stimulus packages that were implemented between late 2008 and 2009, with a particular focus on the employment and social protection components of these packages. This section takes an international perspective in examining Germany's policies, comparing them to other G20 economies. The final section will summarize with a number of policy considerations and conclusions.

A STABILIZING FINANCIAL MARKETS, MAINTAINING LIQUIDITY AND ACCESS TO CREDIT

1 FINANCIAL MARKET STABILIZATION AND OTHER SUPPORT TO THE BANKING SECTOR

The global financial system had already begun to show signs of stress by the summer of 2007, but the collapse of Lehman Brothers in mid-September 2008 led to the near-collapse of a number of international financial institutions. Most countries, including Germany and other European countries, adopted measures to restore market confidence and avoid runs on banks, including (i) ensuring bank funding through explicit government guarantees on retail deposits and other bank liabilities; and (ii) reducing bank leverage through government purchases of distressed assets or through capital injections (Table 2.1).[10] Almost all the major economies increased guarantees of private deposits (at least temporarily), put in place inter-bank loan guarantees, banned or restricted short-selling, and injected capital into troubled banks by buying equity stakes. Australia, Canada, Germany, Norway, Spain and Switzerland opted to buy the “toxic assets”, while the United States originally abandoned this plan in favour of direct capital injections.

As part of the global efforts to save the financial system, on 17 October 2008 the Federal Parliament of Germany passed a Law to Stabilize the Financial Markets (Finanzmarktstabilisierungsgesetz).[11] This legislation provided for the creation of a €400 billion financial market stabilization fund and €80 billion to recapitalize the banking sector via the government taking stakes in banks.[12] The aims of these credit guarantee and credit expansion measures were to maintain interbank lending, avoid bankruptcy of banks and ensure the availability of credit for businesses. As of 31 May 2010, 26 banking institutions had applied to the fund, requesting guarantees totalling €219.3 billion. Of these, guarantees worth €152.9 billion and other liabilities worth €29.4 billion were issued for 11 institutions. In 2009, the

[10] Fender and Gyntelberg (2009).
[11] Finanzmarktstabilisierungsgesetz, in Bundesgesetzblatt, Vol. 1, No. 46 (17 Oct. 2008), p. 1982.
[12] An additional €20 billion was included to cover losses. See Spiegel (2008).

Table 2.1 Crisis response measures to stabilize the financial system, various countries (up to February 2009)

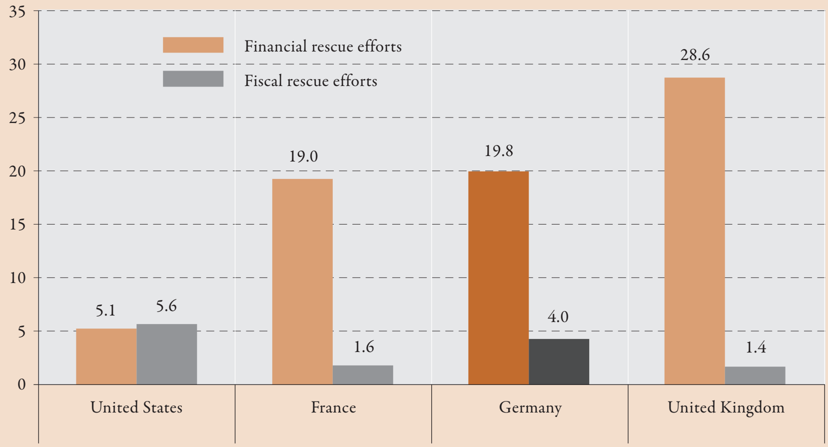
	Increased guarantee of private deposits	Guarantees for bank loans or debt	Fund to purchase commercial papers	Purchase of mortgage bonds	Ban or restriction on short-selling	Capital Injections	Options to purchase toxic assets	Induced Mergers & Acquisitions	IMF's emergency lending
Australia	X	X		X	X		X		
Austria	X	X			X	X			
Belgium	€100 000	X			X	X			
Brazil								X	
Canada		X		X	X				
China						X			
Denmark	X	X		X	X				
Finland	€50 000	X			X				
France	€70 000	€265 billion			X	€40 bn			
Germany	€100 000	€400 billion			X	€80 bn	X		
Greece	€100 000	X			X	X			
Hungary	€50 000	X				X			$15.7 billion
Iceland	X					X			$2.1 billion
India						X			
Indonesia	2 billion								
Ireland	rupiahs	X				X			
Italy	€100 000				X	X			
Japan	€100 000	X			X				
Korea, Republic of		X				X			
Mexico	X	X							
Netherlands		€200 billion			X	X			
New Zealand	€100 000	X							
Norway	X	X					X		
Poland	X								
Portugal	€50 000	X							
Russian Federation	€100 000	X				X			
Saudi Arabia	X	€100 billion				X			
Spain	€100 000	X		X	X		X		
Sweden	€50 000			X		X			
Switzerland			X						
Turkey									X
United Kingdom	£50 000	£250 billion		X	X	£50 bn		X	
United States	$250,000	$1.4 trillion		X	X	$700 bn	X	X	

Note: Most crisis resolution instruments were put in place in Oct-Dec. 2008, but given the persistent financial market instability, countries adopted additional measures or amended the pre-existing ones; only the countries that instituted at least one measure are included. An "X" denotes some action taken by a country in the corresponding area.
Source: IILS.

fund incurred a loss of €4.26 billion.[13] In general, the measures Germany adopted to support the financial sector amounted to approximately 20 per cent of its GDP (Figure 2.1).

[13] http://www.soffin.de/de/soffin/leistungen/massnahmen-aktuell/index.html (accessed 15 June 2010).

Figure 2.1 **Comparison between financial and fiscal rescue efforts, selected countries (percentage of GDP)**



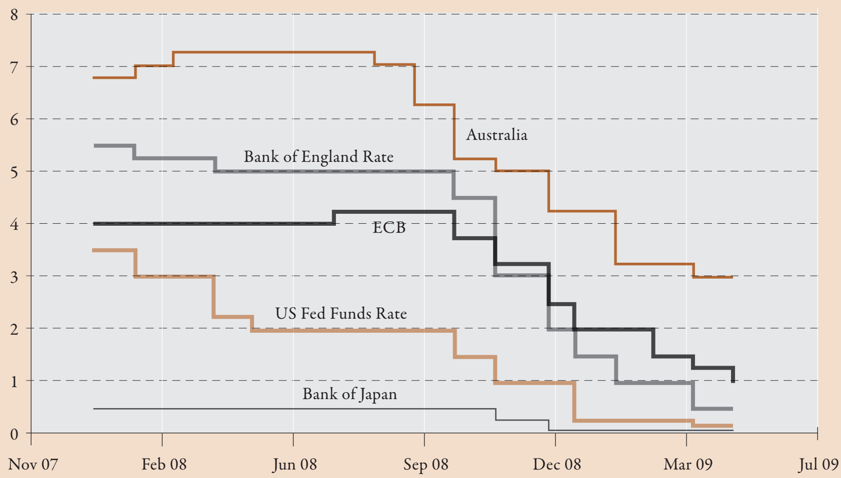
Source: IILS.

2 MONETARY POLICY

As part of the euro zone, Germany cannot independently undertake monetary policy and quantitative easing – but nevertheless, the European Central Bank (ECB), much like central banks around the world, began to reduce interest rates downwards as of early 2008 in an effort to stimulate aggregate demand (Figure 2.2). As the economic outlook deteriorated, a series of internationally coordinated rate cuts took place, especially between the ECB, the Federal Reserve Bank of the United States, the Bank of England, the Bank of Japan and the Central Bank of Australia. During the fourth quarter of 2008 the ECB enacted a reduction of 175 basis points, and between January and May 2009, in the face of the severe economic downturn in the euro area, the ECB lowered the rate on main refinancing operations by a further 150 basis points.[14] In addition, the Governing Council adopted a number of temporary, non-standard measures designed to maintain price stability over the medium term and facilitate the flow of credit to households and corporations. These measures aimed to support financing conditions beyond what could be achieved through reductions in ECB interest rates alone.[15]

[14] ECB (2009).
[15] For more information see ECB (2009).

Figure 2.2 **Monetary response: Reductions in key policy rates, November 2007–July 2009**
(percentages)



Source: IILS.

3 CREDIT GUARANTEES FOR ENTERPRISES

Meanwhile, in March 2009, the Government of Germany established a €115 billion fund (Wirtschaftsfonds Deutschland) for credit guarantees and support for German enterprises. Within the fund, €75 billion was earmarked for guarantees and €40 billion was allocated for credit support – of which €15 billion was reserved for small and medium-sized enterprises (firms with 250 or fewer employees).[16] As of June 2010, applications worth €21 billion in credits and guarantees had reached the fund. The vast majority of applications (95 per cent) have come from medium-sized enterprises, with applications from larger enterprises comprising the remaining 5 per cent.

German export enterprises were also made eligible for credit guarantees, and several existing measures were enhanced in light of the fact that the slump in global demand was hitting Germany's export-reliant economy hard. For example, the maximum security per export enterprise was raised from €80 million to €300 million – and even greater amounts became permissible

[16] ILO inventory of policy responses to the crisis, mid 2008–mid 2010.

under certain circumstances. Another temporary change which eases access to bigger export guarantees is that export guarantees can now be concluded without other engagements of the Government such as supplier credits. In 2009 export guarantees worth €22.4 billion were issued, constituting an 8.2 per cent increase compared to the previous year – an amount not surpassed during the 60-year history of export credits in Germany.

B DISCRETIONARY SPENDING / FISCAL STIMULUS

1 OVERVIEW OF FISCAL STIMULUS[17]

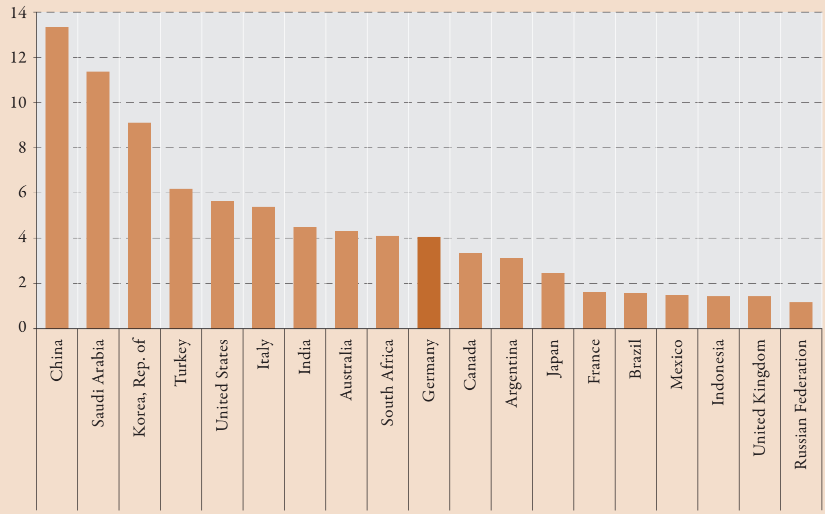
In addition to undertaking efforts to maintain liquidity and access to credit, Germany responded with an array of measures to mitigate the severe employment and social impacts of the crisis. In fact, between November 2008 and December 2009 Germany announced three stimulus programmes in an effort to counter the crisis:

- On 5 November 2008, Germany's first stimulus package (FSP I) was announced, entitled "Pact for employment security through enhanced growth" (Beschäftigungssicherung durch Wachstumsstärkung).[18] According to the Ministry of Economic Affairs, this €50 billion package was intended to save or create 500,000 jobs.
- In January 2009 a second round of stimulus (FSP II) again amounting to €50 billion was announced under the title "Pact for employment and stability in Germany" (Pakt für Beschäftigung und Stabilität in Deutschland).[19] This package contained a mix of tax cuts, support for enterprises, and investments in infrastructure and education.
- A third fiscal stimulus package (FSP III) in the amount of €22 billion was passed in December 2009, entitled the "Law on the Acceleration of Economic Growth" (Wachstumsbeschleunigungsgesetz).[20] Many of the provisions were aimed at providing tax relief for enterprises and individuals.[21]

Considered together, Germany's stimulus efforts have been estimated to represent a little over 4 per cent of 2008 GDP – on par with the G20 average. In comparison, China had the largest stimulus package at 13.3 per cent

[17] Much of the information in this section comes from the ILO inventory of policy responses to the crisis, mid 2008–mid 2010.
[18] Fiscal Stimulus Package I (FSP I), "Gesetz zur Umsetzung steuerrechtlicher Regelungen des Maßnahmenpakets (Beschäftigungssicherung durch Wachstumsstärkung)" [Law on the implementation of tax arrangements into the policy package (job security through strengthening growth)], in Bundesgesetzblatt, Vol. 1, No. 64 (29 Dec. 2008), pp. 2896–2898.
[19] Bundesregierung (2009a).
[20] Fiscal Stimulus Package III (FSP III), "Gesetz zur Beschleunigung des Wirtschaftswachstums (Wachstumsbeschleunigungsgesetz)" [Law on the acceleration of economic growth (Growth Acceleration Act)], in Bundesgesetzblatt, Vol.2, No. 81 (30 Dec. 2009), pp. 3950–3956.
[21] Bundesregierung (2009b).

Figure 2.3 Germany's fiscal stimulus compared to other G20 economies (percentage of GDP)



Source: IILS.

of its GDP, whereas Brazil and the Russian Federation implemented the smallest packages at just over 1 per cent of GDP (Figure 2.3).

Given the variations in which countries were affected, it is not surprising that the composition of fiscal stimulus efforts also differed. Broadly speaking, advanced economies in the G20 focused mostly on tax cuts while developing and emerging economies placed greater emphasis on infrastructure spending. Meanwhile, advanced economies also spent considerably more on labour market measures than the developing and emerging economies. For Germany, more than two-thirds of new stimulus spending concentrated on tax cuts and reductions in social security contributions.[22] But the country also adopted a series of labour market and social measures, including modifications to existing programmes. Indeed, in the case of Germany automatic stabilizers such as unemployment benefits were the principal means through which the crisis was addressed. According to ILO estimates, automatic stabilizers in the German welfare and tax system provided a fiscal impact of 2.5 per cent of GDP both in 2009 and 2010.[23]

[22] See ILO (2010).
[23] ibid.

2 UNEMPLOYMENT BENEFITS, TAX CUTS, AND SOCIAL SECURITY CONTRIBUTIONS

The unemployment benefit system in Germany is comprised of two parts: (i) a contributory, income-related, temporary benefit that can be drawn upon generally for the first year of unemployment (UB I); and (ii) a non-contributory unemployment assistance, which is a tax-funded flat-rate benefit that is paid as long as the person remains unemployed and complies with some other stipulations (UB II).

In terms of amendments, benefits were adjusted upwards for UB II and contribution rates for UB I were reduced. In particular, benefits for UB II rose from €351 to €359 per month – noting, however, that this change was already planned as part of the regular adjustment of the benefit rate, rather than being induced by the economic and financial crisis specifically.[24] In addition, as of January 2009 there was an across-the-board reduction in social security contributions, which are split equally between employers and employees. A reduction in the individual contribution to UB I from 5.6 per cent to 3.0 per cent of gross income had already been planned for 2008–09; this was intended to be permanent. However, a further temporary reduction (to 2.8 per cent) was also enacted as part of FSP II. This additional reduction, applicable to all employers and employees covered by social security contributions nationwide (an estimated 27,800,000) was in effect from 1 January 2009 to 31 December 2010. According to the Government, the contribution rate has reverted back to 3.0 per cent as of 1 January 2011.

With respect to tax, as part of FSP II the lowest income tax levy was reduced to 14 per cent from 15 per cent, effective as of 7 January 2009. In addition, non-taxable annual income levels were initially increased to €7,834 (a €170 increase), but then in January 2010 another increase of €170 brought it to its current level of €8,004. It has been estimated that these measures resulted in a loss of €2.7 billion in revenues in 2010 and €3.1billion in 2011 (compared to 2009) given that as of 2005, 2.7 million persons in Germany had incomes lower than €7,500.

[24] The benefit rate is indexed to pension levels. It is adjusted annually on 1 July. In 2010, the pension level did not rise, so the benefit level was expected to stagnate also. However, a February 2010 constitutional ruling found that the indexation of the unemployment assistance to the pension level was unlawful, and so a new mechanism is being developed (ILO inventory of policy responses to the crisis, mid 2008–mid 2010).

In 2009 the maximum tax-deductible amounts for health care expenditures (Bürgerentlastungsgesetz Krankenversicherung) were increased by €400 to €2,800 (for the fully self-insured) and to €1,900 (for those who receive state support for health insurance contributions), thus reducing the tax burden for citizens. However, this policy change stemmed from an earlier constitutional ruling and was not brought forward explicitly as a response to the financial and economic crisis.[25]

3 PENSION GUARANTEES

Pensions within the public scheme are indexed to a number of factors, including the development of gross incomes and wages – which, in 2009, declined (see Chapter 3).[26] Accordingly, pension levels in the west German states were due to decline by more than 2 per cent in 2009 and by 0.54 per cent in the east German states. However, on 19 June 2009 the Federal Government issued an "extended pension guarantee" stating that individual pension benefits within the public pension scheme would not decline in 2010 – notwithstanding the adjustment rule as it is currently legislated. The latter rule entails that pensioners will have to repay the cost of this stabilization measure in the form of lower increases in future years. Beginning in 2011, the pension will be augmented by only 50 per cent of the increase that had been planned prior to the stabilization; this will continue until the effect of the stabilization has been neutralized.

4 OTHER MEASURES TO SUPPORT LOW-INCOME HOUSEHOLDS

In addition to the tax cuts and social security contributions mentioned above, some other measures were enacted to protect the incomes of low-wage earners. On 1 January 2009 a law came into effect which increased the

[25] Ministry of Finance, Special page on the tax deductibility of health insurance contributions: http://www.bundesfinanzministerium.de/DE/BMF__Startseite/Aktuelles/Monatsbericht__des__BMF/2009/09/analysen-und-berichte/b01-b_C3_BCrgerentlastungsgesetz-krankenversicherung/b_C3_BCrgerentlastungsgesetz-krankenversicherung.html.

[26] In the west German states relevant wages declined by –0.96 per cent, in the eastern states they increased only moderately by +0.61 per cent (ILO inventory of policy responses to the crisis, mid 2008–mid 2010).

social assistance benefit (Heizkostenzuschuss) to cover heating costs. The average benefit level increased from €91 to €142 per month. The decision to implement this reform had already been taken in September 2008 – i.e. it was not a crisis response per se – but it still provided some de facto support to low-income households.

Child benefits (Kindergeld) were also increased as part of the fiscal stimulus packages rolled out by Germany in 2008 and 2009. Kindergeld is a universal benefit for households with children up to 18 years of age (up to 25 years of age if they are in education). In April 2009, alongside the regular monthly benefit the Federal Government issued a one-time benefit of €100 per child. This benefit relatively favoured low- and middle-income households, since beneficiaries of social assistance did not have to declare the benefit as income, and it did not reduce their entitlement to other benefits. Higher income earners, however, would be subject to repayment of this one-time benefit in their tax declaration.

In addition, as part of FSP II in January 2009, the monthly benefit for the first and second child was increased from €154 to €164; for the third child the level rose from €154 to €170; and for the fourth and any subsequent children, the benefit rose from €179 to €195. As part of FSP III, monthly child benefits in 2010 were raised to €184 for the first and second child, €190 for the third and €215 for every additional child as of 2010. In parallel, the tax-deductible amount per child was increased from €5,808 (2008) to €6,024 in (2009) and again to €7,008 (2010). It is estimated that these benefit and premium increases will cost €4.3 billion in 2010 and €4.5 billion in 2011.

5 SHORT-TIME WORKING HOURS

As outlined in Chapter 1, average hours worked in Germany declined during the crisis; this was in some cases subsidized by the state via the short-time work programme Kurzarbeit (see also Chapter 3). Kurzarbeit was introduced countrywide in Germany in 1927 and since 1969, when it was reaffirmed in a national employment promotion law, Kurzarbeit has provided a mechanism which subsidizes the earnings of individuals who work fewer hours due to adverse conditions of a temporary nature (such as inclement weather or an economic crisis). The principal elements of the programme compensate 67 per cent of the lost net wages for workers with dependants and 60 per cent for workers without dependants (Table 2.2).

In response to the severity of the financial and economic crisis, a number of changes were made to the Kurzarbeit programme between 2009 and 2010. First, as of February 2009 the requirement that one-third of the employees had to be on reduced hours was relaxed, and apprentices, temporary agency workers, and other workers on fixed-term contracts also became eligible for Kurzarbeit. Secondly, the maximum duration of benefits was extended first to 18 months, then up to 24 months. In particular, the 24-month maximum applies to applications made before the end of 2009; for applications made in 2010, the maximum duration of benefits is 18 months. Third, social security contributions on the part of employers were also eased. From 1 January 2009 the Government announced that it would cover 50 per cent of the employers' social security contribution for workers on shortened hours. In June 2009 full coverage was announced in relation to workers on Kurzarbeit for over six months. Furthermore, for workers undergoing training while working shortened hours, 100 per cent of social security contributions could be recovered.

Table 2.2 Requirements for the use of cyclical short-time work, and recent changes

	Pre-crisis regulations (since 1997)	Recent changes
Significant unavoidable loss of work	Temporary loss of work due to economic reasons	No or minor changes
	Other options of internal flexibility need to be utilized	January 2009: Under certain conditions working time accounts need not necessarily be reduced
	At least one-third of the staff must be affected	February 2009–March 2012: Compensation can be granted even if the firm is not able to provide full employment to at least one employee
	Estimated loss of income for the entire staff of at least 10%.cent.	No or minor changes
Requirements to the establishment	At least one regularly employed jobholder	No or minor changes January 2009: Under certain circumstances short-time work can also be granted to agency workers
	Good chance that firm returns to regular working hours	No or minor changes
Individual requirements	Employment contract needs to be maintained	No or minor changes
	Short-time worker is obliged to accept job offers from Federal Employment Agency	No or minor changes
	Recipients of unemployment benefits or subsistence allowances while participating in publicly financed training measures are excluded	No or minor changes
Notification	Employers or works councils are obliged to notify the estimated loss of work to the local employment agency	No or minor changes
Social security contributions	Contributions are reduced to 80% for the loss of working hours	No or minor changes
	Employers have to bear the full amount	February 2009: Federal Employment Agency covers 50% of contributions for loss of work. In case of training during the loss of work, the Agency covers 100% of the contributions. Costs of training measures can be reimbursed. July 2009– March 2012: Agency covers 100% of contributions for loss of work from the seventh month of short-time work.
Duration of benefits	Maximum duration of six months	January–June 2007: 15 months July 2007– December 2008: 18 months January–December 2009: 24 months January–December 2010: 18 months
Level of benefits	60% of the net wage loss due to shorter hours	No or minor changes
	67% with at least one dependent child	No or minor changes

Source: Social Code III.

6 PUBLIC EMPLOYMENT SERVICE, TRAINING, AND JOB PLACEMENT PROGRAMMES

Together with the short-time working provisions discussed above, other labour market measures such as new hires for the Public Employment Service (Bundesagentur für Arbeit) and the extension of training were estimated to represent about 9 per cent of Germany's stimulus package. In terms of bolstering Germany's Public Employment Service (PES), in December 2008 the federal government opted to recruit 1,000 additional case managers – with the understanding that this would be on a temporary basis. But with the passage of FSP II in January 2009, the decision was taken to recruit 4,000 additional staff. The aim of hiring these additional caseworkers is to reduce the ratio of unemployed individuals to caseworkers for UB II recipients from 1:85 (for persons under 25) and 1:158 (persons 25 and over) to 1:75 and 1:150, respectively. These additional staff costs were to be paid for by the PES, but since a negative balance was anticipated for 2010 (and potentially 2011), the Federal Government has put in place a mechanism in the form of grants and guarantees to ensure the financial stability of the PES, notably during downturns. This means the PES can, without recourse to increasing contribution rates or disruptions of benefits, ensure a smooth delivery of services. In particular, in 2010 the deficit amounted to €8.14 billion of which approximately €5.26 billion was covered by a one-time government grant. For 2011, any deficit incurred will be financed through loan provisions from the Federal Government.

Over the course of the crisis, the PES increased its training facilities along with the financial resources available for this purpose. However, the demand for training was much lower than expected. Of the €150 million available in 2009, only €35 million was used. Financial support for reskilling and retraining of reemployed temporary employment agency workers was also introduced in 2009. Employers were eligible to obtain training fully financed by the PES for temporary workers who had previously worked for an agency in 2007 or 2008 and who were subsequently reemployed by that same employer in 2009. Employers remained responsible for paying the wages for these workers. Demand for this measure was also lower than expected. Of the €200 million allocated for this purpose, less than €0.1 million (€84,000) was actually used.

In addition, a reeducation programme for elderly and low-skilled workers (WeGebAU) was extended in 2009 with the provision of an additional €770 million through FSP II. The original intent of this programme was the provision of funding to support the placement of these workers, especially in small and medium-sized enterprises. The decision to expand the programme resulted in some key changes: the target groups were expanded to include (i) unskilled unemployed individuals 25 years of age or older, and (ii) youth lacking vocational training. In 2009, over 95,000 individuals were supported via this programme. Of these participants, just over 10,000 were older workers in enterprises with fewer than 250 employees. Nearly 35,000 employers received top-up benefits to support the wages of the programme participants. In July 2010 a pilot programme (Bürgerarbeit) was launched to support the placement of long-term unemployed persons within non-profit workplaces.

7 CROSS-CUTTING "GREEN" MEASURES AND SECTOR-SPECIFIC INITIATIVES

With respect to green-oriented initiatives, additional funding and credits were targeted at enterprises which engage in the development of electro- and hybrid cars and fuel cell technologies. Additional funding was provided from the federal budget, and the state-owned bank KfW was responsible for administering this measure. FSP III contained support for the expansion of renewable energies, in the form of higher premiums paid to plants that had generated renewable energies for the electricity grid prior to January 2009.

Incentives were also implemented to support the purchase of new cars via a "cash for clunkers" programme. Those who owned a car more than nine years old and who were willing to purchase a new car which (at a minimum) complied with the European Union's Euro4 emission standard became eligible to receive a €2,500 premium from the Federal Government. The total budget for this measure was initially planned to be €1.5 billion, but as a result of the popularity and widespread uptake of the measure, additional funds were eventually made available for this purpose (totalling €5 billion). The automotive sector also benefited from a temporary, one-year exemption from motor tax for new cars purchased between November 2008 and June 2009. Additionally, exemptions were granted for cars complying with the European Norms Euro5 and Euro6 standards and for electric cars – the exemption applies for a full five years after the date of first registration. As of April 2009, this measure was estimated to cost €0.1 billion in 2009 and €0.2 billion in 2010.

In terms of other sector-specific measures, FSP II earmarked €10 billion up to December 2010 for infrastructure investment projects in communities and federal states, and provided €4 billion to be used at the national level. The focus of the investments is on universities, schools, child care, hospitals, and information technologies. Additionally, the Federal Government designated €2 billion for transportation infrastructure and €0.75 billion for energy efficiency of buildings.

8 SOCIAL DIALOGUE AT THE SECTORAL AND COMPANY LEVEL

Social dialogue played a major role in reaching agreements on the short-time working hour programme (see Chapter 3 for further details). In addition, many consultations have taken place at the federal, state and local levels, involving representatives of government, industry, employers, and trade unions. And while many of the collective agreements which applied in 2009 had been devised in 2008 before the onset of the crisis, many agreements that were concluded in 2009 and 2010 do reflect the exigencies of the crisis. The specifics of sectoral agreements vary considerably. For instance, in the banking sector, which employs over 250,000 workers, the social partners have agreed to a one-time pay increment of €300 in 2010 and a pay increase of 1.6 per cent as of January 2011. In the metals sector, which was hard hit by the crisis, the agreement for the North-Rhine Westphalia regions, representing over 700,000 employees, provides for a one-time increase of €320 for the period May 2010–March 2011, and by April 2011 wages are set to rise by 2.7 per cent. In some instances, companies actually implemented wage increments earlier than scheduled in the collective agreements.

9 FISCAL CONSOLIDATION GOING FORWARD

As this chapter has so far shown, the German Government has spent a considerable amount of resources in tackling the financial and economic crisis. Now that the effects of the crisis are fading, the Government has announced several austerity measures to make its public finances more sustainable in the medium to long term.

In particular, in June 2010 the Federal Government announced a path forward for financial planning covering the period 2011–2014. The aim is to save €11.2 billion in 2011 alone, with €19.1 billion in savings targeted for 2012, and €23.7 billion and €27.6 billion in 2013 and 2014 respectively. More than a third of the planned savings for 2011 (€4.3bn) is intended to be saved via changes to policies and programmes delivered by the Ministry of Labour and Social Affairs. Reforms have been announced in respect of parenting benefits, unemployment benefits, the Public Employment Service, wages of public employees, and other labour market measures.[27]

One cost-saving measure announced by the Government in June 2010 is the cancellation of parenting benefits for recipients of unemployment assistance. Starting in 2011, unemployment assistance beneficiaries with a newborn child will no longer receive a monthly benefit of €300. Currently this benefit is available for 12 months after the birth of the child. Also in 2011, the heating cost supplement to housing support (Heizkostenzuschuss) will be terminated.

[27] Federal Government of the Republic of Germany (2010).

In 2005–06 a temporary bonus was introduced to cushion the loss in income (when transitioning between benefit types). This temporary bonus is paid to individuals who are no longer eligible for UB I, but whose former income (and thus the level of the UB I benefit they had been receiving) is significantly higher than the flat benefit of UB II. The Federal Government has abolished this bonus as of January 2011. Another planned change is the abolition of the €40 monthly contribution that the PES currently makes to the public pension scheme on behalf of recipients of unemployment assistance. As of January 2011, these payments are slated to be discontinued – a move which is expected to result in annual savings of €1.8 for the PES. This means that approximately 3,7 million unemployment assistance beneficiaries in 2011 will have to make pension contributions on their own or risk lowering their entitlements.

[16] ILO (2010).

C POLICY LESSONS AND CONSIDERATIONS

The German response to the crisis has been rather assertive and persistent. In the first instance, given the impact of the crisis on the financial sector, and concerns regarding liquidity, the Government announced a series of measures to ensure liquidity to sustainable enterprises most affected by the crisis, for example credit guarantees targeted to SMEs and export-oriented sectors. The Government also announced three stimulus packages totalling more than 4 per cent of GDP – the first already in November 2008. This was followed by additional stimulus in January 2009 and December 2009.

The primary focus of the efforts undertaken by Germany was to leverage modifications to existing policy. In this respect, it relied heavily on making a series of adjustments and improvements to a range of employment and social policies in order to mitigate effects of the crisis. In other words, the pre-existing automatic stabilizers were adapted and reinforced. This included easier access to short-time work, improvements to unemployment assistance, pension guarantees, extra resources to the PES as well as a series of initiatives targeted to low-income households. The stimulus packages also contained direct support to certain sectors, such as the automotive sector, including incentives for lower-emission vehicles. The following chapters document in greater detail a number of these measures and the role they played in helping Germany overcome the crisis.

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CHAPTER 3
SUPPORTING EMPLOYMENT THROUGH SOCIAL DIALOGUE

INTRODUCTION[28]

Enterprises adjust to slowdowns in economic activity in a variety of ways. Some make adjustments in labour input by hiring and firing workers, while others tend to vary working hours and productivity per hour. During the current crisis when millions of workers lost their jobs, many countries opted to adjust to the downturn by adjusting employment. In the case of Germany, however, employment levels remained relatively stable and fell much less significantly than output. In this respect, working-time reductions, particularly short-time work, were the principal means by which firms adjusted to the slowdown. These measures – as outlined in Chapter 2 – received support from the Government which made short-time work schemes more affordable. A number of working-time reduction practices were also supported through social dialogue at the enterprise level and at the collective level. The purpose of this chapter is to examine these measures in more detail. In particular, section A examines working-time flexibility at the company level. Section B then elaborates in more detail on the main policy level, i.e. short-time work or Kurzarbeit. The final section discusses some policy lessons and considerations for moving forward.

[28] This chapter is based on Dietz et al. (2011).

A PROMOTING EMPLOYMENT AT THE ENTERPRISE LEVEL: WORKING-TIME FLEXIBILITY

Firms were able to maintain aggregate levels of employment during the crisis...

Although output fell significantly in Germany, considerable efforts were made at the enterprise level in an attempt to avoid dismissals. There is evidence that firms "hoarded" labour during the crisis. First, at the macro level labour productivity per employee declined dramatically – unsurprising given that output fell much less than GDP, as outlined in Chapter 1. A more accurate measure, however, is to assess the extent to which labour productivity as a proxy for labour utilization has fallen below its long-run trend level. Using a time-varying trend reveals that labour utilization during this crisis has never been lower.[29] The analysis by sector reveals that manufacturing and trade, hotels, restaurants and transport have recently displayed large negative deviations of labour utilization from the long-term trend (see Table 3.1). Overall, and especially within these sectors, there appears to be a strong degree of labour hoarding in an attempt to retain workers.[30]

Table 3.1 Cyclical component of labour productivity per person by industry in Germany, Q1 2008–Q2 2010

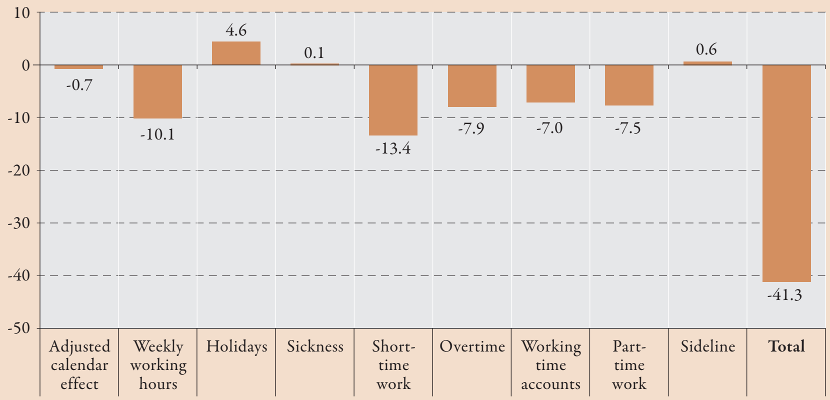
	2008 Q1	2008 Q2	2008 Q3	2008 Q4	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2
Primary sector	**-3.4**	**-7.8**	**-9.6**	**-8.9**	**4.9**	**2.7**	**-0.6**	**0.9**	**5.3**	**2.8**
Secondary sector	**-0.5**	**5.9**	**4.8**	**-3.9**	**-13.6**	**-7.0**	**0.0**	**-2.4**	**-5.1**	**6.3**
Manufacturing	5.0	8.8	3.3	-3.4	-16.7	-15.0	-8.9	-3.1	-1.9	5.0
Construction	-5.4	4.0	7.3	-4.1	-9.4	1.5	8.5	-3.2	-9.0	6.7
Tertiary sector	**1.1**	**3.0**	**3.6**	**0.1**	**-2.6**	**-0.9**	**0.7**	**-1.5**	**-2.1**	**0.0**
Trade, hotels, restaurants and transport	1.6	7.5	7.3	1.2	-7.1	-2.4	-0.1	-2.9	-5.8	1.0
Financing, housing and business-related services	1.2	0.6	1.1	-1.0	0.2	0.1	1.1	-1.1	0.3	-0.5
Public and private services	-0.2	0.9	1.9	-0.2	-1.1	0.1	1.2	-0.2	-0.7	0.1
All sectors	**-0.8**	**2.5**	**2.5**	**-2.4**	**-5.2**	**-1.5**	**1.0**	**-1.4**	**-2.6**	**2.6**

Note: Cyclical component calculated using a Hodrick-Prescott filter with the smoothing parameter λ=1600.
Source: Dietz et al (2011) based upon Federal Statistical Office.

[29] A Hodrick-Prescott filter is used to provide an estimation of a time-varying trend (Hodrick and Prescott, 1997).

[30] Labour productivity is also affected by other factors of production, e.g. cyclical movements in total factor productivity, changes in the capital stock and its utilization, as well as varying returns associated with different inputs. See for example Basu and Fernald (2000).

Figure 3.1 Changes in average yearly working time per employee, 2009
(annual average in hours)



Source: Fuchs et al. (2010).

…by making adjustments to hours worked…

To achieve this a number of strategies were undertaken, notably by reducing hours worked. Interestingly, short-time work was only one manner in which hours were adjusted (Figure 3.1). Five main components contributed to the overall reduction in working hours of salaried workers: (i) shorter weekly working hours; (ii) an increase in part-time employment; (iii) a reduction of paid overtime; (iv) a phasing-down of working-time accounts; and (v) a stronger use of short-time work. In fact, while short-time work accounts for the largest fall in hours (more than one-quarter), the bulk of the decline is due to the other, non-subsidized types of working-time flexibility such as less overtime.

…often achieved through effective social dialogue.

In many instances, notably in the reductions in weekly hours worked, in overtime and in adjustments to working-time accounts, the measures were the result of worker–employer agreements – as opposed to subsidies, as is the case for short-time work (see Section B). In Germany the number of working hours per week depends largely on collective agreements (Box 3.1). In particular, agreements usually allow for longer working hours during peak periods of demand and shorter hours during downturns (often on the condition that a certain level of hours worked is maintained over a defined period).

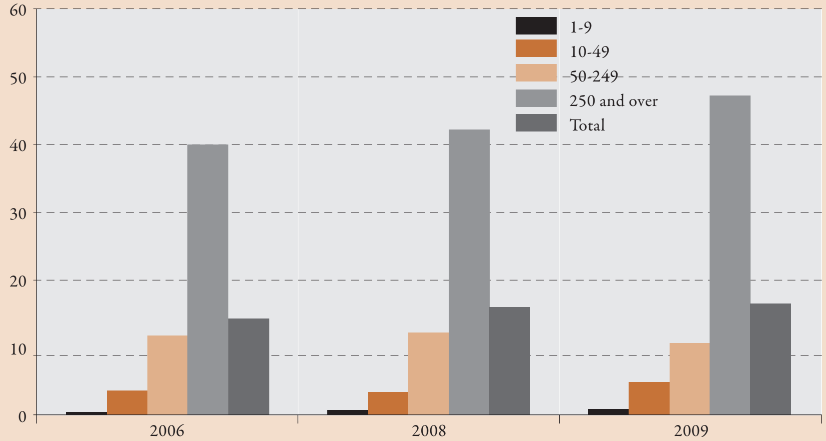
Box 3.1 Enterprise-level agreements in support of employment and output

Support from social partners in support of employment is not a new concept in Germany. As of the mid-1990s, so-called company-level pacts for employment (or "alliances for jobs") emerged with the aim of overcoming enterprise-level adjustments while enhancing competitiveness. The agreements between firms and workers aim to maintain employment levels by means of adjusting compensation and/or working time (e.g. reduced working hours, suspensions of annual bonuses, etc.). In some cases this is associated with additional training efforts – in 2005, almost one-quarter of agreements included such provisions.

In 2009 approximately 16 per cent of all workers were employed in firms with such agreements, up from 14 per cent in 2006. The increase in the number of firms with agreements during the crisis was particularly predominant in large enterprises (with employees of 250 or more) where the share of enterprise-level agreements rose from 40 per cent in 2006 to nearly 50 per cent in 2009.

According to The Global Economic Linkages (GEL) model – a theoretical macroeconomic model of a closed economy – collective bargaining can play a vital role in minimizing a fall in output and employment. In particular, the GEL model allows for two types of collective bargaining: (i) right to manage – where firms and workers bargain over wages while the firm sets the numbers of hours worked unilaterally; and (ii) efficient bargaining – firms and workers bargain over both wages and hours worked. As Figure 3.3 suggests,

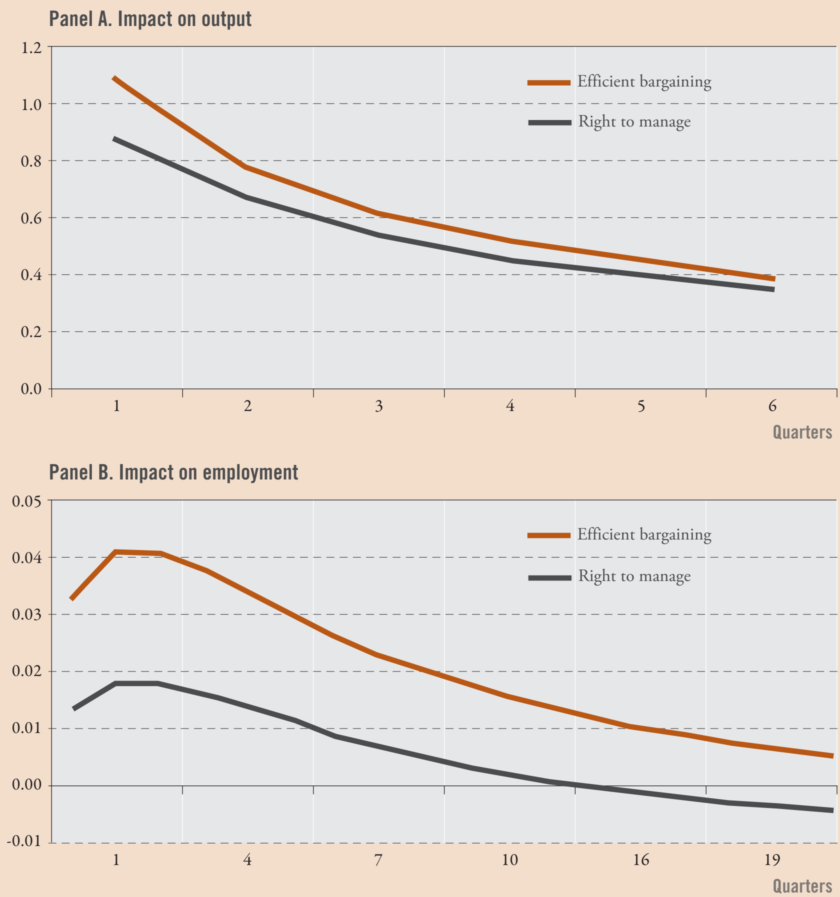
Figure 3.2 Share of employed persons in enterprises with company-level pacts for employment on all employees, by size of enterprise, 2006, 2008 and 2009 (percentages)



Source: Stops (2010), weighted shares.

fiscal multipliers for both output and employment are larger for efficient bargaining than for right to manage. This is explained by the fact that firms need to cope with higher aggregate demand following an increase in fiscal spending, which requires an increase in production. Firms have two possibilities to increase the production necessary to meet the increased demand: (i) increasing the number of hours worked, or (ii) increasing the number of jobs. In the case of efficient bargaining firms are less likely to use the former option given that hours are subject to negotiation between social partners. In this sense, fiscal policy is overall more efficient in the case of efficient bargaining, for the reduction in unemployment has some positive spill-over effects on aggregate demand.

Figure 3.3 **Collective bargaining and its impact on output and employment**



Source: Bridji and Charpe (2010).

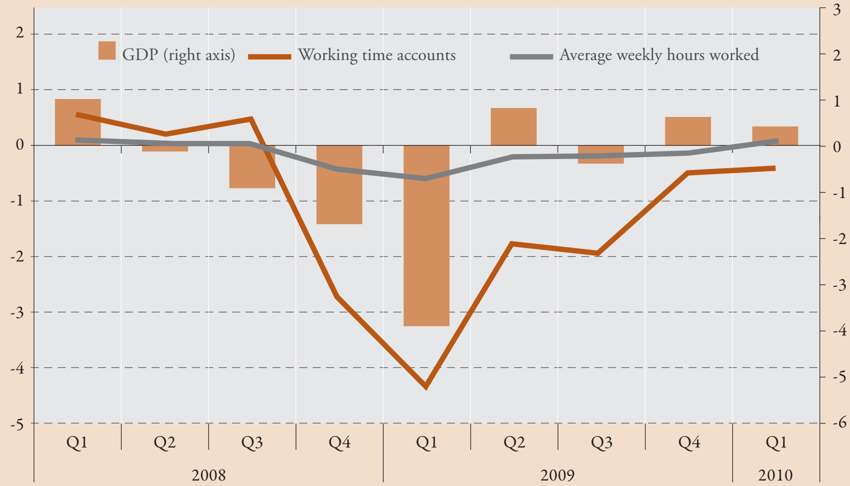
All three main working-hour adjustment mechanisms – average weekly hours, working-time accounts and overtime – have varied with the fluctuations in GDP (Figure 3.4). These three together account for over half the decline in total hours, as illustrated in Figure 3.1. Moreover, the steepest declines occurred in the first quarter of 2009, the peak of the decline in GDP:

- *Average weekly hours*: With respect to total employment, average weekly hours began to fall in the fourth quarter of 2008 – in the first three quarters hours were little changed (Figure 3.4, panel A). The steepest decline occurred in the first quarter of 2009, but from that point, although the change in comparison to the same quarter a year ago continued to decline, it fell at a much slower pace. By the first quarter of 2010, average weekly hours had returned to their pre-crisis levels.
- *Working-time accounts*: Working-time accounts allow working hours to fluctuate with demand, with employment income unchanged. In the case of Germany, it is estimated that over half of employees have working-time accounts.[31] During the crisis, account balances were reduced considerably, especially in the fourth quarter of 2008 and the first quarter of 2009. There is limited evidence that in some instances, accounts actually ran into negative territory, meaning that workers will have to work longer hours during the recovery period.
- *Overtime work*: In some respects, the use of overtime has declined in Germany. In 2009 paid overtime accounted for just over 2 per cent of hours worked, with each employee working on average 38.4 hours overtime – down from 3.5 per cent and nearly 60 hours in 2001. Nevertheless, paid overtime fell by as much as 20 per cent during the first quarter of 2009 (Figure 3.4, panel B).[32]

[31] Zapf and Brehmer (2010).
[32] It is important to note that unpaid overtime is underreported in administrative data and surveys, which can result in underestimation of cyclical variations in overtime hours.

Figure 3.4 **Working time flexibility and GDP, Q1 2008–Q1 2010**
(percentage change from previous quarter)

Panel A. Average weekly hours, working-time accounts and GDP



Panel B. Overtime work and GDP

Source: Federal Statistical Office and IAB.

B SHORT-TIME WORK AS A SUBSIDIZED REDUCTION IN WORKING TIME

The reduction in hours and incomes was also partially compensated through the government-sponsored Kurzarbeit programme…

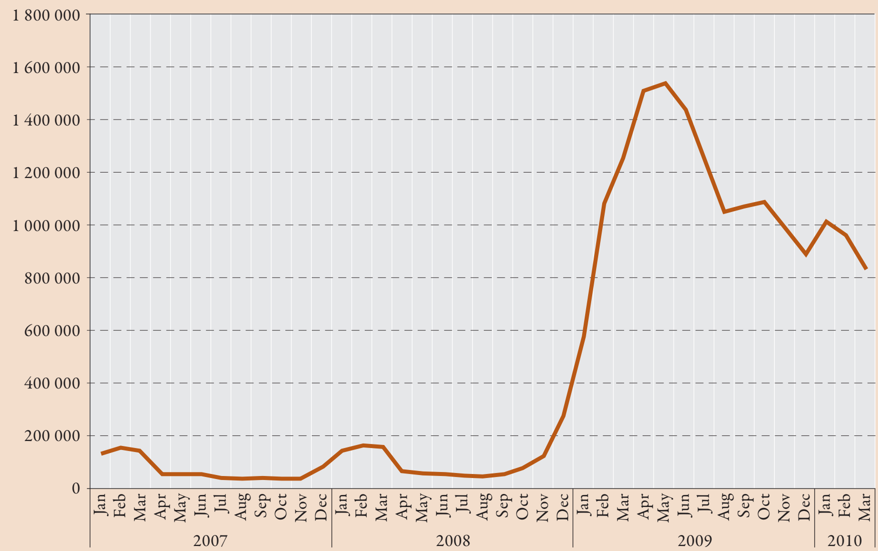
The German short-time work programme (Kurzarbeit) subsidizes the loss of income incurred through working shorter hours. In particular, under the programme employers can apply for temporary state assistance to top up the wages of employees who are working reduced hours. There are currently three different types of short-time work measures in use:

- Seasonal short-time work (Saison-Kurzarbeit): intended for non-productive periods due to weather conditions.
- Transitional short-time work (Transfer-Kurzarbeit): intended for permanent loss of employment due to restructuring measures at the establishment level.
- Cyclical short-time work (Konjunkturelle Kurzarbeit): intended for temporary, unavoidable loss of employment due to economic factors or another unavoidable event.

Of these three varieties of Kurzarbeit, cyclical short-time work (Konjunkturelle Kurzarbeit) has been the most widely used during the crisis. As described in more detail in Chapter 2, under this programme the Federal Employment Agency covers 67 per cent of the net wage loss suffered by the wage earner (60 per cent for workers without dependants), and employers are exempted from a portion of the social security contributions (up to 100 per cent) made on behalf of workers. In addition, the state also pays for employees' contributions towards social benefits, e.g. pension and health care. The Government has modified several requirements and conditions of the programme over the course of the crisis in an attempt to further support employment levels.

As a result of these modifications, the use of all three types of Kurzarbeit – seasonal, transitional and cyclical – rose dramatically during the crisis (Figure 3.5). In the years leading up the crisis the take-up was rather moderate. Throughout 2007, recipients averaged fewer than 70,000, but towards the end of 2008 the number of workers participating started to rise dramatically – peaking in April 2009 at 1.4 million (at which point more than 98 per cent were recipients of cyclical or Konjunkturelle Kurzarbeit). Over the course of 2009, on average 1.1 million workers benefited from the short-time work programme – the highest since the early 1990s when the social security net was reinforced as a means of dampening the structural consequences of German unification. Since April 2009, however, the take-up of the programme has slowly declined, falling to 630,000 in April 2010.

Figure 3.5 Short-time workers, 2007–2010
(number of workers participating)



Source: Federal Employment Agency.

...which benefits sectors, notably manufacturing, that were hit hard by the crisis.

Short-time work was predominately concentrated in the manufacturing sector – at the peak of the programme's use more than 80 per cent of participants were employed in this sector, representing some 14 per cent of total manufacturing employment in Germany. Other sectors also benefited, albeit to a lesser degree. For example, construction and wholesale and retail trade accounted for 8 per cent of short-time workers but these represented less than 1.5 per cent of employment in these sectors. One of the reasons why the manufacturing sector relied more heavily on the short-time work programme was because – as outlined in Chapter 1 – the sector was affected most by the crisis through the decline in external demand.[33] Similarly, more than 75 per cent of the firms that benefited from short-time between January 2009 and March 2010 were located in western Germany.

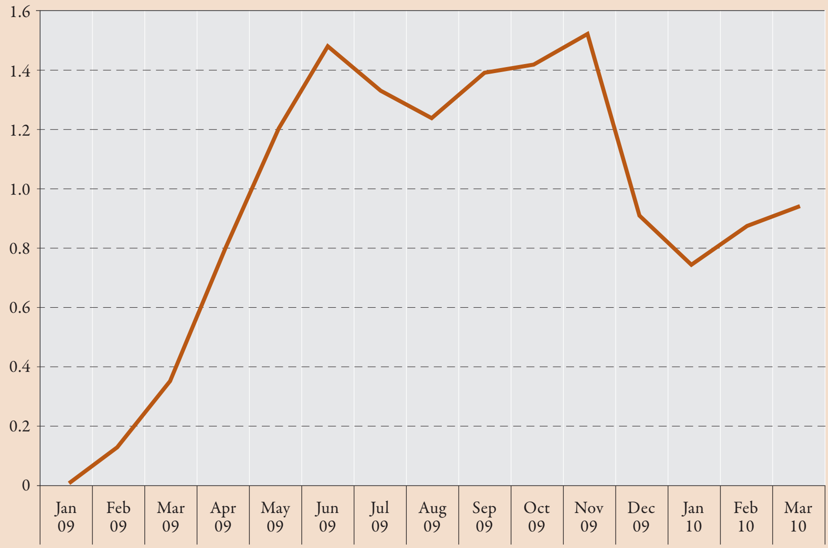
In terms of enterprise size, large firms (200 or more employees) benefited in terms of the numbers of employees participating in the programme. For example, close to 60 per cent of all employees on short-time work were employed in large firms. However, in terms of enterprises, small and medium-sized firms accounted for the bulk of firms partaking in the programme (Figure 3.6). In fact, of the firms benefiting from the programme in April 2009, firms with less than 50 employees accounted for nearly 80 per cent and firms with between 50 and 99 employees accounting for another 10 per cent.

Figure 3.6 Short-time worker by size of enterprise, April 2009
(percentages)

Source: Federal Employment Agency.

[33] See Crimmann et al. (2010) and Dietz et al. (2011) for more detailed information on cyclical short-time work.

Figure 3.7 Short-time work and training, January 2009–February 2010
(percentage share)



Source: Federal Employment Agency.

One of the features of the short-time work programme was to encourage training during downtime. As of February 2009 the Federal Employment Agency covered 100 per cent of social security contributions on behalf of short-time workers placed in training.[34] However, fewer than 2 per cent of short-time workers were in training at any given time (Figure 3.7). Moreover, only a small percentage of firms (fewer than 14 per cent) had at least one short-time worker engaged in training activities.[35] Possible explanations of the low take-up may stem from the lack of suitable training options – it seems to have been difficult to find training programmes that would fit the needs of both the workers and firms. In addition, there is some evidence to suggest that workers did not feel the necessity to upgrade skills further. Finally, the drop-off in training that occurred towards the end of 2009 may also be due to the fact that in July of that year the Government extended the full coverage of social security contributions to all short-time work cases lasting longer than six months, and so the financial incentive for firms to use training concurrently with short-time work was relatively less enticing. These explanations must of course be combined with the general improvement in the economic and labour market outlook.

[34] Training measures must be certified by the Federal Employment Agency.
[35] Bechmann et al. (2010).

C POLICY LESSONS AND CONSIDERATIONS

The costs and benefits of short-time work were shared…

An advantage of state-subsidized shorter working time is that it in some respects the costs are shared among workers, employers and government. For firms, while it to some extent reduces labour costs immediately, they must carry the burden of lower capital utilization and pay wages to people who would otherwise have been laid off, as well as additional wage-related expenses such as pensions and other social security contributions.[36] Bach and Spitznagel (2009) estimate that the remaining costs for firms amount to up to 35 per cent of the usual labour costs. For the state, there are the direct costs associated with the unemployment benefit payments and the indirect wage-related tax losses. Finally, employees themselves experience a reduction in their net income (see Chapter 4).

The benefits to these costs are of course multiple and equally shared as well. First, workers are able to maintain their employment and thus avoid the costs of unemployment. This is particularly relevant given the duration of the current crisis. Indeed, research indicates that unemployment spells – especially of a longer duration – reduce overall well-being. Subsidized shorter working time can also help to positively reinforce the employee–employer relationship. For firms, it avoids the costs associated with employee turnover (including hiring and training) so that they are able to ramp up hours worked in real time when aggregate demand returns – thus adding in many ways an element of flexibility. For governments, it avoids the social and economic costs of massive unemployment while instilling a sense of confidence in the macroeconomic situation. In addition, the relative improvement in the employment and income situation can support overall aggregate demand and tax revenues.

…with low displacement costs – at least initially…

One concern is the extent to which firms would have kept workers in any case, without government subsidies. Indeed, a certain amount of displacement can take place, as both viable and non-viable firms are supported

[36] Crimmann et al. (2009).

during the crisis. This is particularly relevant in the context of the current crisis in Germany where there exists several strategies to sustain employment levels by adjusting working time, but where only one – short-time work –received extra support. Therefore, although Figure 3.1 illustrates that several schemes lie behind the reduction in hours, it is likely that the use of the short-time work scheme may have crowded out the other non-subsidized schemes. Moreover, short-time work may only postpone employment loss rather than succeed in avoiding it entirely.[37]

However, an analysis of firms with short-time work arrangements reveals that only one-third of firms expecting sales increases took advantage of the short-time work programme which suggests that perhaps the displacement effects were limited (Table 3.2). Also, upwards of two-thirds of firms expected steady or rising employment levels for the forthcoming year, which suggests that the short-time work programme may have had some influence. However, it is too early to suggest to what extent the programme has stabilized employment. This is particularly relevant in the context of the mild recovery under way. Indeed, given that the bulk of the adjustment was in hours, during the upswing firms are likely to readjust similarly. In this respect, the employment intensity of growth will probably be lower and could exacerbate insider–outsider dynamics. In this scenario insiders were protected during the crisis, with considerable employment loss among temporary workers while the core workforce benefited disproportionately from the recovery.

Table 3.2 Establishments with short-time work in the first six months of 2009, by subgroup

Sales projections in 2009 compared to 2008	Projected changes in employment from June to 2009 to June 2010	Share (%)
Steady or increasing sales	Increasing	3*
	Steady	27 (+/-5.5)
	Decreasing	3*
Decreasing sales	Increasing	6 (+/-3.8)
	Steady	32 (+/-6.0)
	Decreasing	30 (+/-6.0)

Note: Weighted shares with estimated 95% confidence intervals for the number of establishments (taken from Fischer et al. (2008), p. 37.
* The number of establishments observed is too small. Only those establishments with information about projected sales or changes in employment from June 2009 to June 2010, and use of short-time work, are considered here (5 % +/- 0,5 of all establishments).
Source: Stops (2010).

[37] Mosley and Kruppe (1996).

The evidence presented in this chapter demonstrates that – unsurprisingly – German enterprises sustained employment levels beyond the necessary level to satisfy demand – in other words, they hoarded labour. This is witnessed by the significant declines in labour productivity (per worker and per hour), especially in the manufacturing sector.

This development was a product of a number of factors. During the period preceding the crisis, increased hours were worked via overtime, working time accounts, and so on, owing to the prevailing labour shortages at the time. As a result, there was considerable interest from the perspective of the firm in downsizing these measures in order to retain the existing qualified workforce. Indeed, half of the reduction in overall work hours was due to reduced average hours per week, declines in overtime and adjustment to working-time accounts. The adoption of these measures was facilitated by enterprise-level agreements – based upon social dialogue and consensus – which are an important feature of industrial relations in Germany. These measures were augmented by public subsidies in the form of support for the short-time work programme which accounted for close to a third of the working time adjustment.

As a result, the numbers of persons on short-time work rose dramatically – averaging over a million in 2009 compared to less than 100,000 in the years prior to the crisis. Already, as the German economy begins to recover, the incidence of short-time work has declined and employers are drawing on existing (underutilized) labour. And while there were costs associated with such policies they were shared across workers, employers and governments.

… but moving forward it will be important to monitor the employment content of growth.

The full effects of the measures are yet unknown and a number of challenges remain. First, even though the majority of firms taking advantage of short-time work have a positive outlook, there is a risk that the subsidies have only postponed the layoff process. Second, and similarly, support to unsustainable enterprises delays the overall structural adjustment process, which could affect overall productivity and competitiveness as well as weaken future employment prospects for workers who remain in declining sectors. Third, while employment levels have remained stable, a disproportionate share of the job losses has been borne by temporary workers. And as the recovery takes hold, firms will readjust hours worked for employees rather than hiring new workers. This means that the employment content of growth may be weak going forward and there is a risk of exacerbating labour market dualities. Some of these issues are taken up in more detail in Chapter 5.

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CHAPTER 4
SOCIAL PROTECTION: THE ROLE OF AUTOMATIC STABILIZERS

INTRODUCTION

The purpose of this chapter is to explain the role played by Germany's social protection system in mitigating the effects of the financial and economic crisis of 2008–09. Section A discusses how Germany compares to other countries in terms of social spending, and looks at how spending is allocated across the various components of the country's social protection system. Section B discusses the crisis-related changes that were made to social protection policies and programmes and how they supported individuals and households throughout the crisis. And section C notes some enduring policy lessons and considerations.

A SOCIAL PROTECTION IN GERMANY

The German social protection system is rather comprehensive in nature…

As early as the 19th century, the reforms of Chancellor Otto von Bismarck introduced national insurance programmes for workers' health and occupational accidents and also provided for an old-age and invalidity scheme. As a result of these reforms, Germany became one of the first nations to have a formal comprehensive social protection system in place. Subsequent reforms have built upon this foundation, including reforms following the Second World War during which time there was increased emphasis on linking social security to the market. These reforms fostered a complementary relationship between market competition and the provision of supplementary social protection by the state.

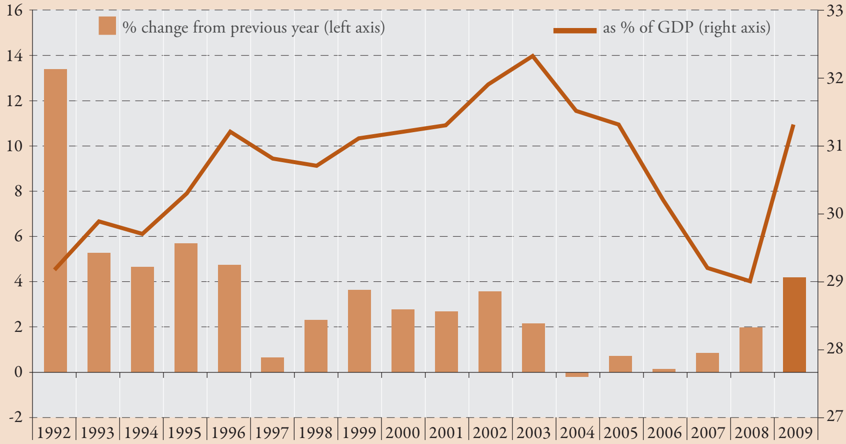
In the late 1990s and early 2000s, social spending in Germany increased rapidly but in parallel to strong economic growth; in the years preceding the crisis social transfers and spending stabilized considerably. With the onset of the crisis, however, social spending rose by more €30 billion to reach 31.3 per cent of Germany's GDP in 2009 (Figure 4.1, panel A). In comparison to other European countries, "social benefit spending" – which refers to transfers that are paid by the Government to individual households with the aim of alleviating financial burdens stemming from a number of risks and needs – is high in Germany.[38] In fact, in both 2008 and 2009, the amount Germany spent on social benefits as a percentage of GDP was the largest among EU-15 countries (Figure 4.1, panel B).

The vast majority (88 per cent) of benefits in Germany are non-means-tested (Figure 4.2). Yet the share of benefits that are means-tested was slightly above the EU-15 average of 11.4 per cent in 2006.[39] Social benefit transfers play an important role in alleviating poverty and lessening inequality, and they account for the majority of redistribution efforts in Germany.

[38] Social benefit spending in this context also includes any tax credits that are paid to households, which are treated as government expenditure in national accounts.
[39] Puglia (2009).

Figure 4.1 Social spending in Germany, 1992–2009

Panel A. Social budget percentage change from previous year and as a percentage of GDP



Source: Bundesministerium für Arbeit und Soziales, Sozialbudget 2009.

Panel B. Social benefits as a percentage of GDP in EU-15 countries, 2008 and 2009

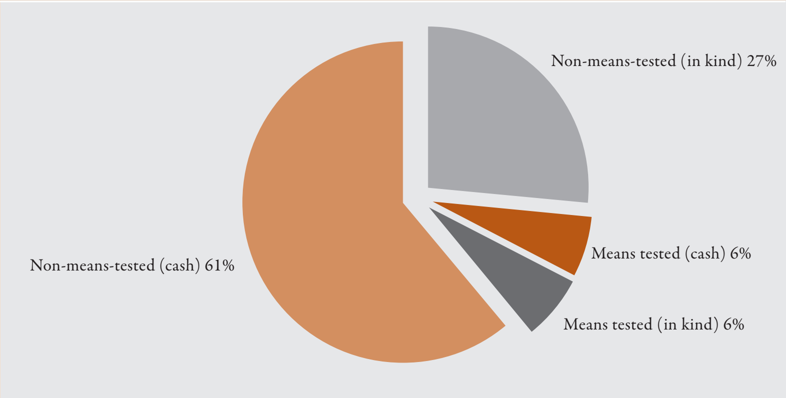
Note: Social benefits are defined as those benefits other than social transfers in kind, and social transfers in kind via market producers, payable. As such the figure differs slightly from the data presented in Panel A.
Source: EUROSTAT, Government Finance Statistics: Summary Tables (2010).

Similar to the situation in other OECD countries, social benefit transfers in Germany account for 75 per cent of fiscal redistribution, whereas taxes account for about 25 per cent.[40]

…with a range of various programmes to target different needs.

Social spending in Germany is comprised of (i) social insurance; (ii) systems of public service; (iii) special schemes; (iv) employer systems; (v) compensation systems; (vi) promotion and care systems, and (vii) tax benefits. Of these, social insurance represents the majority of spending, at 60 per cent of the total social budget in 2008. This tax-funded social insurance system includes five different insurance schemes in the areas of public health, long-term care, accidents, pensions and unemployment.[41] In Figure 4.3, panel A shows the breakdown of total social spending by category and panel B shows the breakdown for the social insurance system in particular.

Figure 4.2 Breakdown of Germany's social benefits, 2007

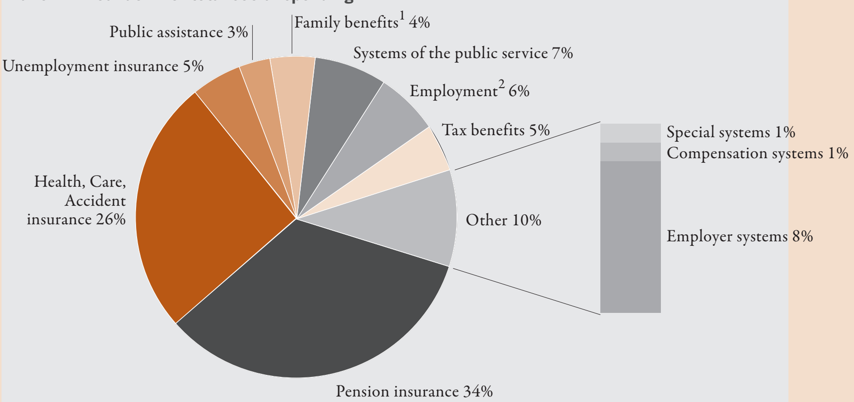


Note: Please note that total social protection expenditures include social benefits, administration costs and other expenditures.
Source: EUROSTAT, Table B3, Detailed breakdown of social protection expenditure, Germany.

[40] Data from Mahler and Jesuit (2006).
[41] Note that the Federal Ministry of Labour and Social Affairs bears only a portion of the social insurance system costs – mainly for the financing of pensions and unemployment insurance. The remaining costs for social benefits are financed out of general tax revenue collected by federal, state and municipal governments.

Figure 4.3 Composition of Germany's social spending, 2008

Panel A. Breakdown of total social spending



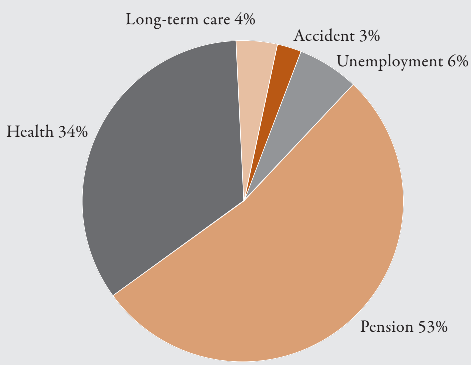
Notes:

[1] Includes Children's Allowance and Family Benefits, Child-rearing Benefits / Parental Allowance, Housing Allowance, and Children's and Youth Welfare.

[2] Includes Unemployment relief / other employment promotion, Promotion of education and training, Basic security benefits for jobseekers

Source: Statistisches Bundesamt Deutschland.

Panel B. Breakdown of social insurance spending



Source: Bundesministerium für Arbeit und Soziales, Sozialbudget 2009.

- *Pensions*: As in most advanced countries, in Germany pensions are an important category of expenditure in both overall and social insurance spending. Germany has a three-pronged system of pension insurance, consisting of compulsory government-run retirement insurance, private company plans, and private individual retirement investments. Statutory pension insurance is the most important welfare benefit for persons over the age of 65, comprising about two-thirds of all income received by this age group. Pensions alone account for over 52 per cent of redistribution in Germany (unemployment benefits account for 5 per cent, and other social benefits such as family allowance and child support account for 17 per cent). Approximately one-third of the public social spending goes towards pensions, owing to the high number of claimants and earnings-related public pension entitlements. Government spending on pensions represented approximately 12.1 per cent of Germany's GDP in 2008.[42]
- *Health, care, and accident benefits*: The second largest social expenditure category is comprised of health, long-term care and accident insurance benefits, which constituted approximately one-quarter of total social spending and about 7.7 per cent of Germany's GDP in 2008.
- *Unemployment and labour market*: Germany has two separate schemes of assistance for the unemployed and recently laid-off workers: an insurance-funded system (UB I), and a fully tax-funded system (UB II). Both benefit schemes are intended to provide a certain level of income support to persons who have lost their jobs. The UB I, managed by the Federal Employment Agency, is only available for a limited duration. The UB II was introduced in 2005 by merging the unemployment aid with social assistance in order to assist jobseekers who are not entitled to the UB I.[43] Unemployment benefits through the social insurance system constituted 5 per cent of social spending in 2008. In addition, there are other employment-oriented benefits which constituted about 6 per cent of spending. These include basic security for jobseekers; funds for the promotion of education and training; and other employment promotion benefits.

[42] Bundesministerium für Arbeit und Soziales: Sozialbudget 2009 [Social Budget 2009], 2009a.
[43] Bundesministerium für Arbeit und Soziales: Monatsbericht [Monthly Report] (Aug. 2010), p. 76.

Both UB I and UB II are designed to promote rapid reemployment and reintegration into the labour market by creating incentives and obligations for the unemployed. There are counselling and training elements to assist with job searches, and there are also sanctions if recipients refuse jobs or training offers.

- *Public assistance*: Public assistance was introduced in 1962 in order to provide assistance to those without a social insurance entitlement or those without an indirect insurance benefit entitlement (such as homemakers or widows). The public assistance programme of means- and income-tested benefits includes cash transfer payments to individuals to help them secure and maintain their basic livelihood. The main reason for receiving public assistance is unemployment. Around 15 per cent of unemployed claimants also receive a regular public assistance cash transfer. Public assistance programmes have been increasing since 2005, and some new benefits have been introduced, including guaranteed minimum benefits including social assistance for those living outside institutions; basic security in old age and disability; and assistance for asylum-seekers. Public assistance represented 3.1 per cent of the social budget and 0.9 per cent of GDP in 2008.
- *Child and Family benefits*: Within the German social protection system considerable support is provided to families with children.[44] The Child Benefit (Kindergeld) is the most important family benefit: it is universal and is paid for every child under 18 years of age (up to 25 years of age if the dependant is still in education). If the child is unemployed, the benefit is paid up to the 21st year. There is no age limit to payments for disabled children. The Child Benefit is paid monthly together with wages and social benefits. It is integrated in the tax system, so that monthly payments can be regarded as an advance tax credit payment. Child and Family benefits (Kindergeld und Familienleistungsausgleich) constituted 8.4 per cent of social spending in 2008. This includes parental benefits and children and youth services (Kinder- und Jugendhilfe) in addition to the Child Benefit.

[44] This is also reflected in the tax system design. The wages and earnings-replacing social insurance payments as designed in the past were meant to cover the needs of a family with children. Such policies still continue to support families with children. However, with the changing patterns of families (increasing numbers of unmarried couples with children, single parents, etc.), the programme design has been changed.

B RESPONDING TO THE CRISIS

Automatic stabilizers therefore played a considerable role in mitigating the effects of the crisis…

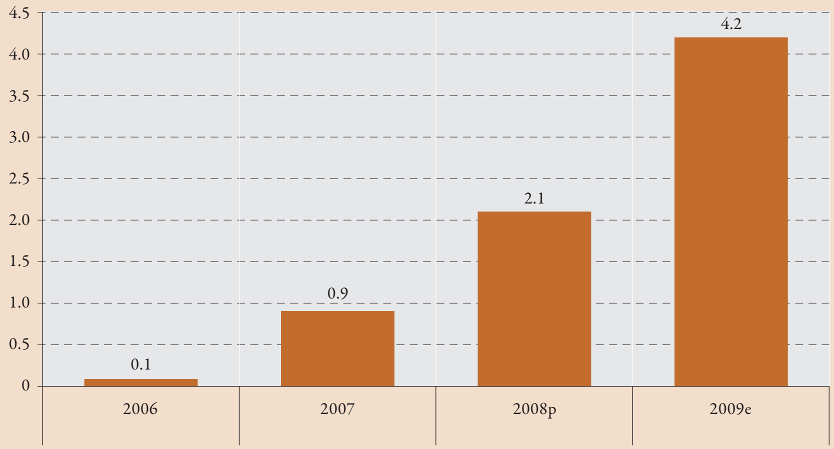
Automatic stabilizers are elements of fiscal policy which mitigate output fluctuations without discretionary government action, i.e. no new legislation needs to be passed, so the measures can start working immediately. Correspondingly, as recovery starts and income increases, automatic stabilizers are reversed. Automatic stabilizers can provide as important a contribution to demand stabilization as active fiscal policy measures. For the G20 advanced countries, automatic stabilizers were estimated to amount to 0.4 per cent of GDP on average in 2008 and 1.6 per cent in 2009.[45] Germany's automatic stabilizers played a significant role in lessening the negative social impacts of the financial crisis. The OECD estimates that they were at least three times more important than the fiscal stimulus packages that Germany put in place.[46] Automatic stabilizers are estimated to have had a fiscal impact of 2.5 per cent of GDP in 2009 and in 2010.

This section looks at how some social policy measures were augmented in response to the crisis. Overall, Germany's social budget increased by €30.5 billion in 2009 compared to 2008 – a 4.2 per cent increase year-on-year (Figure 4.4). The changes in overall social spending are discussed first, and then the reforms to unemployment benefits, other labour market supports, child and family benefits, and pensions are examined in greater detail.

About 80 per cent of the social spending increase can be attributed to social insurance, while about 20 per cent went toward the benefits in the Promotion and Care Systems category (Förder- und Fürsorgesysteme) – although some particular measures within these two broad categories did experience reductions in 2009 (see below). Figure 4.5 presents the

[45] IMF (2009).
[46] http://www.oecd.org/dataoecd/3/62/42421337.pdf

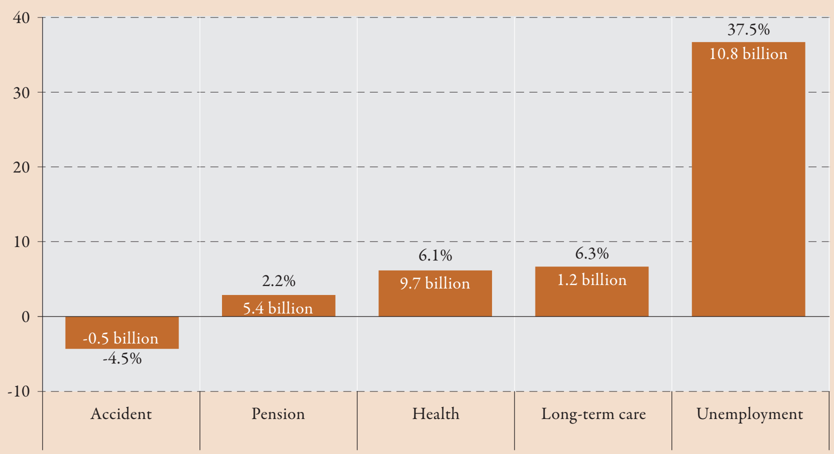
Figure 4.4 Changes in total social budget in Germany compared to previous year, 2006–09 (percentages)



Note: 2008p = provisional; 2009e = estimated.
Source: Bundesministerium für Arbeit und Soziales, Sozialbudget 2009.

breakdown of the spending changes within social insurance. With the exception of accident insurance, all other categories of social insurance spending witnessed significant year-on-year increases in spending, ranging from 2.2 per cent in pensions (€5.4 billion) to more than 37 per cent on unemployment benefits (€10 billion).

Figure 4.5 Change compared to previous year in spending on components of social insurance, 2009 (percentages)



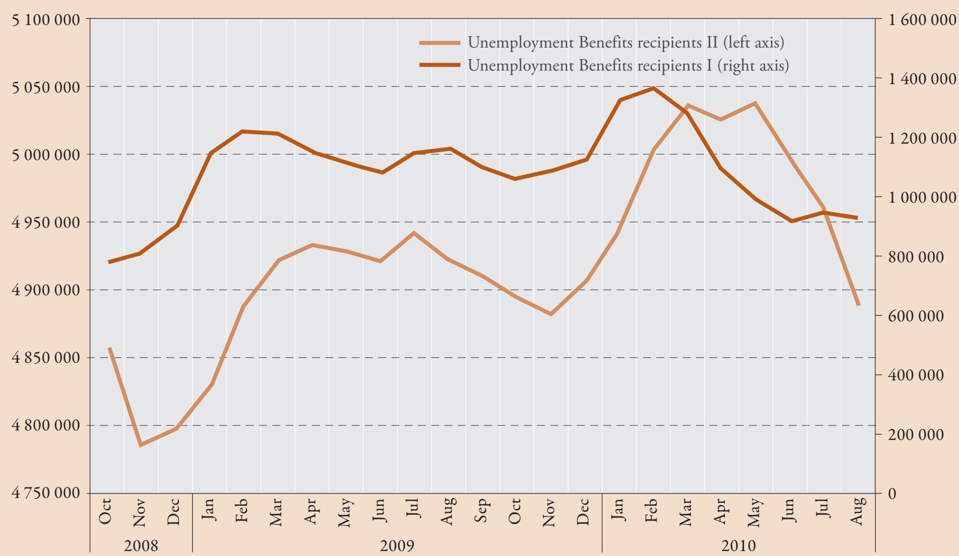
Source: Bundesministerium für Arbeit und Soziales, Sozialbudget 2009.

… especially unemployment benefits for jobs losers…

As witnessed by the strong increases in spending, the unemployment benefit system is a key automatic stabilization mechanism. The number of people receiving Unemployment Benefit I (UB I) increased rapidly during the last months of 2008 at the peak of the financial and economic crisis, reaching 1.2 million in March 2009. It has fluctuated ever since, falling below 1.1 million in June 2009, but increased rapidly in January 2010 to reach a peak of 1.4 million in February 2010. Since that time the number has fallen to reach around 0.9 million in August 2010 (Figure 4.6). However, the number of people receiving unemployment benefits has not yet decreased to the pre-crisis level of under 0.8 million.

The number of unemployed receiving Unemployment Benefit II (UB II) also began to increase during the peak of the crisis, reaching 4.9 million in July 2009.[47] It then decreased to slightly over 4.8 million in November

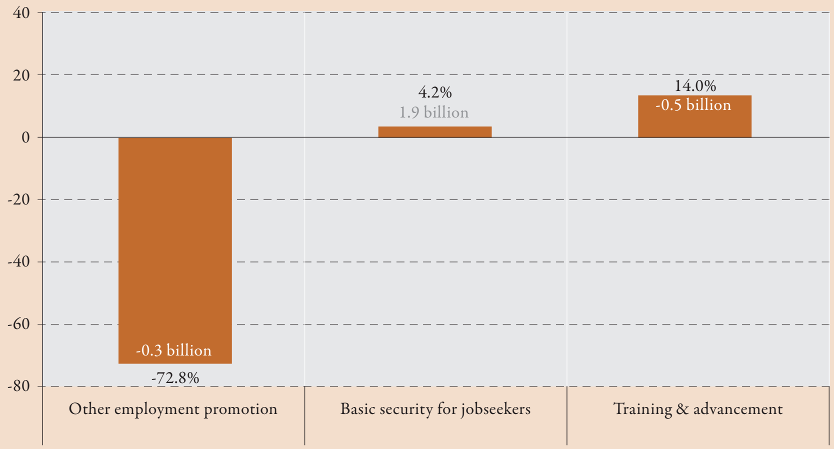
Figure 4.6 Number of recipients of Unemployment Benefit I and II in Germany, 2008–2010



Source: Bundesministerium für Arbeit und Soziales, Monatsbericht, August 2010.

[47] The category "Unemployed" covers people who are fit to work. Some beneficiaries may be receiving both UB I and UB II, and not all those receiving UB II are considered unemployed in the strictest sense according to ILO definitions.

Figure 4.7 Spending on other employment benefits in 2009
(change from 2008)



Source: Bundesministerium für Arbeit und Soziales, Sozialbudget 2009.

2009, only to increase once more in December 2009, reaching a historic high of 5.04 million in May 2010. The fact that the UB II scheme followed a similar but delayed trajectory as the UB I suggests that some claimants shifted over to UB II when their UB I eligibility was exhausted.

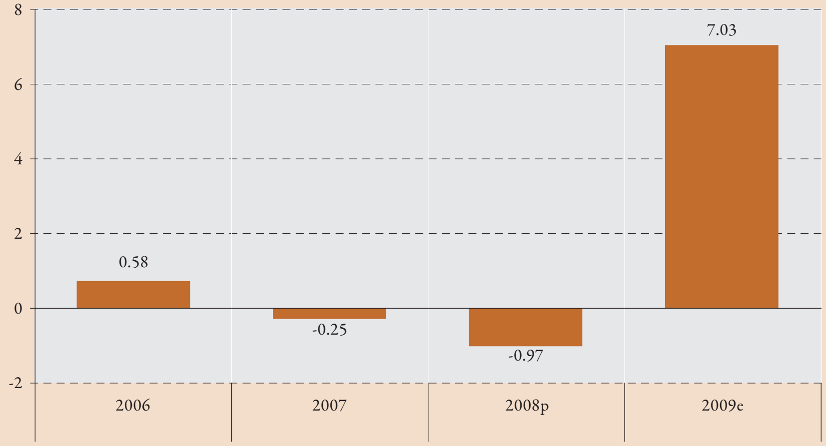
… but also a series of child and family benefits…

Approximately 20 per cent of the budget increase for social insurance spending went toward the benefits in the Promotion and Care Systems category, which includes discretionary spending for social assistance for the unemployed (as distinct from unemployment insurance benefits which are based on employee contributions and are time-bound) along with Child and Family benefits. With respect to the former, spending increased by €1.8 billion in 2009 – the bulk of which was due to an additional €1.9 billion for basic security for jobseekers (Figure 4.7). Spending for employment assistance and employment promotion actually shrank markedly in percentage terms (-72.8 per cent) but represented only €0.3 billion. The budget for training and advancement grew by 0.2 billion – an increase of 14 per cent over 2008 levels.

An additional €2.3 billion was allocated to the category Child and Family benefits in Germany's second and third fiscal stimulus packages. The monthly allowance per child was increased in 2009. The Child Benefit was further increased in 2010. In addition, the tax-deductible amount per child was increased in 2009 and 2010 (see Chapter 2 for benefit amount changes). In addition to these changes, the Government also gave a one-time child allowance of €100 per child for all households that receive Child Benefit. The Government spent €36.7 billion on the Child Benefit in 2008 and this increased to €39.3 billion in 2009 – a 7 per cent increase (Figure 4.8). In 2009, the households of approximately 15 million children received this benefit.

According to the budget plans, the Family Ministry's budget increased considerably from €34.21 billion in 2006 to €53.9 billion in 2008.[48] It is estimated that these policy changes will have cost the Government an additional €4.3 billion in 2010 and a further 4.5 billion in 2011. In 2009, there were 8.87 million families (including 14.6 million children) receiving family allowance assistance, compared to 8.95 million families (representing 14.7 million children) in 2008.[49]

Figure 4.8 Child and Family benefits spending, 2006–2009
(percentages)



Note: 2008p = provisional; 2009e = estimated.
Source: Bundesministerium für Arbeit und Soziales, Sozialbudget 2009.

[48] Bundesministerium der Finanzen (2006).
[49] Bundesagentur für Arbeit und Soziales (2009b).

… and income stability for pensioners.

Unlike in other OECD countries, the German pension system has not been strongly affected by the crisis, and public confidence in private pensions remains high.[50] This stability comes as a result of the many layers of protection to occupational and personal pensions that the German Government has sought to provide, as well as the adoption of a conservative approach to investments. However, the Government further tried to protect pensioners by issuing an "extended pension guarantee" in June 2009, which guaranteed that benefits would not decrease in 2010, regardless of the adjustment rule in place based on gross income. This pre-existing adjustment rule would have meant that pension levels in the west German states would decline by 2.09 per cent in 2009 and by 0.54 per cent in the east German states. But the extended pension guarantee stipulated that individual pension benefits within the public pension scheme would not decline in 2010, notwithstanding the adjustment rule as it is currently legislated. Given that approximately 20 million people in Germany are pensioners, this policy had a wide-reaching impact.

[50] OECD (2009).

C POLICY LESSONS AND CONSIDERATIONS

By increasing social spending and reinforcing its social protection system during the crisis, the German Government provided its citizens with safeguards to maintain high standards of living relative to its European counterparts, despite the increasing risks of unemployment and poverty. Indeed, this chapter has shown that Germany's automatic stabilizers and social assistance policies bolstered the country's capacity to weather the financial and economic crisis. In total, there was a 2-percentage-point increase in social benefit spending as a share of GDP.

Against this backdrop of a strong social protection system, the most common responses to the crisis were modifications of existing programmes. These were made with a view to preventing – and successfully in the case of Germany – the higher structural unemployment that had occurred in past recessions.[51] However, a reduction in the social security budget – in the order of €3 billion – is anticipated for 2011.[52] Of course, once the recovery is under way it is to be expected that there will be a natural stabilizing effect of social spending. But in light of the fragile economic recovery, there may be scope for more targeted programmes to address specific vulnerabilities such as labour market integration and skills training – issues explored in Chapter 5.

[51] ILO (2010), p. 132.
[52] Zipfel (2010).

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CHAPTER 5
POST-CRISIS POLICY CHALLENGES

INTRODUCTION

As the previous chapters have demonstrated, employment in Germany has remained resilient in proportion to the significant drop in output — in 2009, employment fell 0.2 per cent compared to the 4.7 decline in GDP. At the heart of the recovery was the interaction between well-designed employment, social and economic policies. Moving forward, however, a number of structural issues merit careful consideration.

Among the policy challenges confronting Germany is the issue of promoting inclusive growth in the immediate term as firms draw upon existing labour supply. In the medium term, however, more fundamental reforms will be required to improve the labour force participation of key groups, in particular women and older workers, in an effort to mitigate the decline in the working-age population. Part of the strategy to encourage greater labour force engagement also lies in making sure that future gains in productivity are matched by wage improvements. The challenge going forward is how to ensure that wages grow in line with productivity without undermining the competitiveness of German firms. And lastly — and not unrelated — is that firms (particularly SMEs) are financially constrained and pay higher lending rates than anywhere else among the advanced EU countries. This has stunted entrepreneurship development and employment growth. As Germany strives to balance the budget by 2016, fiscal consolidation efforts of €11.2 billion are expected for 2011— one-third of which is expected to come from changes to policies and programmes delivered by the Ministry of Labour and Social Affairs. Therefore, good policy design lies at the heart of how to address these challenges in light of the fiscal constraints. Each of these issues is addressed in more detail in the sections that follow.

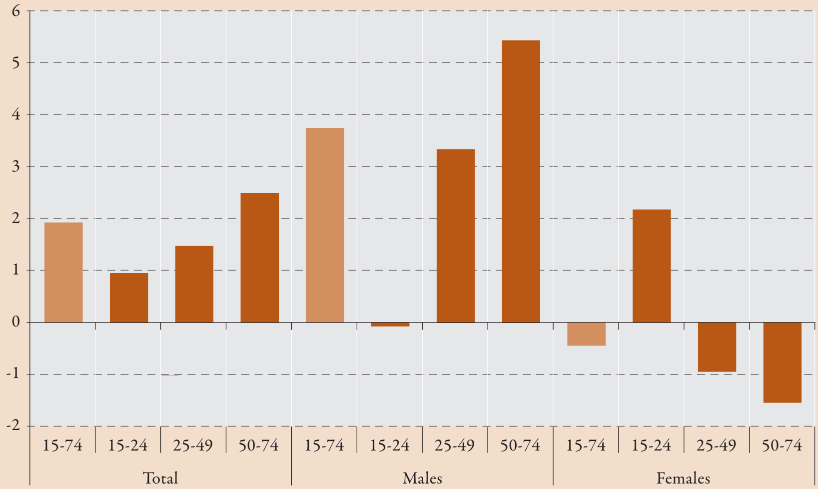
A JOB-RICH AND INCLUSIVE GROWTH

Moving forward, it will be important to promote the employment-content of growth…

Germany's short-time work (Kurzarbeit) programme, and other related working-time adjustment mechanisms, has been a major contributor to its relatively low unemployment rate. However, despite Kurzarbeit's utility in preventing layoffs, as economic activity returns there a number of pitfalls. In particular, these schemes tend to reduce the rate of hiring as firms adjust to the increase in activity by increasing hours worked. This is particularly harmful for the long-term unemployed or low-skilled workers, as it can further delay their reemployment. As a result, despite falling unemployment levels the share of long-term unemployed in Germany remains comparably high. In fact, despite the reductions in the number of long-term unemployed – unemployed for more than a year – leading up to the crisis, there are signs of an increase in the past two years, for example by 27.5 thousand workers from quarter one 2009 to the same quarter of 2010. Male workers have been most affected by this trend – in the same period, the number of long-term unemployed increased among males by 55.4 thousand. In total, 1.4 million people were long-term unemployed in Germany by Q2 2010, which amounts to 48.5 per cent of the total unemployed. This is all the more worrying given that close to one-third of the unemployed have only primary education and roughly 56 per cent has attained secondary education; which will increase the difficulties in reintegrating them to the workforce.

The incidence of long-term unemployed in total unemployment, however, has decreased since the beginning of the crisis. Yet, compared to a year ago, rates have started to increase – by 1.9 percentage points – probably due to a weakening in labour market programmes (Figure 5.1). The rise in the incidence of long-term unemployment is more worrying when analysing older and male workers. Among workers aged 50–74 years, rates increased by 2.4 percentage points in the

Figure 5.1 Change in the incidence of long-term unemployment in total unemployment between Q2 2009 and Q2 2010, by age group and sex (percentage points)



Source: EUROSTAT.

four quarters to Q3 2010; and among male prime-age workers and older workers the increase reached 3.3 and 5.4 percentage points, respectively. What is more, relative to the EU-27, Germany was the country with the tenth highest incidence of long-term unemployment – at 47.6 per cent in Q3 2010. Further, the long-term unemployment rate in Germany is 6.7 percentage points higher than that of the average for the EU-27.

…by providing necessary job-search support and training initiatives.

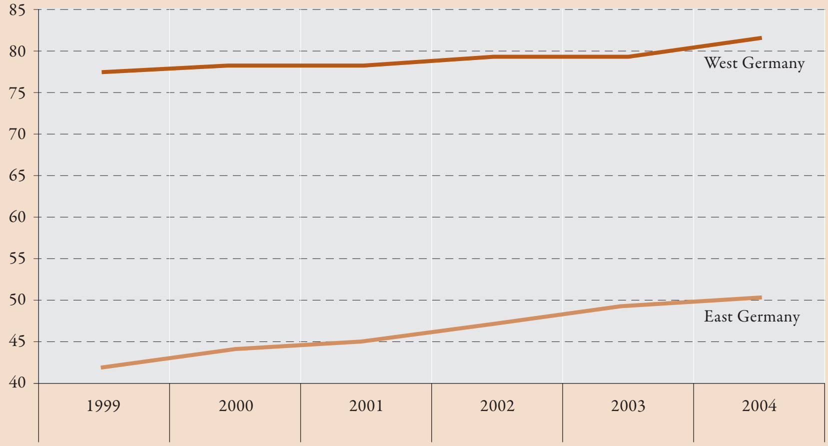
In the short term, active labour market policy needs to ensure that these long-term unemployed receive the right placement services and other support to avoid the risks posed by an increase in inactivity and also to prevent skill erosion. Government policies that might be of help in addressing this challenge include: (i) public employment services that are able to adjust their capacity to a larger workload; (ii) enhancing active measures such as training, hiring subsidies and mobility support.[53] In addition to the obvious

[53] OECD (2010).

social advantages of integrating unemployed workers, maintaining a qualified labour supply will be especially important when the economy recovers fully and the labour shortages that characterized the German labour market prior to the crisis begin to be felt again. However, the German Government has recently adopted a fiscal consolidation strategy – more than a third of the cuts are to come from the programmes delivered by the Ministry of Labour and Social Affairs. This means that the design of cost-effective measures will have to be carefully considered; this is especially relevant since close to three million unemployed workers are receiving some form of unemployment benefit. In this respect, a continuation of a number of policies and programmes in certain areas merit consideration:

- *Continuing to improve unemployed/client ratio within the PES*: The efforts to recruit additional staff in an attempt to improve the effectiveness of service delivery to unemployed persons was a welcome step. The new law for UB II aims to achieve a ratio of 1 to 75 for jobseekers under 25 years of age; 1:150 for those above 25 years is also a move in the right direction. It will be important to monitor these developments to ensure effective delivery of services to those most at risk among the unemployed.
- *Closing the gap between west and east through skills development*: Disparity in productivity between workers in west and east Germany is due to a number of reasons, including structural issues regarding the activities of east Germany firms – for example, they are often smaller and concentrated in the public sector rather than in manufacturing. However, in some cases it is also a result of low human capital, lack of necessary skills, and lack of technical expertise to run the businesses (Figure 5.2).

Figure 5.2 Differences in productivity between west and east Germany, 1999–2004
(value added per full-time employee, thousands)



Note: Value added per employee is calculated at 1995 prices.
Sources: Federal Statistical Office; IMF.

- *Reinvigorating training initiatives*: Skill requirements have changed over the past two years at the same time as unemployment has caused the erosion of skill sets. Greater utilization of training support for unemployed workers is urgently needed. Importantly, over the course of the crisis the Government allocated a significant amount of resources for training, much of which went unused. For example, of the €150 million additional resources to PES for training, only €35 million was used. At a minimum, the Government should leave the funding for these measures in place; efforts are also needed to improve the delivery and effectiveness of training programmes, perhaps by leveraging private–public partnerships.

B REVERSING THE DECLINE IN LABOUR SUPPLY

The problem of a decreasing labour supply in Germany has been pending for some time now. The unprecedented support by firms in sustaining employment levels, going beyond the incentives provided by the Government (see Chapter 3) can be partly attributed to this. Indeed, a number of measures were put in place before the crisis to address the economic limitations of the prevailing labour shortages at the time, so that when the crisis broke firms reacted quickly by decreasing the number of hours worked and even hoarding labour. There was considerable interest from the perspective of firms in downsizing the measures put in place before the crisis in order to retain an existing and qualified workforce.

And while the urgent challenge will be to absorb all the current labour market slack, in the medium term it will be important to address the declining labour force which will affect overall growth patterns and productivity.

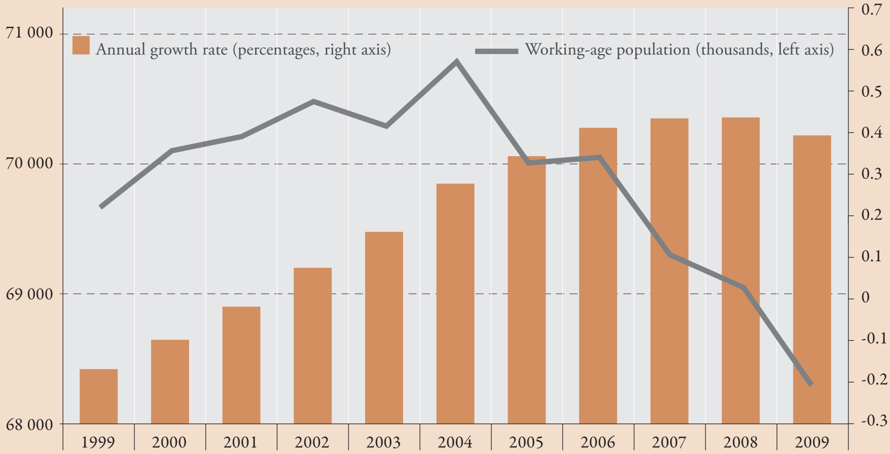
Over the medium term,
the challenge is to address the declining labour supply.

The growth rate of the working-age population in Germany (Figure 5.3, Panel A) had been slowing for some time before it started to fall in 2004. In 2009 growth turned negative, and as a result the expansion of the labour force has been sluggish and has been affecting the ability of firms to find enough suitable workers.

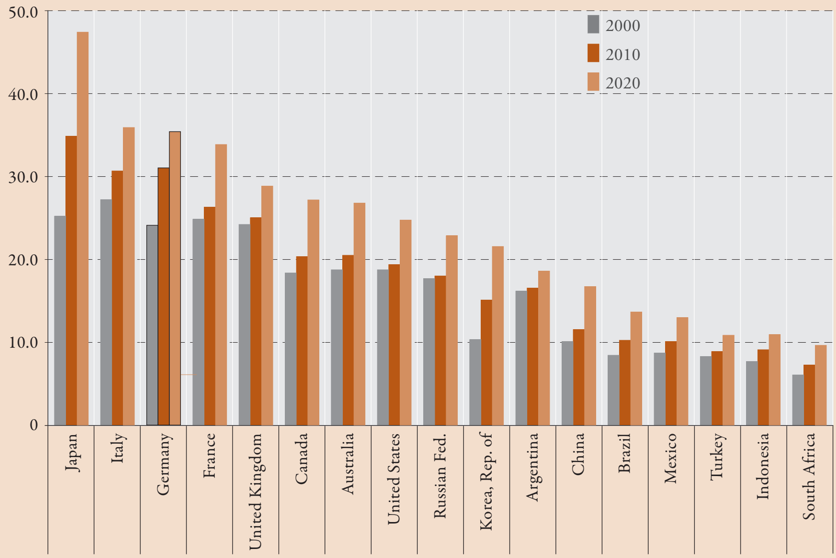
The fact of an ageing workforce raises a number of other concerns such as the imminent challenges for the pension and social security systems to provide for a significantly older, non-working population. According to the dependency ratio – which measures the portion of the workforce composed by those who are 65 years old and above – the prospects for Germany are worrying (Figure 5.3, Panel B). Among the G-20 countries Germany has the third highest dependency ratio (after Japan and Italy) and is estimated

Figure 5.3 Evolution of the working-age population in Germany, 1999–2009; and dependency ratios in selected G-20 countries, 2010 and 2020 projections

Panel A: Evolution of the working-age population in Germany, 1999–2009



Panel B: Dependency ratios* in selected G-20 countries, 2010 and 2020**



Notes:
*The dependency ratio is defined as the share of the eldest (65+) in the total working-age population.
**Projections.
Sources: IILS calculations based on ILO LABORSTA and EUROSTAT databases.

to experience the second highest increase over the next decade. By 2020 the dependency ratio in Germany is expected to increase by 11.4 percentage points from its level in 2000.

Another important concern linked to the ageing of the workforce is the lower level of qualifications among prime-age workers aged 40-59, i.e. next generation of older workers, compared to current older workers. For example, the share of tertiary education among workers aged 40–59 is less than 30 per cent in 2010 while it rises to over 34 per cent among workers aged 60-64. This gap in qualification may add a new factor to the challenge of a declining labour supply and existence of skill shortages.

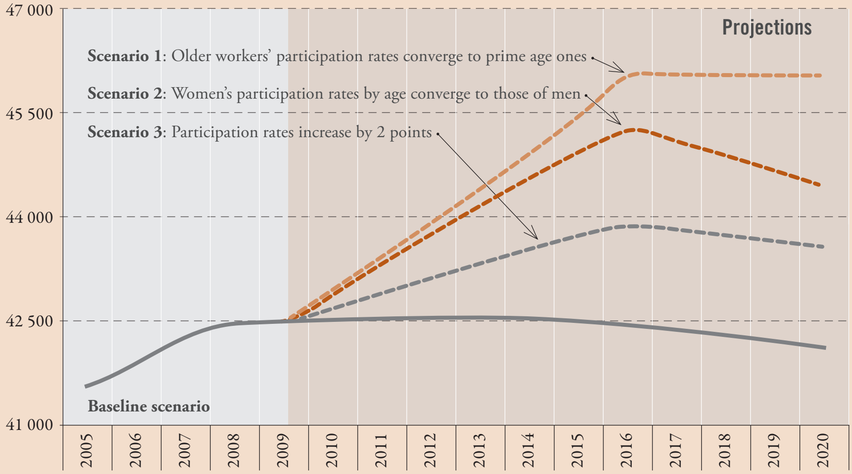
With this in mind, three alternative scenarios have been estimated to show the effects that different policies would have on increasing labour supply (Figure 5.4, Panel A).[54] A number of interesting results arise from the analysis:

- The first finding is that efforts to increase the participation rates of older workers (55–64 years) – scenario 1 – are the most effective measure in accelerating labour force growth. According to the analysis, raising older workers' participation rates gradually to the rate of workers aged 35–44 would increase the labour force by 8.3 per cent from 2010 to 2020. Moreover, this is the only scenario able to keep up with the sharp drop in working-age population expected from 2016 onwards.
- Scenario 2 tests the effect of an increase in women's participation rates to converge to men's (gradually and by 5-year age group). The analysis shows that raising women's participation rates would be almost as effective as raising older workers' rates during the first three years. The impact, though, slowly decreases afterwards and proves to be ineffective in offsetting or reducing the pervasive effect of a falling population. This measure would raise the labour force by 4.6 per cent over the next ten years.
- Scenario 3 shows that attempts to raise overall average participation rates would boost labour supply growth by 2.5 per cent over the next decade.

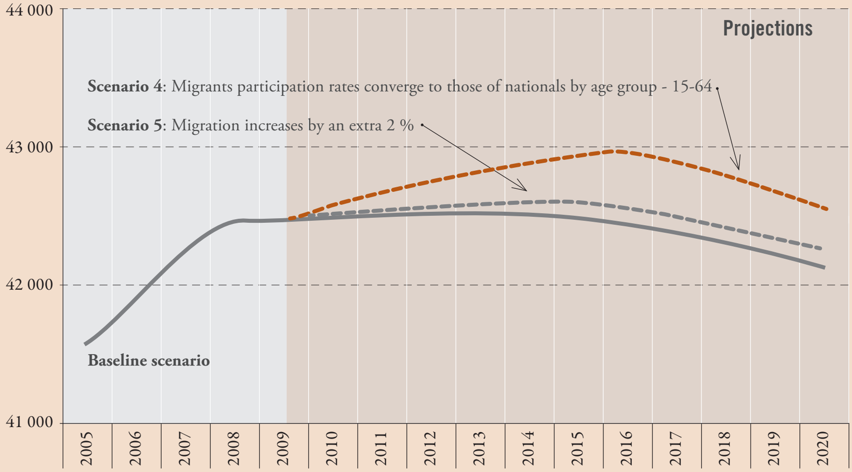
[54] The baseline scenario depicts the estimated labour force based on the projected decrease in the working-age population, as discussed above.

Figure 5.4 Labour force outlook, 2005–2020*

Panel A: Participation rate scenarios



Panel B: Migration scenarios



Note: A break in series in 2004 does not allow for an analysis of trends prior to 2005.
Source: Own calculations based on ILO, EAPE and EUROSTAT database.

- Finally, policies linked to migration prove to be the least effective in increasing the labour force supply (Figure 5.4, Panel B). An increase in migrants' participation rates – to match participation rates of nationals, by age group (scenario 4) – would raise the labour force by a mere 0.2 per cent in 2020. In addition, an increase in the stock of migrants is even less effective (scenario 5). Doubling the current annual inflow of migrants would barely increase the labour force.

…while there is no easy solution to the labour supply challenges, employment policies play a central role in a comprehensive strategy.

Clearly, no one policy option is a panacea — indeed, what is needed is a comprehensive approach. Yet the analysis demonstrates that efforts can in fact lead to growth in the labour supply — with the right mix of policies. Each of these groups, however, faces a unique set of barriers:

Raising older workers' participation rates: In Germany, many older workers withdraw from the labour force well before reaching the retirement age of 65, with participation rates tailing off dramatically within the age group 60–64. In fact, participation rates of persons in this age group are 45 percentage points lower than for persons aged 50–54 — one of the highest gaps in advanced economies.

The Parliament adopted a law in 2007 that increases the retirement age from 65 to 67, effective from 2012. In addition, as of 2008, Perspektive 50 plus – a federal programme of the Ministry of Labour and Social Affairs – is designed, via employment pacts for older people in the regions, to improve the employment prospects of the older long-term unemployed. Indeed, pension reform on its own is not sufficient. A recent study of 12 OECD countries – including Germany – demonstrates the important role of labour market policies and conditions – rather than supply-side pension reforms – in explaining labour force participation of older workers.[55] As such, while

[55] O'Brien (2010).

the initiatives of Germany are certainly welcome, a more comprehensive strategy is required, one that takes into consideration that the barriers older workers face to increased labour force participation are multiple, ranging from disincentives to work longer, reduced work capacity and negative stereotypes, to skills erosion and lack of lifelong learning.

Raising women's participation rates: In 2009, 53 per cent of women were active compared to close to 67 per cent among men – a 13.6 percentage point difference. The gender wage gap has been discussed extensively in the context of Germany; a wage difference of about 18 per cent in monthly gross income exists between full-time employed women and men, with only two-thirds of the difference attributable to factors such as education, experience, motherhood and other structural characteristics. However, other issues seem to be more relevant, notably the challenges to work–life balance and the lack of childcare support for parents reentering the labour market. Although parents have had a legal claim since 1996 to an available place in a (half-day) childcare institution (Kindergarten) for children between the ages of 3 and 6 years old, only about 20 per cent (by March 2009) of children between the ages of 0 and 3 had a place in a Kindergarten at the beginning of 2009.[56] This represents a 13 per cent increase – an important improvement from the year before. However, a long leave of absence after a child is born is still unavoidable for many parents. More efforts are needed to improve the social infrastructure that allows for the simultaneous pursuit of career goals and family desires, in particular an increase in the number of childcare institutions catering especially to younger children (1–2 years old) and for full working days. A new government initiative to improve the provision of childcare for children less than 3 years old will be effective from 2013 and aims to increase the day-care rate to 35 per cent. This is a welcome change yet the ratio may need to increase further – and substantially – to have a considerable effect in women's participation rates.[57] A 2010 study by the Deutsches Institut für Wirtschaftsforschung (DIW) shows that an increase in childcare institutions would have a higher impact

[56] Federal Statistical Office.
[57] The day-care ratio of 35 per cent is still substantially below the 42.4 per cent ratio of children less than three years old enrolled in day care facilities in Eastern Germany in 2008 (Vogler-Ludwig et al., 2009)

on the labour market that an increase in child benefits.[58] Furthermore, policies that support and facilitate the return of mothers to the labour market need to be improved. Examples include the support of temporary part-time agreements and the promotion of telecommuting.

The second limitation stems from excessive taxation, which lowers the financial incentives of single parents and second earners in joint families to pursue their careers. In Germany there is a "splitting rule" through which the income of the two parents is added and divided by two. The applicable tax rates are then applied to each half, reducing the total amount of taxes to be paid, especially when wage differentials are high. But the splitting rule also means that any additional income by the lower earner – usually the woman – is taxed at a higher marginal rate, which becomes a disincentive to go back to work after maternity leave. Likewise, sole earners also face weak financial incentives to work. According to an OECD study (2007), single parents earning below 65 per cent of the average wage face an 80 per cent effective tax rate, the highest among OECD countries. This means that after taxes are paid, and taking into account the benefits lost by working, single parents would be left with only one-fifth of their salaries. As such, measures that depenalize joint and single parents' income taxation are another possible means of raising female participation in the labour force.

[58] An increase in childcare infrastructure would have a particularly significant impact on the higher participation of women who have children between 0 and 3 years. Women with high educational background are expected to benefit most from such a policy, either by having children or by returning to the labour market. On the contrary, an increase in child benefits would have no direct effect on labour market projections but the probability of giving birth would rise marginally – with the strongest effect on women who already have children and who have a relative low level of education (DIW, 2010).

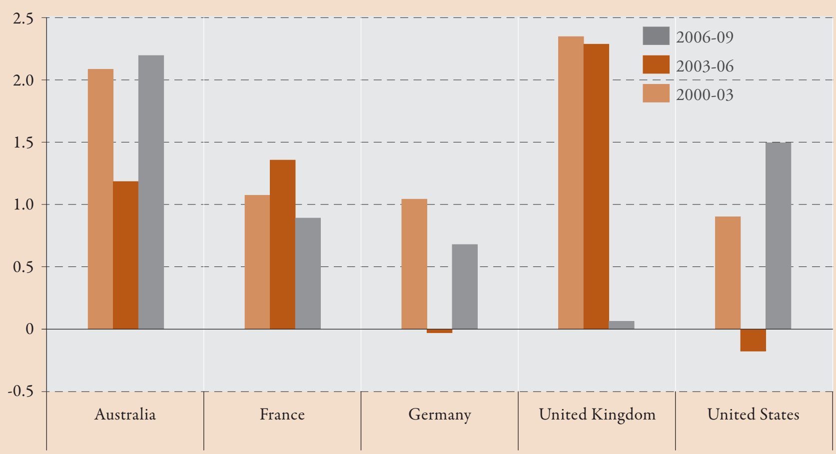
C NARROWING THE GAP BETWEEN WAGE AND PRODUCTIVITY GROWTH

Real wage growth and disposable income in Germany has fallen behind…

Among countries with available information, real wage growth in Germany in the years preceding the crisis (2003–2006) was actually negative – only the United States had lower wage growth over this period (Figure 5.5). Similarly, during the crisis period (2006–2009), the average growth rate of hourly wages in Germany (0.7 per cent) was among the lowest rates when compared to the other countries analysed, with the exception of the United Kingdom.

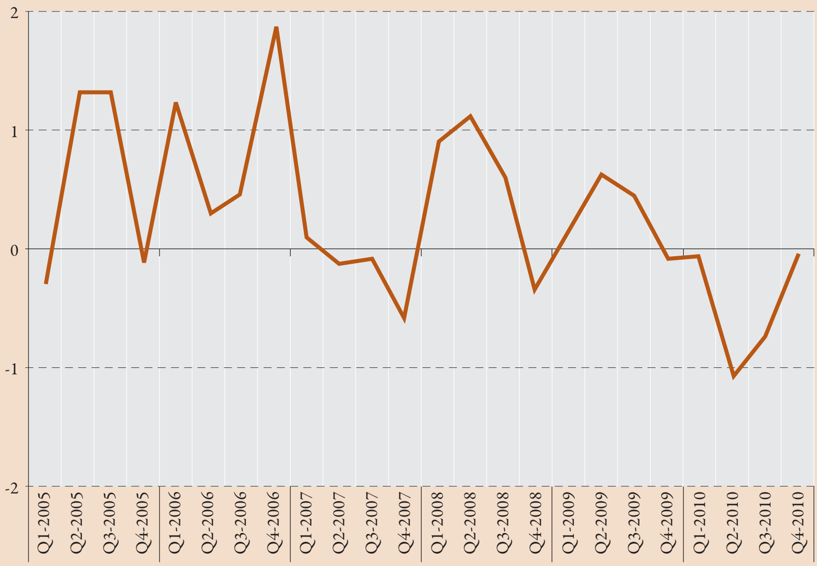
Moreover, real household disposable income has fallen (Figure 5.6). The growth rate of disposable income started decelerating in the second quarter of 2009 and by the beginning of 2010 had turned negative. Disposable income effectively decreased by more than 1 per cent in the four quarters to Q2 2010, with further falls expected in the second half of 2010. It is important to note that the calculation of disposable income takes into account net

Figure 5.5 Annual average real wage growth, selected countries, 2000–03, 2003–06 and 2006–09 (percentages)



Note: Wages correspond to hourly private sector wages.
Source: OECD, Olisnet indicators.

Figure 5.6 Real household disposable income, growth rates Q1 2005–Q4 2010*
(year-on-year percentage changes)



*Values estimated for the second half of 2010.
Source: OECD, Olisnet indicators.

transfers and social benefits,[59] which increased during the crisis. The decline in real household disposable income in Germany is due in part to the reduction in the number of weekly working hours – as discussed above.

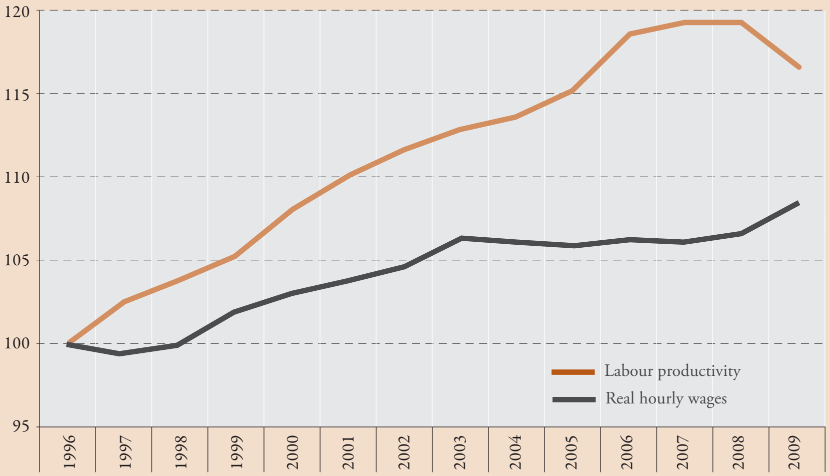
…with the gap between wage and productivity growth widening in recent years.

There is already a large gap between wages and productivity in Germany. Real wages have been growing slower than productivity since the 1990s, and the gap widened from 1999 onward when wage growth began to slow further while productivity growth accelerated slightly (Figure 5.7, panel A). The situation worsened in 2003, when wages flattened and remained depressed until the beginning of the 2008 crisis.[60] Since 2008, the tendency was reversed; declines in labour productivity accelerated while real wages per hour increased – probably due in part to the fact that wages were compensated for workers' reduced hours and output (Figure 5.7, Panel B).

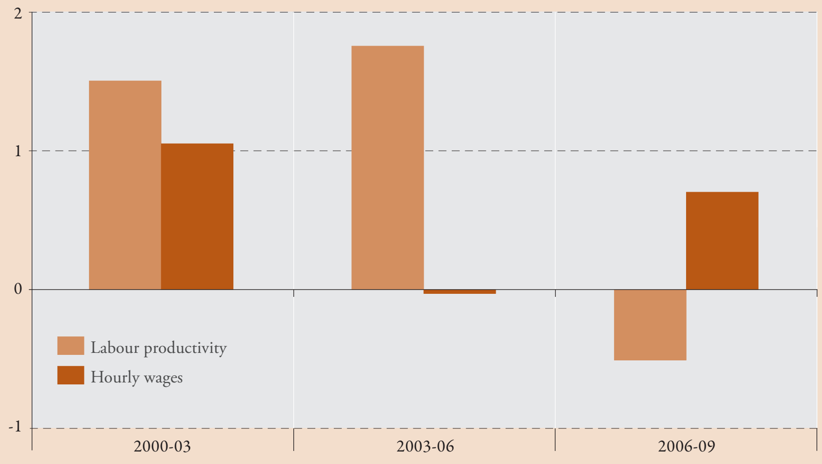
[59] Household disposable income corresponds to the sum of wages and salaries, mixed income, net property income, net current transfers and social benefits other than social transfers in kind, less taxes on income and wealth and social security contributions paid by employees, the self-employed and the unemployed(OECD, Olisnet).
[60] The average annual growth rate of real wages from 2000 to 2007 equalled -0.1 per cent.

Figure 5.7 Labour productivity and real hourly wages, 1996–2009

Panel A. Evolution of labour productivity and real hourly wages, 1996–2009 (1996 = 100)



Panel B. Average growth of labour productivity and hourly real wages



Note: Wages correspond to hourly private sector wages.
Source: OECD, Olisnet indicators

As such, part of the boost to Germany's competitive vis-à-vis other European countries is due to a lower effective exchange rate compared to its southern neighbours resulting from wage moderation. For example, some recent estimates suggest that Germany's real effective devaluation in terms of relative unit labour costs compared to the EU27 during 1994-2009 is about 20 per cent (Marin, 2010). Moving forward it will be important to ensure that wages are better aligned better productivity gains. This can be achieved without compromising Germany's competitiveness. First and foremost, there is room to increase productivity even further – especially in light of the significant productivity gap that exists between Eastern and Western Germany. Improving productivity in the East is going to boost the country's overall competitiveness. Second, there is room to improve investment rates in Germany which have been declining for some time – an issue to be discussed in more detail in the section below.

D IMPROVED ACCESS TO CREDIT TO SUPPORT INVESTMENT

Investments rates in Germany have fallen considerably…

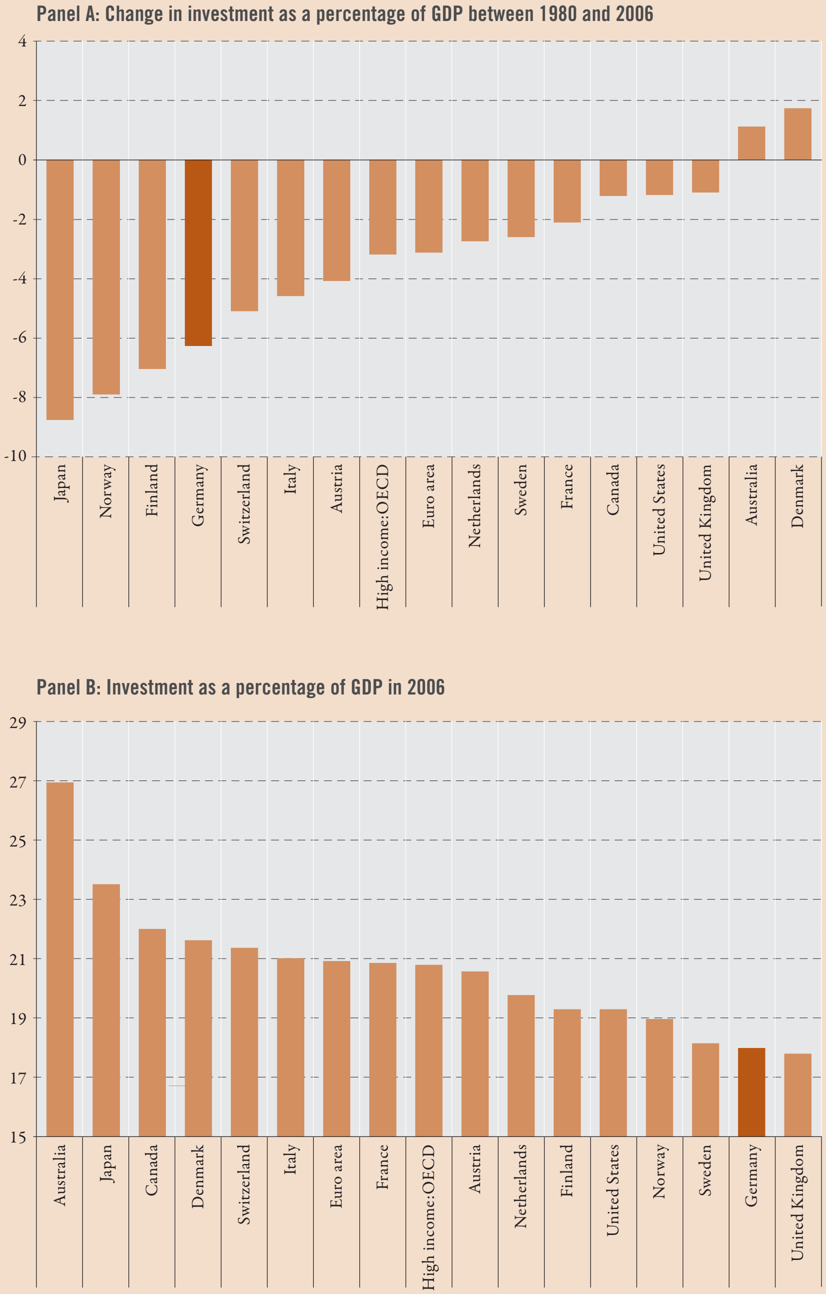
Pre-crisis investment trends show that Germany has seen one of the largest declines in real investment. Between 1980 and 2006, investment as a percentage of GDP declined by 6.3 percentage points (Figure 5.8). In comparison, among OECD countries investment declined by only 3.1 percentage points between 1980 and 2006. Among the advanced economies, Japan posted the largest decline in investment in the same period – by 8.7 percentage points; but despite the decline, the level of investment in Japan is considerably higher than in Germany. As a result, in 2006 investment as a percentage of GDP in Germany was at 17.9, two percentage points lower than the OECD average of 20.8. And during 2008–09, fixed investment collapsed among advanced economies, accounting for the lion's share of the decline in economic output which was already exacerbated the pre-crisis investment trends. Some countries have managed to spur investment (or limit the declines) and encourage business growth (see Box 5.1).

…due in part to challenges firms face to financing activities.

German enterprises tend to rely extensively on bank financing for external funds, but equity financing is limited except for large firms – a situation which is exacerbated by weak competition among banks, higher user costs of capital (and likely to rise with higher capital requirements under the Basel III framework) and limited access to venture capital. For example, the lending rates charged by German banks to firms has hovered around 10 per cent throughout the past decade, while for all other major European economies it has been lower than 6 per cent for much of that period (Figure 5.9). In fact, for the last 10 years, the gap in lending rates between German and other European banks has been between 3 and 4 percentage points, a significant burden for small and medium-sized enterprises (SMEs). A comparison of capital structures shows that German SMEs tend to rely heavily on bank debt – close to 50 per cent, while for other European economies it is around 30 per cent.[61] In particular, while the bank debt

[61] Bannier and Grote (2008).

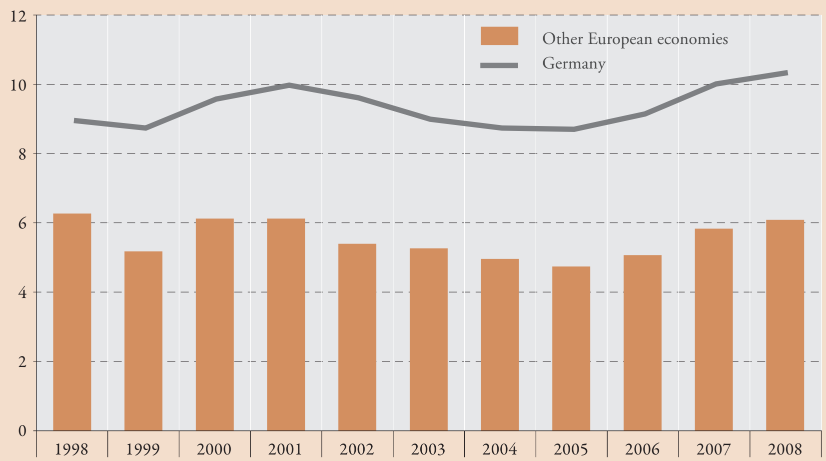
Figure 5.8 **Pre-crisis trends in real investment among advanced economies, 1980 and 2006**
(percentage of GDP)



Source: IILS based on OECD.

for SMEs in Germany is close to 50 per cent of total liabilities, it is only around 20 per cent for large firms. In contrast, the share of bank debt out of total liabilities in other European economies such as France, Spain and the United Kingdom is between 20 to 30 per cent for all enterprises, with a very small difference between large firms and SMEs.[62] While the equity ratio for German SMEs has edged up since the early 1990s, it is still considerably lower than in its European counterparts. Not surprisingly, investment growth is also considerably lower for German firms facing financing constraints than it is for financially non-constrained firms.[63] Evidence suggests that would-be entrepreneurs face considerable financing difficulties in Germany – in other words, business start-ups have difficulty establishing themselves.[64]

Figure 5.9 Lending rates in Germany compared to other European economies, 1998–2008 (percentages)



Notes: "Other European economies" includes Belgium, Denmark, Finland, France, Italy, Netherlands, Spain, Sweden, Switzerland and the United Kingdom. "Lending rates" refers to rates charged by banks to firms.
Source: IILS based on Economist Intelligence Unit and IMF data.

62 ibid.
63 Ploetscher and Rottman (2002).
64 Schäfer, Talavera, and Weir (2010).

Box 5.1 Policy measures to support investment and business growth

Training and Consultancy

- In November 2003, New Zealand started an Investment Ready Training programme to help businesses learn about the financing opportunities available for expansion or diversification of their current business, and commercialization of a new business idea. The programme is offered as a series of free workshops provided by New Zealand's national economic development agency – New Zealand Trade and Enterprise (NZTE).
- The United Kingdom runs a Business Link programme, a government-funded business-support service with a network that covers the entire country. It provides free business advice and support services, which are available both online and through local on-site advisers.

Capacity building

- In Canada, the National Research Council of Canada Industrial Research Assistance Program (NRC-IRAP), created in 1961, provides financial support to qualified small and medium-sized enterprises to help them develop technologies for competitive advantage. Each year, qualified SMEs from all industrial sectors access a range of NRC-IRAP services, including technical and business-oriented advisory services, competitive intelligence, non-repayable financial support, and networking and linkages to potential partners.

Entrepreneurship development

- In the Republic of Korea, the Small and Medium Business Administration (SMBA), founded in 1996, operates numerous schemes that are all targeted at assisting SMEs in the areas of entrepreneurship, human resources, financing, marketing and innovation. Among the schemes is a start-up course, which is an education programme targeted at would-be entrepreneurs, and designed to improve their management capabilities and raise the start-up success rate.
- In the United States, the Small Business Innovation Research (SBIR) programme assists small, high-tech and innovative businesses in the country as part of the Federal Government's research and development efforts. The programme encourages commercialization of new technology products and services. Since its inception in 1982, the SBIR has helped thousands of small businesses to compete for federal research and development awards.

Source: ISSA (2010); M. Caetano (2009); J. Savoia (2007)

While the Government has introduced measures to foster an environment that is conducive to start-ups, the recent evidence suggests that the difficult financing environment persists, which shows that there is a need to reassess the policies that are in place to promote entrepreneurship. For the German economy to be more resilient to economic shocks the private sector needs to be more vibrant; entrepreneurship needs to thrive, but for that to happen it is imperative to remove the financing bottleneck that persists. A number of options exist:

- *Reduced costs of borrowing*: One of the ways of reducing the user cost of capital is to increase competition in the banking sector, and perhaps to move away from a bank-based financial system to one that is more capital-based.[65] While the lifting of state guarantees on regional banks (Landesbanken) is a step forward, the Government can further increase competitiveness in the banking sector by making the Landesbanken more efficient.[66] Second, it is important to make sure that the new capital requirement from the Basel III framework does not create a situation where German banks transfer the additional cost to firms by increasing already high lending rates. Third, one of the ways the Government can encourage medium and small firms to tap into equity financing (to move away from bank-based financial system) is by giving tax incentives to publicly listed firms – this will provide a new source of finance and reduce costs for firms.
- *Increased access to credit for SMEs*: In March 2009 the Government established a €115 billion fund (Wirtschaftsfonds Deutschland) for credit guarantees and support for German enterprises. The evidence shows that most of the guarantee and direct credit support has helped medium-sized enterprises – firms with 250 or fewer employees – the most. Another measure that was put in place was export guarantees (a form of credit security) to help firms in the export sector; this has proved to be very popular among medium-sized firms. The success of Wirtschaftsfonds Deutschland and

[65] The ratio of bank assets to GDP is higher than in most other OECD countries, and stock market capitalization as a ratio of GDP is lower. Close to 40 per cent of the German banking sector is in public ownership, and this already in 2005, before the crisis. Among the OECD countries, the other country with high public ownership of its banking system is Portugal, at 25 per cent.
[66] Hüfner (2010).

the export guarantee schemes shows that there is a strong demand for such programmes and indicates that the Government might consider ways to continue support of a similar nature.

[67] Elschner and Vanborren (2009).
[68] ibid.

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GERMANY :
A JOB-CENTRED APPROACH

It is often argued that the cost of social equity is less economic growth, highlighting the supposed trade-off between these two goals. The crisis that erupted in 2008 – which was preceded by rising social inequalities – has shown that this is simply not the case. In fact, if properly designed, equity-enhancing policies can also promote prosperity and reduce the risk of future crises. The aim of the *Studies on Growth with Equity* is to show how such policy complementarities can be achieved.

Germany experienced one of the most dramatic declines in output as a result of the crisis. And yet employment fell only marginally. This study shows how this was achieved through a carefully designed job-centred strategy. It also highlights areas where action is needed in order to consolidate economic recovery. In particular, by making the labour market more attractive to workers, Germany would be rewarded with significant gains, both economic and social.

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