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Low Pay as an Alternative to Public Direct Job Creation? Lessons from the German Case

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Forschungsinstitut
zur Zukunft der Arbeit
Institute for the Study
of Labor

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March 2015

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March 2015

ABSTRACT

Low Pay as an Alternative to Public Direct Job Creation? Lessons from the German Case*

This contribution draws some conclusions from the experience of attempts by the German government at integrating the most vulnerable groups into the labor market, in particular the long-term unemployed and the low skilled. There has been a sort of paradigm shift that goes beyond active labor market policies and public direct job creation in favor of allowing for a more flexible labor market to emerge, thus implying a growing low-pay sector. This policy reversal can be seen as a partial success as those that were formerly excluded now have a somewhat better access to the labor market. However, this improved access comes with some limitations in terms of the quality of jobs and with respect to the upward mobility of those who enter the labor market at low-pay levels.

JEL Classification: J64, J65, J68

Keywords: direct job creation, low pay, subsidized employment, evaluation, Germany

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All developed countries face rapid technological progress and increased globalization, which both have immediate repercussions on labor markets. Recent research has highlighted the tendency towards a polarizing labor market in terms of labor demand and working conditions, with growth and upgrading of some occupations to the benefit of the highly skilled in combination with a certain expansion of job opportunities in the low-pay/low-skill sector, in particular in the private service sector (see, e.g. Autor and Dorn 2013; Goos, Manning and Salomons 2014). In such a situation, long-term unemployment may be hard to tackle, especially given the fact that jobs for the low skilled may either not be easily available or only found in the low-pay segment. This raises important policy issues.

In this contribution, we try to draw some conclusions from the experience of Germany with attempts at integrating the most vulnerable groups into the labor market. There has been a sort of paradigm shift that goes beyond active labor market policies (ALMPs) and direct job creation (DJC) in favor of allowing for a more flexible labor market to emerge, thus implying a growing low-pay sector (Eichhorst, Grienberger-Zingerle and Konle-Seidl 2008).

Basically, the core question is what could a potential policy solution be for tackling long-term unemployment as well as for stabilizing the labor market careers of the most vulnerable groups, in particular the low skilled in developed countries, where skill demands seem to be generally increasing?

From a theoretical point of view, there are four fundamental options for policy makers to deal with long-term unemployment of low-skilled people who have difficulties in entering the labor market (see, among others: Iversen and Wren 1998; Dräbing, Hemerijck and Eichhorst 2012):

1. The first is a social investment strategy that would require major efforts to provide better education and training to all working-age people. This constitutes a long-term investment that tries to ease the problem of low-skilled labor by raising worker productivity.
2. A second alternative is to make the labor market flexible enough so that it is capable of creating jobs for those who cannot enter into a regular, standard job after a phase of long-term unemployment due to a lack of relevant skills. In such an approach, flexible forms of work and low pay jobs are seen as entry opportunities.
3. The third alternative is one of the major implicit strategies being implemented in many European countries, namely, to tolerate unemployed benefit receipt and the long-term payment of unemployment benefits for the low skilled without any major policy attempt

at labor market integration. This is a more passive strategy relying on unemployment benefits and minimum income support associated with major funding requirements.

4. Finally, the last alternative is to have subsidized employment with private employers and/or direct job creation mainly in the public sector. This policy tries to overcome hiring obstacles by either giving incentives to employers or by setting up a separate segment of the labor market for the hard to place.

The German case can be used to show the pros and cons of the different strategies and highlight the ambiguity of some policy choices. First, to get an overview, we examine the shares of the long-term unemployed within total unemployment and look at the employment rates of the low skilled. As Figure 1 shows, Germany has reduced the share of long-term unemployment over the last decade, albeit still exhibiting one of the highest shares amongst the countries compared. However, not only has the overall employment rate increased in Germany to more than 70%, but also the low-skilled employment rate has increased by about 5 percentage points, as can be seen from Figure 2. This is more positive than the experience of other European countries or other OECD countries over the last several years.

Figure 1: Share of long-term unemployment within total unemployment

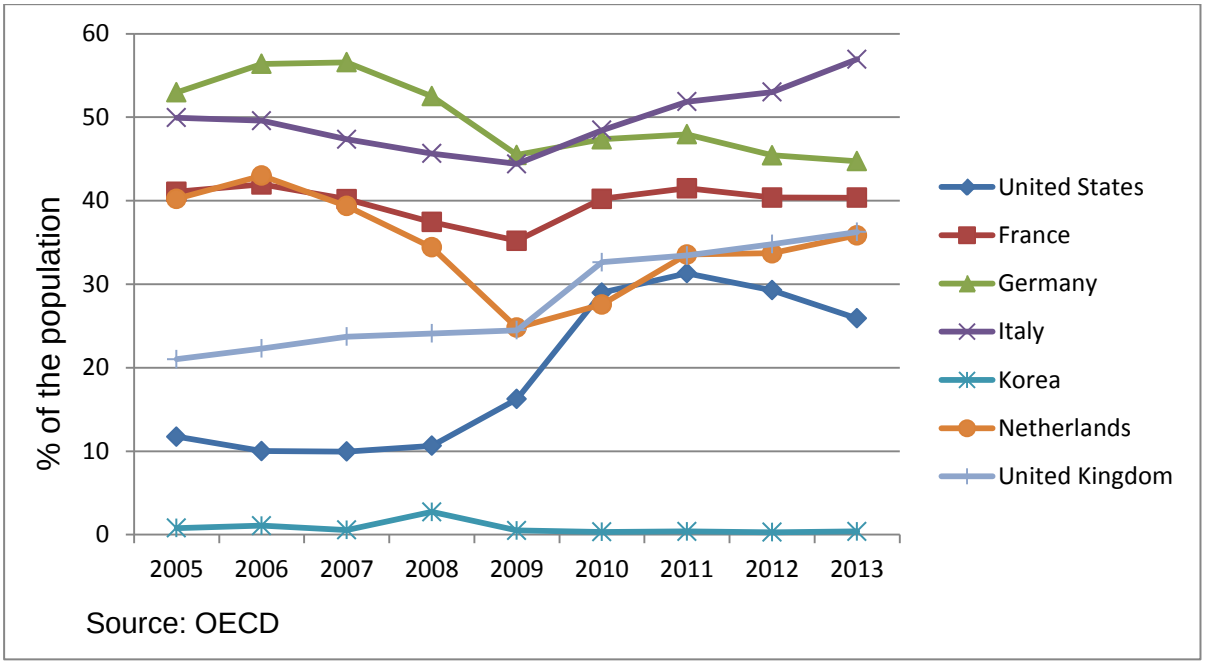
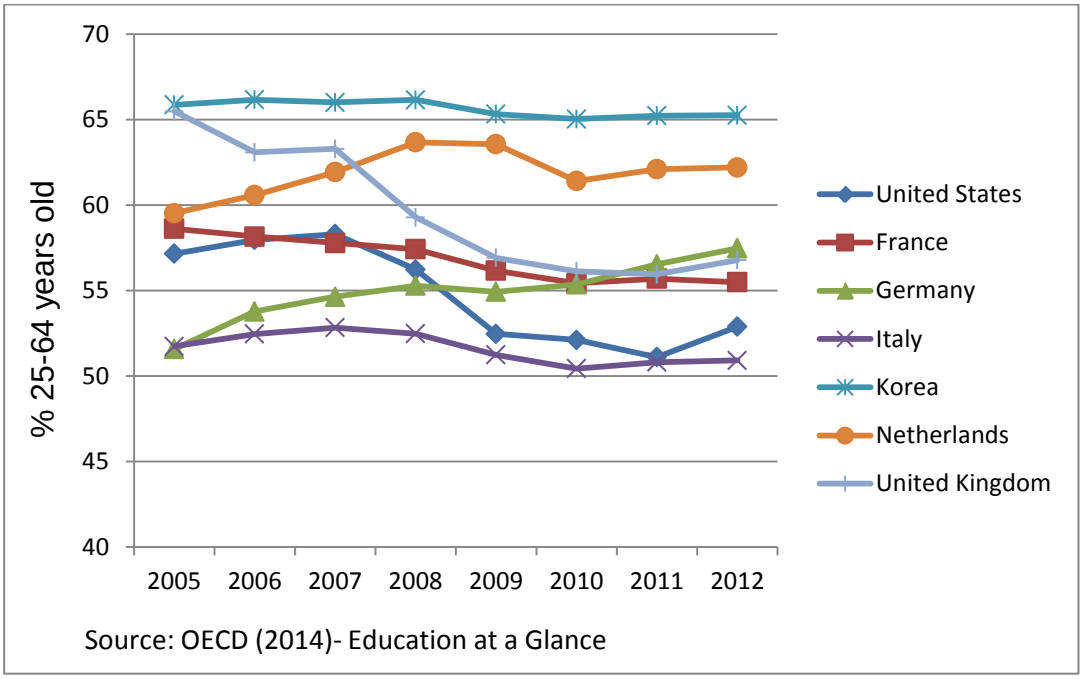


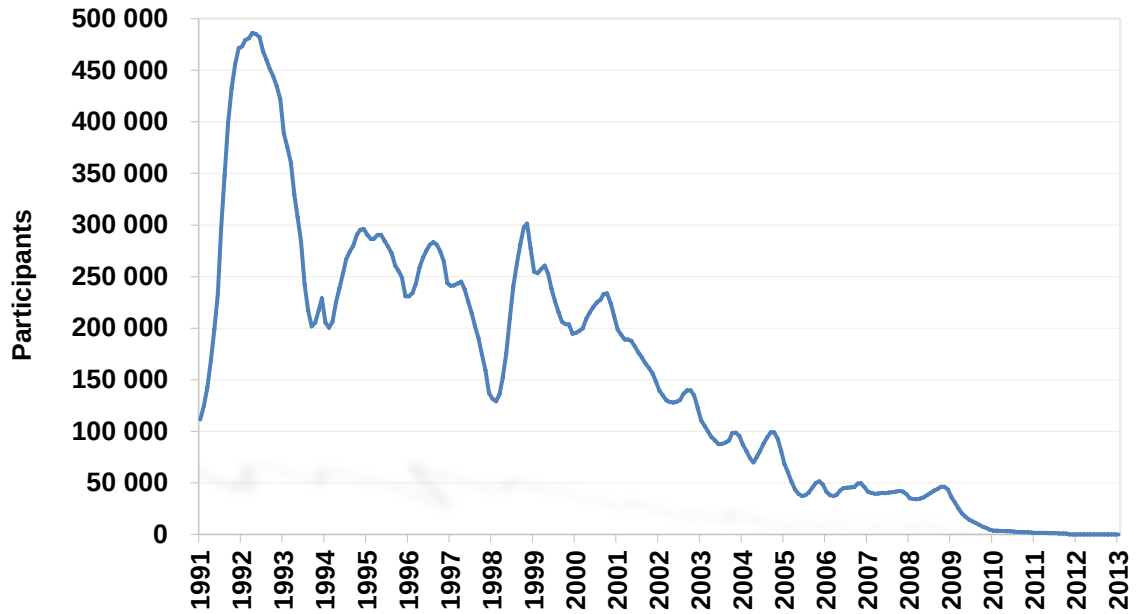
Figure 2: Employment rates of the low skilled



In order to understand the German case in detail, the more general policy background has to be taken into consideration. Germany has a very long and strong tradition of DJC measures in the public ALMP portfolio as has Korea (Kim 2015). This strategy, invented in the late 1960s and early 1970s, was designed to promote employability, stimulate structural change in the economy, and create societally-useful output to communities. A more implicit goal was to keep unemployment figures at a relatively low level in years of economic slumps, especially when this coincided with general elections in Germany.

DJC also played a huge role in the deindustrialization process of Eastern Germany, when a large share of East German firms went out of business or shed major parts of the workforce after reunification. Hence, DJC was part of the response that policy makers implemented, in particular in Eastern Germany, in the first half of the 1990s. Employment conditions in this scheme were somewhat comparable to regular contracts, with pay being in line with collective agreements along with full social security coverage. These conditions were somehow on par with, or even superior to, what was available on the general labor market, and it was even possible to requalify for unemployment benefits through the participation in DJC measures. Over time, this raised some criticism in terms of costs and in terms of competition with the non-subsidized private sector. Most importantly, though, there have been largely negative evaluations regarding the mobility to regular jobs for those who participated in DJC in Germany, despite some heterogeneity of the effects regarding different target groups (see, among others, Caliendo, Hujer and Thomsen 2004, 2008, Eichhorst and Zimmermann 2007, Heyer et al. 2012 and Card, Kluve and Weber 2010 for the international evidence). The general observation was that people who participated in DJC ended up being trapped in this type of quasi-employment. As in many cases the DJC option was already the type of job that was the most attractive one could realistically get either in the publicly subsidized or the private sector, job search intensity greatly decreased.

Figure 2: Traditional DJC in Germany, 1991- 2013



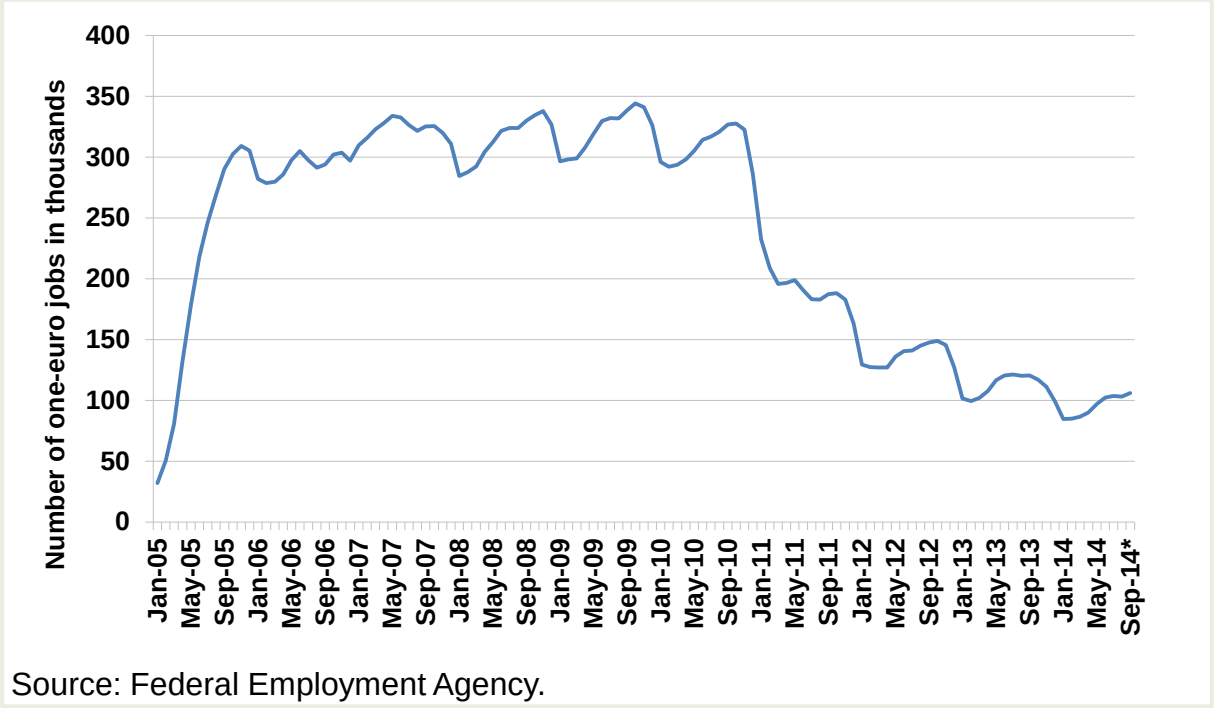
Source: Federal Employment Agency.

Against this background, there has been a policy shift since the 2000s, as seen in Figure 2, which reports stocks of traditional DJC in Germany. After the peak in the early 1990s after the reunification, figures consistently went down, in particular in the context of subsequent labor market reforms. Germany basically departed from DJC in the traditional sense ten years ago, and the formal measure that was heavily used in 1990s ("Arbeitsbeschaffungsmaßnahmen") is now abolished.

This development was the response to the fact that DJC was largely seen as one of the most ineffective and expensive ALMP instruments. The Hartz reform package that Germany implemented about ten years ago changed the situation completely by closing this older model of large scale DJC instruments in favor of more integration into regular employment instead of these artificial types of work that were created at relatively attractive conditions but resulted in relatively poor labor market prospects of participants. The policy response was, thus, to adopt a strategy of stricter activation. Therefore, all jobs, no matter the conditions, were defined to be acceptable for the long-term unemployed on minimum income support, and participants were expected to take any available job instead of remaining on benefits. At the same time, in order to increase the capacities of the labor market to create new jobs for this segment, there was major deregulation of non-standard forms of employment, and simplified conditions under which benefit receipt can be combined with part-time work were created. In addition, traditional DJC was restricted and downsized significantly after 2004.

Since then, work opportunities ("Arbeitsgelegenheiten"), oftentimes called "One-Euro jobs", have been dominant. With this measure, long-term unemployed people can participate in societally beneficial jobs for about nine to twelve months (for the majority of participants). This is not seen as regular employment but rather is viewed as a work opportunity that only provides a small earnings "top-up" which is received in combination with the benefit. This model has currently become less attractive in terms of working conditions, and recently it has also lost its original importance in terms of participant figures. Evaluation studies do not find clear positive effects, however (see Hohmeyer and Wolff 2010, 2012).

Figure 3: Work opportunities in Germany- stock figures



Source: Federal Employment Agency.

Regarding work opportunities in Germany, the maximum stock was about 300,000 people in the late 2000s. Since then, there was another downsizing on DJC-centered active labor-market policies in Germany implemented in 2010 and 2011 (see Figure 3). This came at a time when, due to the general improvement of labor market conditions, it was increasingly possible to better integrate the low skilled into the regular labor market and lower the number of long-term unemployed, at least to some extent. This was also taken as an argument to reduce the number of unemployed in ALMP programs.

As a response, the focus shifted towards a public debate about in-work poverty. Over the last few years in Germany, there has been a heated debate about the potential side effects of the strategy of pushing more people into the labor market, not least into the low-pay segment. As

the low skilled were activated into a more flexible labor market, low pay increased over the last ten years, making it easier and more frequent that people combine benefit receipt and low pay. For many, this is seen as an indicator of in-work poverty. In the current German arrangements, benefit recipients have some incentive to work part-time and do not necessarily have strong incentives to go into a full-time employment option that may be available.

About 1.3 million people receive basic income support while working (Bruckmeier et al. 2013). This is around 3% of total employment; however, it is not necessarily an indication that people cannot live from what they earn. It is rather an issue of creating working incentives that facilitate the move from a part-time job to a full-time job. The majority of those who combine benefits with earnings from work only work part-time. This strong incentive allows a recipient to work only up to approximately 200 Euros per month before they lose major parts of their unemployment assistance benefit. This can be seen as a massive disincentive to move on with their labor market career. Thus, moving to longer working times is the real issue that needs to be discussed.

There is still a question about the right role for DJC within ALMPs and the labor market. According to some, DJC should revive the secondary or even tertiary labor market segment and be available for those who do not have any opportunity to enter the regular private labor market. In this scheme, publicly sponsored (temporary or even permanent) jobs should be created that are systematically filled by the most hard to place long-term unemployed. This raises tricky organizational and funding issues, and to avoid major distortions in the labor market, this can only be a limited policy. It is certainly not the solution for the overall problem of long term unemployment and low pay. Such a policy would need careful design, screening and targeting. Another challenging point is that Germany has now introduced a statutory minimum wage in January 2015. Certainly, this is a remarkable policy change in the German context, and it will probably have some negative side effects on the most vulnerable groups that could at least partially be integrated into the labor market with this activation-plus-flexibility regime that has been in place for the last ten years.

Under this more flexible labor market with publicly sponsored jobs, Germany was able to integrate more people into the labor market, in particular into some forms of non-standard employment, so that now one can see a wedge between standard workers and the segment of the unemployed or inactive that have now become activated. We now have more people working on marginal part-time jobs, more temporary agency workers along with a moderated increase in the self-employed. This development has contributed to the increase in employment figures in Germany. According to Table 1, one can see that under such regime,

workers in certain occupations and low-skilled people have a relatively high risk of receiving low pay (defined as less than two thirds of the median gross wage in the German economy). These striking numbers show the high shares of low-pay workers in areas of marginal part-time jobs, i.e., around twenty hours per week or less. According to these data, pay rates in marginal part-time, but also in some temporary agency work, are lower than a typical wage received by comparable standard workers (see Baumgarten et al. 2012; Jahn 2010). Not surprisingly, this is a concern for the low skilled and for those in the more elementary occupations that dominate these forms of non-standard work. Even if new jobs are created for these groups, they would only be within the low pay sector.

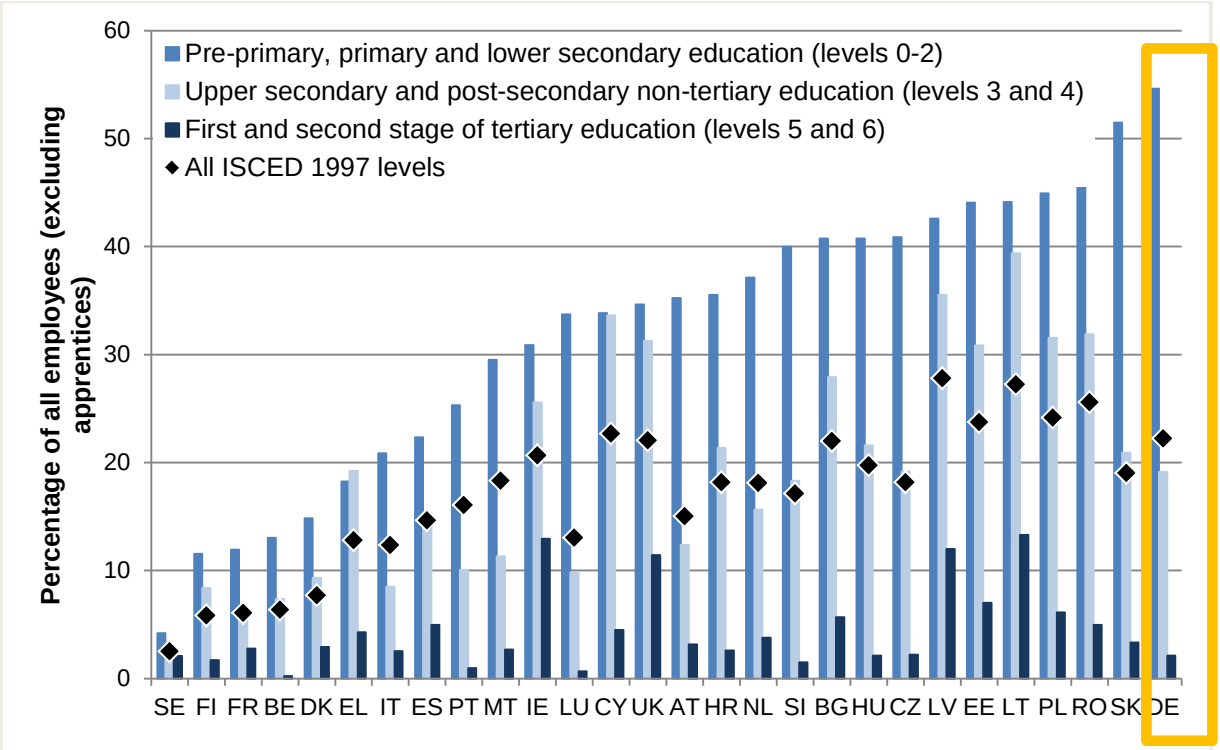
Germany's labor market is characterized by a certain occupational dualization or polarization that is particularly high in some private service sector occupations with medium- to low-skill requirements. These are somehow the jobs that are most affected by the flexibilization and deregulation of the German labor market after 2002 to 2004. In such a situation, Germany is now one of the countries with the highest share of low-pay workers, in particular in the low-skill segment (see Figure 5).

Table 1: Low pay shares in some occupational groups, 2010

share of low-wage earners %	total	Standard employment (FT and PT > 20h)	Non-standard employment				
			total	part-time (< 20h)	fixed-term	marginal part-time	agency work
Total	20.6	10.8	49.8	20.9	33.5	**84.3**	**67.7**
Female	26.5	15.1	47.6	19.2	35.5	**84.8**	**72.9**
Male	15.8	8.1	53.7	34.3	31.6	**83.4**	**65.4**
low qualification	52.8	22.7	**77.8**	44.7	62.2	**88.1**	**85.5**
medium qualification	17.7	12.1	39.4	17.1	36.2	**77.2**	57.6
high qualification	1.7	0.5	8.3	2.7	5.7	61.4	20.7
selected occupational groups							
academic professions	3.0	1.0	10.5	3.5	5.7	64.9	/
technicians and equivalents	7.6	4.0	24.9	4.7	17.3	**68.1**	29.2
office workers	23.4	10.9	48.1	13.2	39.4	**80.3**	62.5
retail and service staff	42.3	28.4	**65.4**	30.0	58.3	**88.6**	**72.1**
craftsmen	16.1	11.1	48.7	32.6	31.3	**81.0**	47.6
operators and fitters	23.7	17.1	60.6	33.2	39.7	**89.3**	63.0
labourers	61.5	39.7	**79.2**	56.3	**70.7**	**90.3**	**89.2**

Note: standard employment incl. part-time > 20h, part-time is < 20h, but above marginal part-time. Low pay threshold: 10.36 EUR. Only employees in firms with > 9 employees. *Source:* Federal Statistical Office.

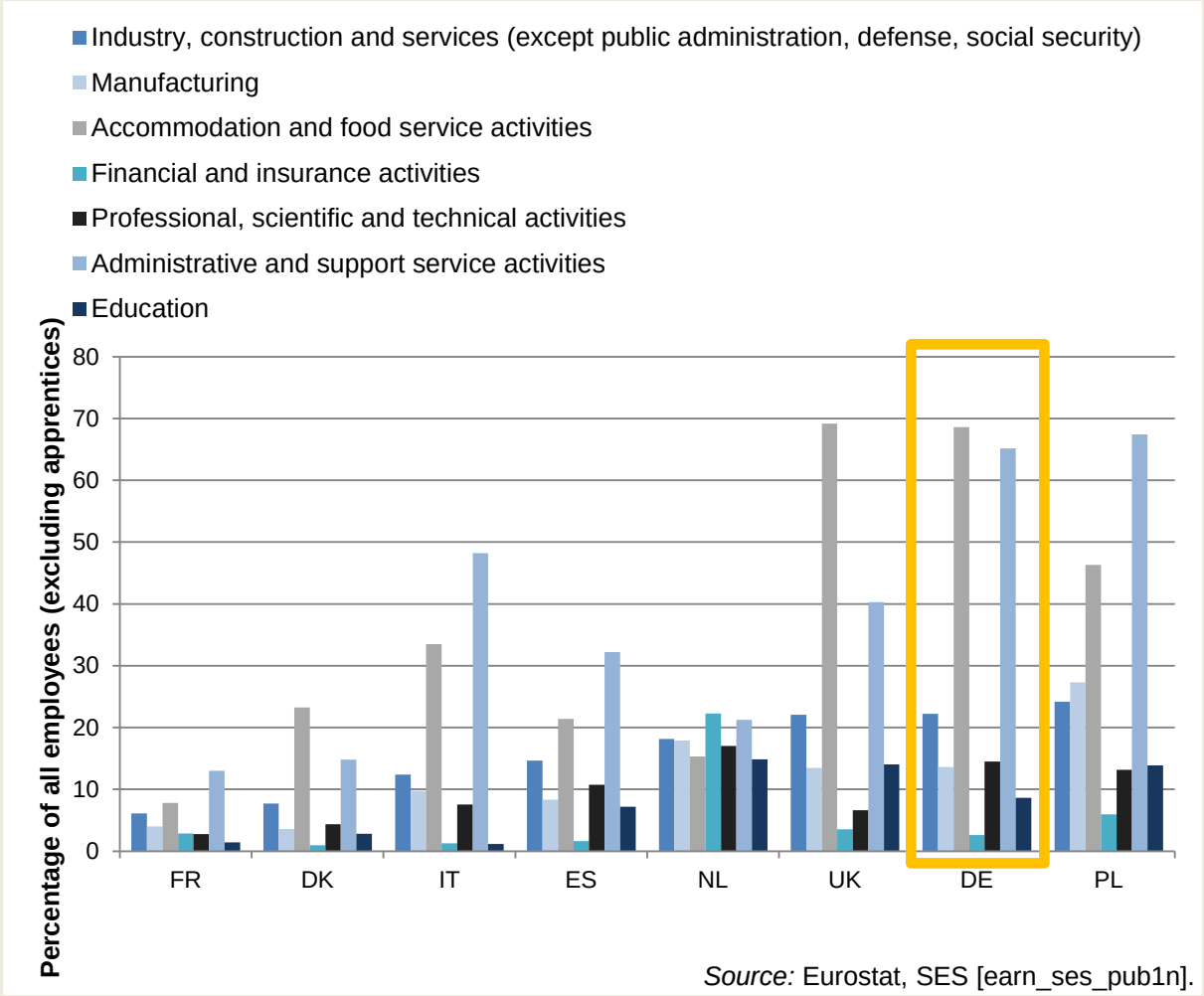
Figure 5: Proportion of low- wage earners by education in 2010



Source: Eurostat, SES [earn_ses_pub1i].

From Eurostat data, we can see that in Germany, wage dispersion increased quite strongly as a consequence of the more flexible labor market with its characteristics of low collective bargaining and increased use of non-standard forms of employment. But at least some low-skilled jobs were maintained or even newly created under such a regime since the early 2000s. Compared to France, for example (see Figure 6), there is quite a diverse development of pay dispersion in different occupations. There is a particularly high share of low-pay workers in support service activities, i.e., many services delivered to households. Specifically, the hospitality sector and the cleaning sector have both greatly expanded under the low-pay arrangement.

Figure 6: Share of low-wage earners by sector in 2010



Source: Eurostat, SES [earn_ses_pub1n].

To summarize the key findings, we can conclude that Germany has moved its policy regime from one with a very strong emphasis on equality, at the price of relatively few jobs, to a regime allowing for more job diversity and stronger employment growth. This was triggered by a significant deregulation of the labor market combined with the phasing-out of traditional DJC in favor of prioritizing the integration of the unemployed, in particular the long-term unemployed, into the regular labor market, even at the price of some low-pay jobs. This can be seen as a response to the general disappointment with the effectiveness of earlier DJC policies, specifically with respect to the balance between the costs and benefits associated with large-scale DJC programs. This policy reversal can be seen as a partial success as those that were formerly excluded now have a somewhat better access to the labor market. However, this comes with some limitations in terms of the quality of jobs and with respect to the upward mobility of those who enter the labor market at low-pay levels.

Given the fact that the German public and the German government are uneasy with the pronounced wage dispersion that emerged over the last decade, the situation is currently undergoing some changes. The introduction of the statutory minimum wage in early 2015 can be seen as a consequence of this development, but the pending restrictions on temporary agency work also point in that direction. With such policy changes, we will likely see a more regulated labor market in the near future. In addition, there is a new debate about early intervention policies to combat long-term unemployment by having more targeted support services and focusing more on training and other support services so that the long-term unemployed can enter the labor market and move upward into other jobs more frequently and easily. It is still important to consider that it is necessary to have flexible and accessible entry jobs while, at the same time, investing in the skills of those that are not well equipped to participate in a highly modern, skill- and knowledge-intensive labor market. Hence, there needs to be an increase in the kind of entry jobs that act as an effective stepping stone into more stable employment. This poses major challenges to the delivery of training and other incentives to increase productivity. In this case, the public and private sectors play an important role, but also employers and individuals have growing responsibilities when it comes to ensuring employability. From an international perspective and with respect to the Korea case, these findings call for a careful design, targeting and limitation of DJC as well as for a combination with training and job search assistance so that the transition to the regular employment is facilitated while minimizing distortions on the labor market (see also Kim 2015).

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