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Labour Market Institutions in Germany : Current Status and Ongoing Reforms

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Discussion Papers

Labour Market Institutions in Germany: Current Status and Ongoing Reforms[1]

Dr. Silke Bothfeld

WSI-Discussion Paper No. 152

April 2007

Wirtschafts- und Sozialwissenschaftliches Institut
in der Hans-Böckler-Stiftung, Düsseldorf

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[1] This paper was prepared for the Conference "The Welfare State in Armenia", organised by the DAAD Yerevan in cooperation with the CRRC Yerevan on the 25th/26th February 2006 in Tzakhdor/Armenia. Silke Bothfeld is researcher at the Economic and Social Science Research Institute of the Hans-Böckler-Foundation, Düsseldorf (WSI/ HBS) (silke-bothfeld@boeckler.de). The author is indepted to Britta Seine for providing valuable research assistance and to Yvonne Silber for her thorough proof reading of this paper.

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Dr. Silke Bothfeld
WSI in der Hans-Böckler-Stiftung
Hans-Böckler-Straße 39
D-40476 Düsseldorf, Germany
silke-bothfeld@boeckler.de

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I. Introduction

In Germany, there is there is general consensus that unemployment rates are too high. In autumn 2006, the registered unemployment rate was 9.6%, which amounts to approximately 4 million unemployed. Since 2002, the German unemployment rate has even exceeded the EU average, which was unprecedented in the past (see Figure 1 on standardized unemployment rates in the Annex). At the same time, the duration of unemployment has increased dramatically: In 2005, more than one third of those registered as unemployed were long-term unemployed, i.e. unemployed for more than 12 months.

Although all economists agree that a major precondition for employment creation is sustainable economic growth of at least 2% per annum, they disagree about the effects of the institutional framework on the labour market: Optimistic observers stress the high performance of external trade and the highly specialized small and medium-sized companies operating at high potential. These have a well-qualified workforce, which relies on the existence of a highly differentiated system of labour market institutions that provide a reliable basis for sustainable economic development. These analysts point to the fact that economic growth and the demand for labour is appropriately restrained by the extremely low domestic demand (Horn 2005). Conversely, pessimistic observers blame the relatively high labour costs resulting from institutional regulation by labour and social law, collective bargaining and labour market policies as the main barrier to the creation of employment. Despite their differences, both the EU employment strategy and the OECD job strategy serve as frameworks and references for German economic and labour market policy-making. While the OECD's strategy mainly promoted the deregulation of labour market institutions, such as dismissal protection and collective bargaining systems (OECD 1994 and 1999: For a critical perspective cf. Schmitt/Wadsworth 2002), the EU employment strategy focused on the social dimension of employment and the

enhancement of active labour market policies that support social integration and qualification of the labour force.[3]

As the German employment system can be generally characterised as highly protective and favourable to employees in respect to their labour rights, democratic participation in the economic sphere and the level of social protection, this article addresses the question of the consequences of these two diametrical strategies for the underlying principles of the German employment system. The main argument will show that intentional government reforms are a factor that only partly accounts for the ongoing basic changes. Other factors that influence the system are ongoing changes in social practices and initiatives or rulings by supra-national organisations.

[3] The initial EU employment strategy that was adopted at the Luxemburg summit in 1997 was a four-pronged approach. It aimed at the enhancing workers' employability through qualification efforts, supporting entrepreneurship by encouraging people to run their own businesses, supporting business in its adaptation to new market demands and strengthening equal opportunity policies. It focused on the strategy of activating social expenditure and supporting transition into paid employment rather than on deregulating existing labour market and social institutions.

II. The regulatory framework of the German employment system

A number of minor, mainly deregulating reforms have been introduced to labour law to tackle the problem of rising unemployment (see Table A1 in the annex) since it began to steadily increase in the mid-eighties. However, these reforms were rather symbolic as they had hardly any effect on the level of employment protection but caused fierce debates on the underlying principles of the German employment system. In 1998, the new Red-Green government took the chance to develop major labour market reforms. These major reforms included amendments to the domain of labour law and active labour market policies as well as to the unemployment insurance. Albeit under fierce discussion and strongly criticised by some of the employer's organisations, the German system of collective bargaining has remained unchanged so far. Nevertheless, new practices are evolving that entail far-reaching changes to the system of collective bargaining.

1. Labour law

The German labour law, whose core elements are dismissal protection, the regulation of working hours and parental leave and codetermination on the company level, provides a relatively high level of social protection to the German employees. This legislation may have quite different impact however, on different groups within the German workforce.

1.1 Dismissal protection

According to the OECD definition and analysis, Germany figures among the countries with the strongest dismissal protection (OECD 1994). Tight regulation of fixed-term employment and dismissal protection are considered to be most obstructive to job creation and the hiring of employees as these regulations reduce for the freedom of companies to dismiss workers in periods of economic downturn. Albeit largely shared by European economists and policy makers, this assumption has not been empirically proven to date. On the contrary, dismissal protection is also

considered to have a positive effect in the long term as it enhances employment stability and the perception of employment security. Employees may feel encouraged to invest in company-specific as well as general qualifications and develop a stronger commitment to their employer. In both cases, employee productivity would increase in the mid-term and possibly allow the employer more flexible adaptation to work organisation and new technological processes.

Employment protection – dismissal protection and the regulation of fixed-term contracts – has undergone changes within recent years. Until 2004, the regulation exempted only very small companies with less than five employees and protected employees from the first day of the employment relationship, although probation periods of up to six months were legal. New legislation has increased this threshold to 10 employees so that now firms with up to ten employees are exempted by new hirings. Further deregulation has been discussed, including the abrogation of dismissal protection during the first two years of employment and another increase in the employee threshold bringing it up to 20 employees. Under this model, only 9% of employees would remain covered by dismissal protection. The social-democrats, who participate in the Federal Government, reject these plans pointing to the changes that have been made to the regulation of fixed-term employment: Employers are permitted to conclude fixed-term contracts with a duration of up to 24 months without justification. If they refer to justifications formalised in the law, fixed-term employment relations may even exceed this two years. An average of about 8% of dependent employees (excluding apprentices) have a fixed-term contract. But indeed, in West Germany, over one third of new entries to the labour market (East Germany nearly the half) have fixed-term contracts (data from 2002).

1.2 Working-time regulation

The law regulating working time, which was reformed in 1994, principally allows for working times of up to 48 hours and under certain conditions, of up to 60 hours a week. In fact, collective agreements on the branch level have reduced regular weekly working time to between 35 and 40 hours. Unlike in the UK, very long working hours

are quite rare in Germany (Anxo/O'Reilly 2000). In Germany, women have much shorter working hours than men as a large percentage of them work part-time: On average, women work 30.8 and men work 40.2 hours per week (Klenner 2005, S. 199).

In contrast to the situation in France, the improvement of part-time work opportunities as a means of reconciling paid and family work has been demanded by the women's movement since the 1970s, but the right to part-time work was first introduced in 2001 by the Part-time Work Act, which also regulates fixed-term employment, and by the Parental Leave Act of 2002. According to the former, workers can request a reduction in working hours provided that they have been employed by the company for at least 6 months and the company employs more than 15 employees. The Parental Leave Act allows the parents of children under three years of age to reduce their weekly working-time to a maximum of 30 hours under the same conditions. However, the new regulation simply reinforced a development that began long ago, women's option for part-time work. The proportion of men working part-time is about 6% in both parts of Germany. About two thirds of Western German women opt for part-time work in order to reconcile paid employment with family duties, while only one fifth of Eastern German women do so. The majority of the latter (56.4%) opt for part-time work because they cannot find full-time employment. Men who opt for part-time work for family reasons are still quite rare, more so in the East (3.8%) than in the West (13.1%) (Bothfeld 2005, S. 140). This reflects the high division of labour between German men and women, which is far less pronounced in the Nordic countries – or in Slovenia, were differences in the employment rates are far smaller than in Germany.

1.3 Codetermination

Perhaps the most typical feature of working conditions in Germany is the regulation of codetermination by the Works Constitution Act (*Betriebsverfassungsgesetz - BetrVG*), which enables workers in companies with at least five employees to organise works council elections. The works council is entitled to information and

codetermination rights on issues under debate; e.g. it must be informed and heard in personnel decisions; decisions related to social issues such as working-time organisation and to management's demand for overtime and short-time work require its approval. The works council can conclude agreements with the company's management as long as they complement collective agreements concluded by trade union representatives; but it may not conclude collective agreements itself (see Section 2.1) or call for strikes. Both rights are reserved to the trade unions and the Works Constitution Act obligates works councils to support order and peace within the company. In 2002, works councils covered about the half of all German employees (48%), albeit only 11.0% of companies – a fact that may be due to the high percentage of small companies (with less than 50 workers) in Germany (cf. Table 1). This proportion however, has remained stable during the past ten years.

Table 1: Companies and employees with works councils in Germany by firm size, 1998 and 2002

Percentage on all companies/employees (1)

	All Companies	Company Size				
		5 - 50 employees	51 - 100 employees	101 - 199 employees	200 - 500 employees	> 500 employees
	Companies with works councils as % of all companies					
1998	10	6	46	74	84	92
2002	11	7	45	72	85	95
	Employees in companies with works councils - as % of all employees					
1998	48	11	48	75	85	95
2002	48	12	46	73	86	96

(1) Private sector with at least five employees excluding agriculture and charitable organisations.
Source: IAB-firm panel (6th and 10th wave for West Germany and 3rd and 7th wave for East Germany).

Trade unions are interested in maintaining good relationships with works councils – especially those of big companies – as their contact with the workers is the most important source for the recruitment of new members. However, works councils'

interests can conflict with the trade unions objectives, which has been the case e.g. in relation to overtime or the use of so-called “opening-clauses” to sectoral collective agreements. Insofar, works councils try to pursue their workers interests and agree to overtime even though trade union policy might aim at the reduction or elimination of overtime in order to increase employment rates (through a redistribution of working time). In certain cases works agreements may undercut working conditions that are specified in sectoral agreements; this must be stipulated within the agreement concerned in an “opening clause”.[4] At the beginning of the 90s, these clauses were mainly used to regulate working time arrangements. These clauses are more and more frequently used to regulate temporary working time reductions or temporary reductions in pay with the objective of maintaining employment and avoiding dismissal (Bispinck/Schulten 2003). At present, opening clauses are agreed to when a sector experiences decreasing business volumes and companies use them when they would otherwise have to reduce their workforce. These so-called “company pacts for employment and competitiveness” have become widespread – an estimated 29% of all companies that were covered by collective agreements (in 2002) have made use of these agreements. Of course, this development is problematic for the trade unions, as the increasing use of opening clauses fundamentally places the system of sectoral collective bargaining in question because it entails decentralising effects, i.e. shifts in collective bargaining from a sectoral and regional level to a company level (Bispinck 2005). In general, this development is considered to question the trade unions’ role within the system of collective bargaining as such. This accounts for the trade unions’ fundamental scepticism towards these forms of “controlled decentralisation” albeit they cannot avoid them without losing legitimacy among their members.

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[4] Of course, cases where companies arbitrarily violate collective agreements (“uncontrolled decentralisation”) also occur Bispinck, Reinhard/Schulten, Thorsten (2003): Decentralisation of German Collective Bargaining? Current Trends and Assessments from a Works and Staff Council Perspective, WSI-Mitteilungen, Jg. 56**,** Special Issue: Industrial Relations in Germany, p. 24. .

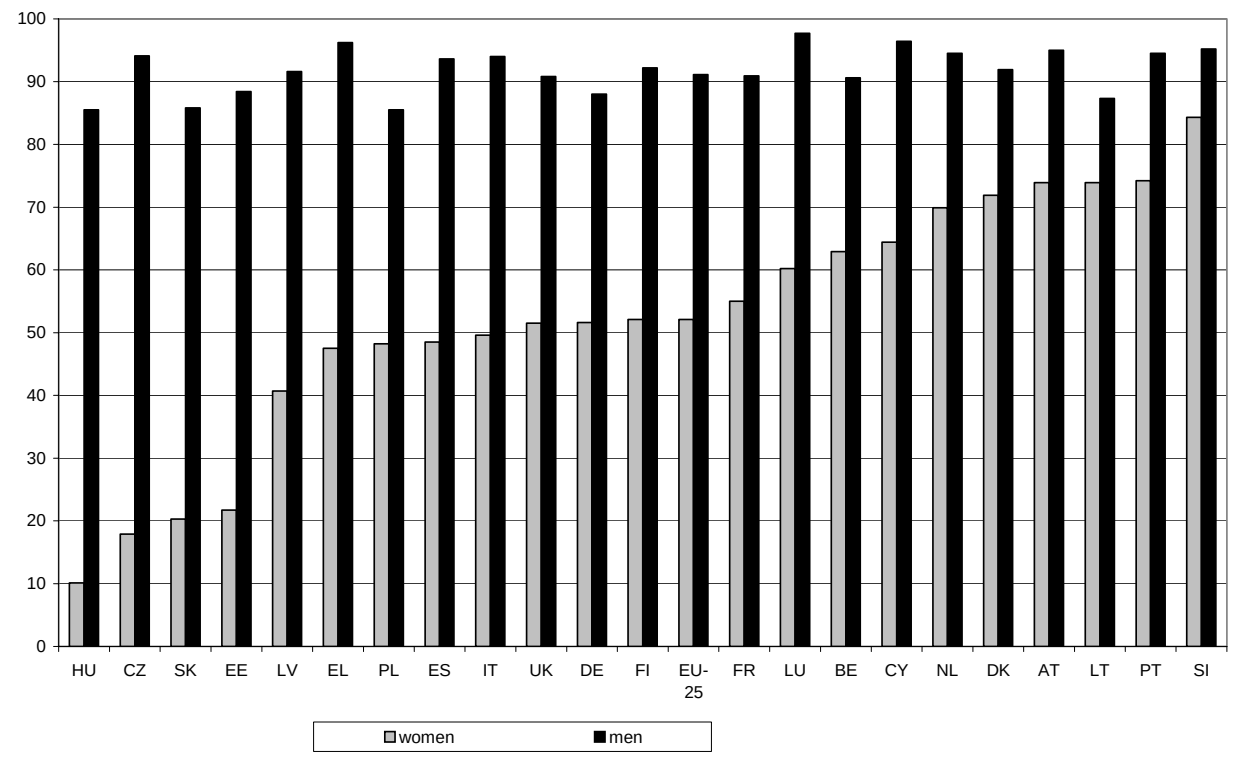
1.4 Parental leave regulation

Of course, there are many other domains of legal regulation that influence the German employment system. The law on sick pay and the law on parental leave are among those that have been frequently debated in recent years.

The parental leave reforms of 2001 and 2006 also belong to the major reforms of recent years. These reforms became necessary because EU law stipulated that beyond the maternity leave of 8 weeks after childbirth[5], an individual right to three months leave must be guaranteed to each parent. Although parental leave already existed, it was not in line with EU law as the entitlement to leave was not individualised but depended on the other parent's employment status. Since the reform in 2000, both parents can reduce their working hours or take full-time leave at the same time until the child's third birthday. Aside from an income-tested, flat-rate benefit of € 300. -, which was paid for a maximum duration of 24 months, the leave was unpaid. Because the responsibility for family work continues to be assigned to women, women's active employment rate, especially when they have (small) children, has remained very low – only about one third of women with a child under three years of age were actively engaged in employment in 2003. (see Fig. 1). For this reason, a parental leave wage replacement benefit was introduced in 2006. Working parents with children born after the 1st January 2007 are entitled to a replacement benefit of 67% of their previous net salary (resp. the difference if they reduce their working time) for a duration of 12 or 14 months leave if each parent takes leave for at least two months of this period. It is most advantageous however, if parents make sequential use of the benefit rather than sharing it equally and simultaneously since the cumulative duration is limited to 14 months independent of whether parents use it as a full- or part-time income replacement., The scope of this new regulation is therefore limited in terms of promoting gender equality , the more so as substantial child care provision is still not guaranteed for under-3-year olds.

[5] The total duration of maternity leave in Germany is 14 weeks – of which 6 weeks can be taken prior to the birth, and of which 8 weeks are obligatory following childbirth. Here, the German regulation conforms with the requirements of the ILO Convention of 1952.

Figure 1 – Employment rates of men and women with at least one child of under three years of age in the EU countries, 2003



No reliable data is available for Ireland, Sweden and Malta. The average difference between the employment rates of men and women is 39% for the EU-25.

Source: Eurostat, Labour Force Survey, 2003

The increase in child-care provision has become another major issue in family policy (Klammer 2004). Both issues are core elements of the EU employment strategy, although they are not subject to EU regulation, but rather to the EU "Soft Law" – namely the open method of coordination between the EU member states (Lefresne 2007).

2. The German system of collective bargaining

The German labour law is complemented by the system of collective bargaining, which produces collective agreements on working conditions and pay. The German constitution guarantees trade unions and employers associations the freedom to conclude agreements (*Tarifautonomie*). The Act on Collective Agreements (*Tarifvertragsgesetz*) specifies the issues and conditions of collective bargaining. The core element of this law is the so-called favorability principle (*Günstigkeitsprinzip*), which stipulates that collective agreements may establish minimum standards that may not be undercut by company agreements concluded by works councils. The latter may pass regulations that specify working time arrangements and they may stipulate higher levels of pay but they may principally not undercut standards that have been determined on the collective sectoral level (for exceptions see the paragraph on opening clauses in section 1.3). Agreements to higher pay levels than those stipulated in the collective agreements have regularly been made by large companies in the metal manufacturing industry.

2.1 How relevant are collective agreements?

Collective agreements are concluded between the regional or national entities of trade unions and employer's associations and they are valid for all employees of a branch that belongs to the employer's association that concludes the agreement. Collective agreements however, can be extended to an entire branch by the Labour Minister of a state (*Land*) or the Federal State (*Bund*) and gain a quasi-statutory status as working or pay conditions become binding for a whole branch independently of the membership of employers and employees (*Allgemeinverbind-lichkeitserklärung – AVE*, cf. Table 2). Further, collectively agreed pay standards can become a reference for companies that apply these standards voluntarily.

Table 2. The three forms and levels of regulation within the German system of collective bargaining

	Regulating Body	Object of Regulation	Examples	
			Working time	Pay
Law	Parliament	(All) companies, (all) employees	Act on working time (6x8 hours per week, up to 60 hours exceptionally)	No minimum wage legislation
Collective agreement (TV) (sectors/federal level or regions/ company)	Regional or national unit of trade union and employers' federation/ company management AVE: State Ministry of Labour	Working conditions and pay in all companies that belong to a sectoral or regional employers' association or: All companies of a sector and region if TV is extended	35-40 hours of contractual weekly working hours (excluding overtime work)	Pay levels and nominal amounts (agreements with a term of 1-2 years); special benefits (leave pay, Christmas pay)
Works agreement (Betriebsverein-barungen)	Company management and works council	Specification of collectively agreed working and pay conditions	Working time reduction, working time arrangement, compensation for working time reduction	Possible supplements, esp. supplements to special benefits

The German system of collective bargaining has been eroded by two developments during the last fifteen years: The decrease in trade union membership and their relative loss of political power, and the process of decentralisation that was reinforced by the German unification as a consequence of the general decline of the German manufacturing sector as a whole.

Nevertheless, the German collective bargaining system remains crucial in determining working conditions and pay levels since the legal framework confines these areas to regulation by collective bargaining. Concerning wages, it should be stressed here that unlike the majority of EU member states, Germany has no minimum wage legislation so that collective agreements provide the only references for pay standards in Germany.

2.2 The decrease in trade union membership

Another development that threatens the German system of collective bargaining is the “internal” erosion of the German labour movement as trade union membership has continued to decline for more than 15 years.

The German trade unions are organised by sector and principally represent employees of one sector independent of their actual activity (unlike in Denmark, where workers of one company belong to different trade unions or in France, where trade unions are politically structured). The eight trade unions that belong to the biggest German trade union federation, the DGB, counted 6.8 million members in December 2005. Of course, the former GDR had a high degree of trade union membership but many workers were not integrated into German trade unions or quit them after the unification. The total number of members was 11.8 million in 1991. Today, about 20% of all employees belong to a DGB-led union.

Declining union membership is a problem as the waning financial basis decreases their capacity for campaigns and mobilisation.[6] Additionally, trade unions defending the interests of their members in the political discourse on labour market reforms have often been portrayed as social actors setting barriers to necessary and indispensable reforms. The traditional good relationship with the Social Democratic Party has also suffered in recent years and this has led to major disputes about recent labour market reforms. Finally, this problem is also aggravated by the fact that employers increasingly quit the employers federations or opt for membership without binding obligation (*OT Mitgliedschaft)* in order not to be bound by collective agreements (Behrens 2003): If employers are not full members of an association, the concluded agreements are not binding for them unless they have been applied to the entire branch by the Labour Minister, which has become very rare. The practice of partial membership is mainly followed by companies that need to gain advantages in

[6] The decrease in membership is a phenomenon that can be observed in the majority of EU member countries. Between 1990 and 2002, the average decrease was – 7.6%; in Germany the decrease was 11.2%. The decrease was still higher in the Anglo-Saxon countries (AUS, NZ, UK) and highest in the post-communist countries (HUN; PL etc.) (Visser, 2006: 38).

cost competition, for example in the retail sector. However, collective agreements remain an indispensable instrument of regulation as they still cover about 70% of German employees in the West and 50% in the East (cf. Fig. A2 in the annex). Nevertheless, this percentage is steadily decreasing.

2.3 Does the increase of low-income earners threaten the system of collective bargaining?

Another problem for the trade unions strategy is the growing number of people earning very little money. Recent analyses have defined low-income earners as full-time employees who earn less than two thirds of the median wage within a national employment system. The overall average of low-income earners in the EU is 15%; comparative figures from 2001 show that Great Britain has the largest share with 19.4% and Denmark the smallest with only 8.6% (European Commission 2004: 168). It is estimated that there are approximately 20 million low-income earners in the EU.
According to national statistics, 17% of German employees were low-income earners in 2004. The threshold for low-income in Germany is relatively high. In 2001, it was € 1700. - (Rhein et al 2005). About two thirds of low-income earners are women and surprisingly, low qualified workers are hardly over-represented among them. Low wages however, may be attributed to two different mechanisms. On the one hand, companies may simply refuse to pay salaries stipulated in collective agreements, either because they fail to comply with a regulation of the federation or because they have quit the federation in order to avoid the obligation of complying with pay standards. On the other hand, collective agreements, especially in some areas of the services sector, stipulate very low pay levels. For example, the normal basic wage for hairdressers, florists or cleaners is about € 1300. - per month (gross wage).[7] For low qualified workers however, there are collectively agreed pay standards that fall even

[7] The Archive for Collective Agreements at the Hans-Böckler-Foundation (WSI-Tarifarchiv) constitutes the largest and most important research unit that registers and analyses current developments in wage policies and the conclusion of collective agreements. Theses for a European minimum wage policy were formulated in 2005 see: http://www.boeckler.de/pdf/wsi_2005_thesen_mindlohn_en.pdf.

below these thresholds and amount to only 50% of the average wage, e.g. in agriculture or private households. In 2006, the German Trade Union Congress decided to demand the introduction of a legal minimum wage as it exists in other European countries. At 7.50 Euro per hour, it would not exceed the average minimum wages that already exist in other EU member countries such as France or the UK (Bispinck et al. 2006). The problem of increasing numbers of low-income earners and growing wage disparities will however persist. In all, the German trade unions, even though they figure among the strongest trade unions in the EU, are also exposed to new political tensions and conflicts and need to adapt their political strategy to these new challenges.

3. The Activation strategy within the German Unemployment Insurance

The continuous deterioration of the labour market situation accompanied by rising unemployment rates and the increasing percentage of long-term unemployed have been the main driving forces for the most recent labour market reforms. These may represent the most comprehensive reforms to labour market legislation since the establishment of the active labour market policies and the coming into force of the "Labour Promotion Act" in 1969. Of course, several reforms have been undertaken since then, e.g. the first step of deregulation of fixed-term employment in 1985, the restructuring of the active labour market policy in 1997 and the amendment of the principles of active labour market policy in 2001 (see Table A1 in the annex). The so-called "Hartz reforms" however, were the furthest-reaching reforms as they tackled almost every domain of the employment system, including the regulation of unemployment insurance, which had remained unchanged until that point in time.

The amendments to active labour market policy and to the unemployment insurance system were the core elements. In the literature, these reforms have been considered "paradigmatic" as they are strongly oriented towards the "activation" of the unemployed.

3.1 The underlying concept of labour market "activation"

The concept of activation is currently the most debated solution to the problem of rising unemployment figures and social expenditure in the EU member states. The activation strategy departs from a former tolerance of the fact that many unemployed who received unemployment benefits remained at home, doing little to alter their situations. Rather than passively living on social benefits, they should be actively searching for a new job or participating in labour market programmes. Moral and economic arguments are usually inextricably interlinked in this perspective (Trickey 2001; Barbier 2004).

The economic critique of the existing benefit system is that unemployed persons remain passive because the economic incentives to return to paid employment are too weak. The economic rationale assumes that the unemployed would prefer to stay at home when unemployment benefit systems are generous and employers are not willing to pay sufficiently high wages[8]. In this perspective, unemployment insurance systems with long durations and generous levels of benefit payment are considered to be positively correlated with the duration of unemployment periods and consequently, higher levels of unemployment. However, unlike in the US, a longer employment search e.g. in Germany is associated with a better matching of the supply and demand of paid labour and secures it in the long term (Gangl 2002). Finally, long-term unemployment correlates with rising unemployment rates and decreasing labour demand; and as the most recent experiences have shown, many long-term unemployed in Germany prefer very badly-paid, publicly-supported jobs to unemployment. And even if the micro-economic argument that unemployed persons prefer being recipients of social security to reintegrating into paid work accounts for a small minority of the unemployed in a short term perspective. This argument certainly underestimates two aspects: The social relevance of paid employment to social identity and social recognition and the fact that a decent level of social security, at

[8] The reservation wage defines the wage level that unemployed would accept and take up paid work rather than remaining on unemployment benefits.

least in a long-term perspective, can only be derived from paid work. Both arguments certainly hold for the majority of citizens. To sum up, generous unemployment benefits do not unavoidably deter unemployed persons from searching for employment but if they do so, longer search periods may also have positive effects on the quality of employment as they lead to a better matching between the of supply and demand of labour. Consequently, a generous benefit system may even avoid the loss of human capital.

The moral critique of generous benefit systems is twofold. A very negative view assumes that it is not legitimate that long-term unemployed receive benefits without contributing to the general welfare of a society. Sometimes, especially when cases of freeloading or the abuse of social benefits are exposed by the media, the unemployed are considered undeserving of social benefits. The public discourse on the social security system in Germany increasingly questions the legitimacy of long-term unemployment benefits and portrays the unemployed as freeloaders and as being costly to the social security system. This opinion, of course, questions the two basic principles of the German unemployment system: The principle of equivalence and the principle of solidarity. These two principles mean that employees acquire legal entitlement to benefits in the event of unemployment through payment of a proportion of their earnings as contributions in advance and that they are entitled to collectively organised social security when they encounter risks such as unemployment, old age or sickness. Of course, the relationship between contributions and benefits is subject to legal determination – and political decisions – as well as the definition of what is considered a social risk that should be covered by collective schemes. In Germany, the view of being unemployed is changing slightly: Unemployment is increasingly interpreted as being due to an individual deficit and not to a structural economic problem.

A more empathetic view considers that the social state should assume responsibility for social benefit recipients in a more elaborate manner than merely paying benefits: Public policy should develop policy measures that enable, qualify and motivate citizens to participate in the labour market. With reference to the (core) objective of

the EU employment strategy to enhance the employability of employees and the unemployed, employment experts recommend an expansion of public employment programmes and that a larger share of labour market expenditure be spent on active measures (Schmid et al. 1992). Although this basic, normative idea has influenced the most recent labour market reforms in Germany, the question of how public expenditure could be better used for active measures, and how measures can be allocated to the unemployed, remain largely unsolved so far. In addition to these technical questions however, the relationship between the German welfare state and its citizens is at present undergoing a process of redefinition in terms of what social rights are appropriate and how they can be articulated by public structures such as the administration, the social code, adjudication and politics. Of course, trade unions and other autonomous social groups try to influence these debates from the employees' perspective.[9]

3.2 The German unemployment benefit system

Before the reform came into force in 2005, German unemployment insurance was one of the most generous systems in the EU. Unlike most of the others, the German system consisted of the unemployment benefit that was usually paid for a period of one year[10] followed by unemployment assistance, which was paid until the end of the unemployment period. Both benefits were income related in order to secure the living standard of the unemployed person; the wage replacement rate of the unemployment benefit was set at 60%, and at 53% for the unemployment assistance. Both replacement rates were topped up to 67% and 57% respectively if the unemployed person had custody of dependent children. The unemployment insurance benefit –

[9] The political protest against the labour market policy of the red-green government has even lead to the foundation of a new left-wing party in Western Germany, which merged with the left-wing post-communist party of the Ex-RDA before the last elections in September 2005 .

[10] The benefit duration depended on the duration of contribution and the age of the unemployed. The benefit duration of one year was attained after one year of contributions. Older workers, over 58 e.g. could attain benefit durations up to 32 months.

as well as the active labour market policy measures – is financed by contributions, which amount to 9% of the gross wage. The employee's share (4.5%) is deducted directly from their wages by the employer and transferred to the Federal Labour Office.[11] Because the growing expenditure for benefits was considered too high and the employers' contributions as weighing too heavily on labour costs, the demand for a reduction of expenditure and the reduction of contributions became more urgent.

Although a number of proposals for a reform of the financing of the system were developed, the recent reform tackled exclusively the expenditure and not the income side of the system.[12] The main initiative was the merger of the social assistance and unemployment assistance schemes in order to eliminate a dualistic principle that was notoriously inefficient. The main objective of this merger was to eliminate the different treatment of recipients of social assistance and unemployment assistance in terms of employment promotion and to give recipients of social assistance better access to the active labour market policy measures, thus making their integration into the labour market easier. Another objective was to bring an end to the ongoing argument between the municipalities that were responsible for the regulation and payment of social assistance and the local public employment agencies that were responsible for the recipients of unemployment benefits. In addition to the organisational problems of which organisation would take care of which groups and how financial compensation between the federal office and the municipalities should be regulated, the question of the level of benefits also had to be resolved.

Justified by the argument that too generous benefits would hinder the quick reintegration of unemployed persons into paid employment, and after a fierce debate and hard bargaining processes within the parliament, the level of benefit for the long-

[11] Unlike the unemployment benefit, unemployment assistance was tax-financed and its administration was incumbant upon the municipalities. Unemployment assistance recipients however had access to the labour market policy programmes.

[12] Experts demand e.g. that the employment promotion and occupational training measures be financed using taxes or alternatively, that income be increased by integrating self-employed or public servants into the system. Another proposal referred to the basis on which contributions are calculated, suggesting it could be extended to included capital and other income.

term unemployed was reduced to the level of the former social assistance. At the same time, the maximum duration of the unemployment insurance benefit, for which the wage replacement rate remained unchanged, was reduced to 12 months. This resulted in a dramatic deterioration in the income situation of a large number of long-term unemployed: Since 1.1.2005, long-term unemployed receive a quite low monthly benefit of € 345. - in the West and € 331. - in the East.[13] At the same time, the rules according to which private real estate or cash assets are taken into account have become much stricter, and include the property of the partner. A further amendment that makes this reform so drastic, is that the criteria for employment that a long-term unemployed person must accept in order to maintain his or her benefit entitlement have also been made much stricter.[14]

The changes to unemployment insurance do not only impair the financial situation of unemployed persons, but they also reinforce the subjective perception of uncertainty and social insecurity of the unemployed. On the societal level, the reform is an expression of a shift in the underlying social consensus about what a decent social standard is. To sum up, the reform leaves a number of questions unresolved, e.g. concerning the quality and forms of standard employment, the level of decent pay and how reasonable protection against poverty should be shaped in order to avoid downward mobility. The trade union's interest in introducing a minimum wage as well as the old Green Party's demand for the development of basic income regulation, appear to be both legitimate and appropriate. To put it briefly, the merger of unemployment assistance with social assistance and the fundamental changes in the German system of social rights raise the question of how the old German Welfare State should adapt to ongoing and growing economic challenges (for a discussion on the changes see Bothfeld 2006).

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[13] Of course, the benefit recipients can get housing benefits that is paid according to the rent they pay.

[14] Long-term unemployed must now accept every employment – also those small jobs without social security contributions and entitlements – that are not indecent. This includes the obligation to accept badly paid jobs - a mechanism that may lead to substantial pressure on wage bargaining in the long run.

III. Driving forces and remaining questions

We have seen that policy reforms proceed at very different speed in all three areas. We can distinguish three different factors that drive these reforms: Concrete government projects and initiatives that are based on experience with the existing institutions and programmes, changes in social behaviour and dominating social practices that occur and that are more or less well described by social scientists and finally, supra-national policy making that may either lead to binding regulation as in the EU policy-making system or to the development of the discourse of reference as in the case of the OECD policy strategy (cf. Table 3). Of course, these forces are not independent, but inextricably interlinked. Nevertheless, it appears fruitful for policy analysis to distinguish these three factorial complexes as the latitude of action for national policy-makers becomes clearer. In fact, it is the national government that takes account of both social behaviour and supra-national issues to varying extents in the course of its work (developing labour market policy programmes).

Table 3: The driving forces of institutional change within the German employment system

	Labour law	Collective bargaining	Labour market policy
Government projects and initiatives	Since mid eighties: Continuous activities	Debated but not realised	Minor reforms since 1969, major reforms since 2002
Social behaviour/ changing practices	Strong micro economic assumptions on companies' and unemployed persons' behaviour, gradual adjustment to changes in women's employment orientation	Controlled and uncontrolled decentralisation Erosion of membership on both sides	Assumption of massive misuse of social benefits but no supporting data
Supra/ International regulation and policy-making	EU law requires compliance of national legislation OECD job study supports de-regulation, EU supports "flexicurity" strategy	Sceptical view of centralised bargaining systems	Massive (discoursive) support of activation strategy, strong criticism of the obvious inefficiency of labour market expenditure
Source: Own analysis			

The ongoing changes in the German employment system entail three concrete questions that social and economic policy makers should explicitly address and that

have not been solved either by national or by supra-national policy strategies so far. First, the regular employment status (*Normalarbeitsverhältnis*) that has provided strong standards in terms of pay, weekly hours and working time organisation is losing its dominance, but it remains unclear what shape a new standard employment might take. In Germany, the increase in weekly working hours has been fiercely debated for two years, while at the same time, women' average weekly working hours have continued to decrease. As many labour and social laws refer to a standard form of employment, the erosion of the regular employment status questions the institutional and legal framework as a whole. Legal amendments remain highly contradictory as they aim on the one hand to extend part-time work, self-employment, temporary contracts and small jobs, but on the other they still consider the regular employment status to be the reference e.g. for social security regulation.

The second question addresses the standard of social security that should be maintained by social security schemes and labour market policy programmes. The reforms to the German unemployment benefit system came along without any clear and consensual definition of the necessary level of social security and the definition of social risks that should be covered by public intervention. It was mainly driven by the diagnosis that the increase in expenditure for passive measures was no longer tolerable as it did not help to bring the unemployed back into paid employment. The drastic reduction of benefits for long term unemployed to the level of social assistance was implemented very quickly as the result of internal Parliamentary Committee negotiations and without being accompanied by a broader social debate that might have lead to a new social consensus.[15] The dissatisfaction of the Germans with the development in labour market policies has caused massive public protests

[15] Unlike the reforms to the pension scheme that have been ongoing since the end of the eighties, the time frame was extremely short and did not allow for social learning processes. In the area of pension politics however, the argument that demographic development requires fundamental adjustment of the existing schemes has been widely shared for a number of years, despite fundamental differences in concrete policy solutions that respond to this problem.

and the foundation of a new left-wing political party (*Wahlalternative Soziale Gerechtigkeit – WASG*), and it certainly contributed to the election result in September 2005, where neither of the two large political parties could gain the majority. Nevertheless, the definition of the standard and the organisation of social security remains core problems for the changing German Welfare State.

The third question concerns the form of governance in social policy and this is perhaps the most fundamental problem as recent developments reveal a fundamental shift in power relations from public (parliamentary and social) structures to closed-shop, political and technocratic commissions. As we have seen, the basis of participation of social partners is waning at present, albeit in an incremental way. The fundamental reform of the unemployment insurance scheme was not subject to broad social debate and classical corporatist decision-making, both of which characterised former social policy decision-making processes. It is nevertheless, a fundamental task of a democratic welfare state to consider how societal and social actors shall and can participate in policy development in order to develop more consensual and sustainable solutions that are broadly accepted by the citizens within a national employment system.

To achieve emancipation from internal and external driving forces, national policy decision-makers should address these three questions conscientiously and thoroughly and aim at the greatest possible integration of societal actors into public and political debate. However, this should not result in the avoidance of necessary social reforms, but lead to more consensual and more broadly shared solutions. Of course, cuts and reductions in benefits would then need to be compensated by complementary measures, e.g. a right to retraining or basic social security in old age in order to provide flexibility and security at the same time. A more fundamental participation of societal actors and a new balance between purely economic arguments and democratic decision-making would certainly lead to the development of more sustainable social policy.

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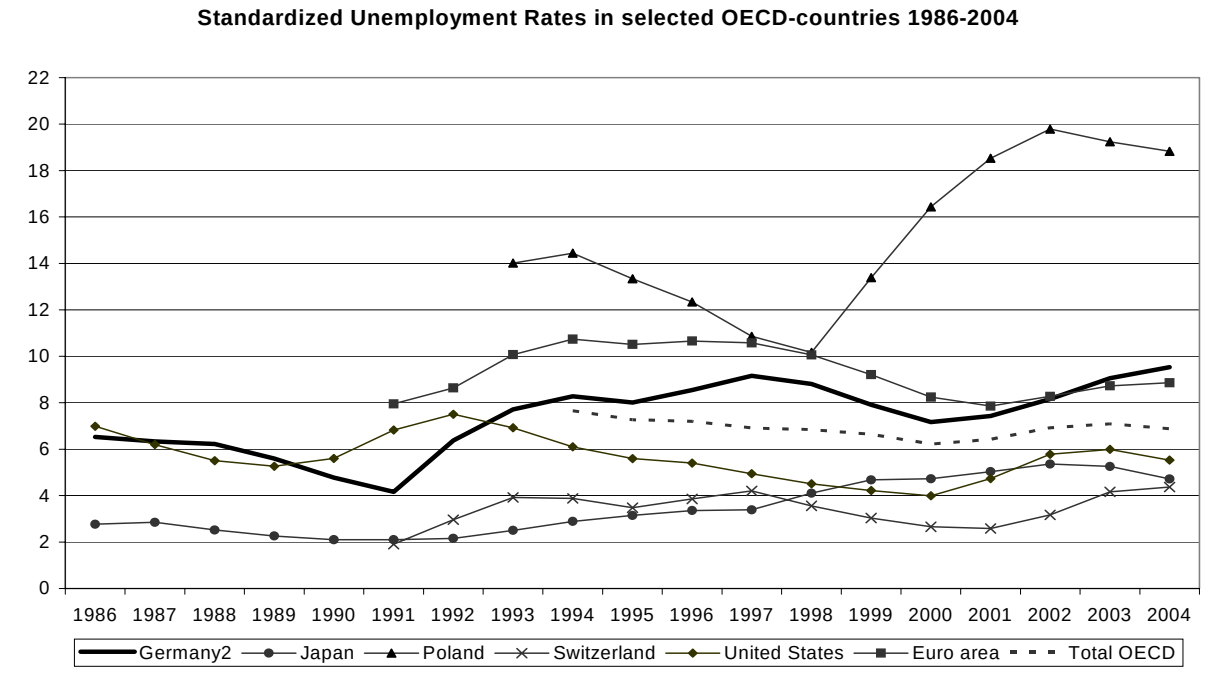
Annexe

Figure A1: Standardised unemployment rates in selected OECD countries 1986-2004

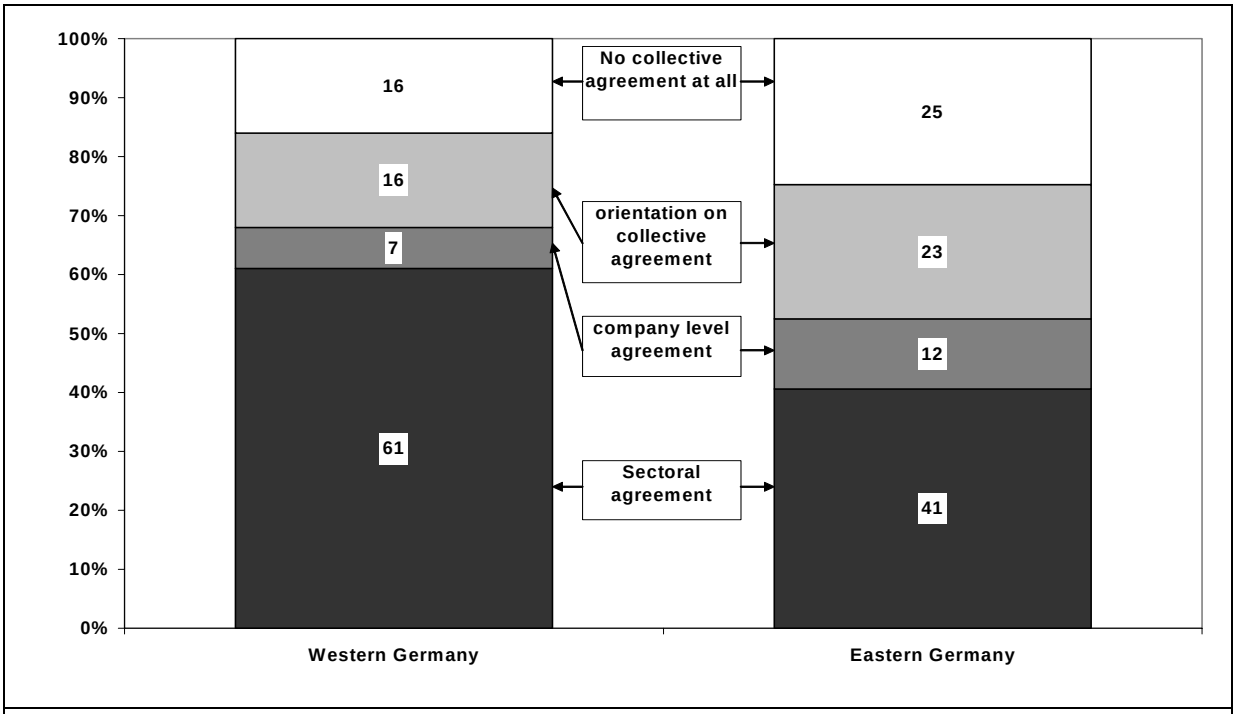


Note: As far as possible, the data has been adjusted to ensure comparability over time and to conform to the guidelines of the International Labour Office. All series are benchmarked to labour force survey-based estimates. In countries with annual surveys, monthly estimates are obtained by interpolation/extrapolation and by incorporating trends in administrative data, where available. The annual figures are then calculated by averaging the monthly estimates (for both unemployed and the labour force). For countries with monthly or quarterly surveys, the annual estimates are obtained by averaging the monthly or quarterly estimates, respectively. For several countries, the adjustment procedure used is similar to that of the Bureau of Labor Statistics, U.S. Department of Labour. For EU countries, the procedures are similar to those used in deriving the Comparable Unemployment Rates (CURs) of the Statistical Office of the European Communities. Minor differences may appear, mainly because of various methods of calculating and applying adjustment factors and because EU estimates are based on the civilian labour force. 1. See technical notes in OECD Quarterly Labour Force Statistics.

2. Data prior to 1993 refers to Western Germany.

Source: OECD Economic Outlook 78 database.

Fig. A2 Coverage by collective agreements as percentage of all employees by form of collective agreement, 2004



Source: IAB-Betriebspanel 2004.

Table A1: Legal reforms of the German employment system since 1969

	Name	Content
1969	Labour Promotion Act (AFG)	Objective: Securing a high level of employment, enhancing labour market structures. Giving priority to active labour market measures and preventive intervention through the promotion of professional mobility, vocational training, retraining and professional training measures. Introduction of entitlement to measures provided by the AFG. Fundamental restructuring of the Federal Labour Office (*Bundesagentur für Arbeit - BA*).
1976	Budget Containment Act	Reduction of professional training measures. Stronger focus on contributing employees. Restrainment of criteria for acceptable employment (Zumutbarkeit).
1978	4. Amendment to the Labour Promotion Act	The claim for employment assistance, the duration of which is unlimited, has to be renewed every twelve months. Obligation of recipients of unemployment benefits, employment assistance and training benefits to pay contributions to the pension scheme. Alteration of criteria for acceptable employment. Reduction of the personal choice to refuse a position on the grounds that it is unsuitable (Zumutbarkeit).
1979	5. Amendment to the Labour Promotion Act	Enhancement of the promotion of professional training (focus on short term measures that aim at identifying professional skills and knowledge). Enhancement of employability of the unemployed. Development of competence in local self-administration. Increased competence for local administration. Higher flexibility in the combination of labour administration measures.
1984	Act on Early Retirement	Objective: Replace elderly workers by registered unemployed. On the basis of a collective agreement or individual contract, workers over 58 years, who are willing end their employment careers, can opt for an early retirement benefit of 65% of their average gross wage of the previous six months. This is paid by the employer. If the employer hires a registered unemployed person to replace the worker who has retired early, the federal office pays a third of the early retirement benefit to the employer.
1985	Employment Promotion Act	Equal treatment of full-time and part-time workers. Prolongation of period of temporary agency work (from X to X months). Compensation procedure for sick pay. Temporary contracts can be concluded for a duration of up to 24 months without justification.
1986	7. Amendment to the Labour Promotion Act	Enhancement of instruments of vocational training, better access to employment creation measures (ABM) for elderly workers and the promotion of self employment for the unemployed. Maintenance of the social security function of unemployment insurance and unemployment assistance and enhancement of the social situation of the older and long-term unemployed. Reduction of level of contribution to the Federal Labour Office.
1989	Amendment to the Labour Promotion act and amendment to the early retirement Act	Part-time work replaces early retirement: Public subsidies allow for gradual transition to retirement for workers over 58 years of age. Employers are entitled to compensation by the Federal Office if registered unemployed are hired . to replace a semi-retired, elderly worker for at least 18 working hours per week.
1994	Employment Promotion Act	Labour market services are no longer limited to the Federal Office of Labour. Private and commercial providers can offer labour market services. Change and extension of active labour market policy instruments.
1994	Working Time Act	Replaces Working time regulation (*Arbeitszeitordnung*) of 1938. Allows more flexible working hours and stipulates the possibility for social partners to agree on diverging regulations.
1996	Unemployment assistance Reform Act	Reduction of the so-called original unemployment assistance to a maximum duration of one year (the o.u.a. was paid when the conditions of access to unemployment insurance where not fulfilled, e.g. in case of short-term employment contracts). Further cuts to professional training and retraining. Payment for positions generated by employment creation measures was reduced to 80 percent of collectively agreed wages.

1996	Act on Part-time retirement	The Federal Labour Office pays subsidies to workers over 55 years of age, who reduce their working hours before the 31st July 2001 and so enable their employer to hire an – otherwise – unemployed person.
1997	Labour Promotion Reform Act	Integration of Labour Promotion into the Third Book of the Social Code (SGB III). Change to the basic objectives of labour promotion: Focus on the increasing the level of employment is replaced by the objectives of enhancing professional and regional mobility, and promoting the reintegration of long-term unemployed and self-employment. Responsibility is shifted from the public to the labour market agents (supply and demand side of labour), the responsibility of the unemployed and his/her contribution to change their individual situation is stressed, individual obligations are stressed and sanctions are developed. Criteria for acceptable employment are again reduced and it is easier for the administration to withhold benefits.
1998	Act on Social Security for Casual Workers	Social protection of public health insurance, long-term care insurance, pension and unemployment insurance is maintained for employees during periods of leave. Social security contributions
1999	Law on Regulation of Marginal Employment	A uniform wage threshold for permanent small jobs is set at DM 630 per month for East and West Germany
2000	Act on Part-time work and fixed-term contracts	Objective: To promote part-time work and to make fixed-term employment easier by determining conditions for the conclusion of fixed-term contracts. Employees have the right to reduce their working hours if they have been employed for at least 6 months by a company with at least 15 employees. Fixed-term contracts can be concluded for a maximum duration of 24 months without justification. For longer fixed-term contracts, employers must justify this according to the conditions prescribed by law.
2001	JobAktiv-Gesetz	Objective: To make labour promotion more effective by “activation“, to attain a high level of employment, to enhance the structure of employment and to promote the equality of men and women within the labour market. Employers are obliged to inform the labour offices of significant changes in their employment strategy. Further, they shall contribute to the maintenance of the employability of their workers Employees are expected to develop their own professional perspectives. Decrease of long term unemployment by quicker reintegration into employment by enhancement of labour market services. Introduction of job rotation schemes as a regular instrument. Integration of employees on parental leave into the pension scheme (contributions are paid by the Federal Labour Office).
2002	First and Second Act on modern labour market services	Obligation of employees to register as unemployed at the Labour Office as early as possible. Establishment of private service providers in all Local Labour Offices (PSA, *Personnel Service Agencies*). New instruments: Training vouchers for training; access to promotional measures for self-employment is made easier (*Ich-AG*). Change in criteria for jobs that unemployed must accept (higher mobility, abolishment of any reference for pay of offered job). Wage threshold for small jobs is increased to € 400, Reduction of social security contributions for wages between € 400 and € 800 (Mini-jobs).
2003	Act for the Modernisation of the Labour Market	Reduction of benefit duration to 12 months (18 months for elderly unemployed over 54 years of age)
2003	Third Act on modern labour market services	Renaming of the federal office to “Federal Labour Agency”. General restructuring of organisation and working processes within the Labour Agency.
2003	Fourth Act on modern labour market services	Merger of two benefit systems: The flat-rate unemployment benefit II replaces unemployment and social assistance benefit and is paid to every needy, employable person. Social assistance remains reserved to non-employable persons (who are not able to work at least for 3 hours per day) Own and the partner’s income and assets are taken into account; means-test level is reduced. Reduced criteria for the right to reject a job as unacceptable and obligation to accept a “work opportunity“ without full social, labour rights and wages (compensated by a supplementary unemployment benefit II).

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