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Research Report

Education policy for growth and employment

More growth for Germany - Current Issues, No. 10

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Education policy for growth and employment*)

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The views of guest authors are not necessarily the same as those of Deutsche Bank Research.

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I. Foreword

Germany's education system is under fire. Several international studies, and some carried out in Germany, say that graduates of the German education system merit no better than average grades. They have strongly shaken the way Germany's politicians, education administrators and employees have perceived the system to date. The sharpest criticism of the outdated system is being voiced by the business community: despite in some cases heavy investment in information technology, productivity growth in the German economy has lagged far behind that in competing service economies over the past ten years. There are indications that the weakness of productivity is associated with the deteriorating quality of human resources, a factor mainly influenced by the education system.

In the following we shall present eleven propositions for further discussion. They are partly aimed at highlighting the need for reform in selected areas of the German education system. Also, they aim to show how the education system can be remoulded to help Germany master the challenges it faces. These include the slowdown in economic growth, mass unemployment, demographic change, the high and increasing level of government debt, the deepening and widening of the European Union, and the growing lead in innovation commanded by the USA.

II. The propositions

1. Education is a major driver of economic growth

Education has positive quantitative and qualitative effects on the overall growth of an economy, with the quality of the education system providing the larger contribution. Therefore, a quality-oriented education policy is a growth, employment and location policy all in one. Quality improvements could be achieved especially by reforming structures in primary and secondary schooling and in university education, but also in vocational training.

2. Education expenditures have no bearing on the quality of schooling

Education expenditures in the school segment correlate closely with expense indicators, especially with the level of teacher salaries and the number of teaching hours. Changes in the spending level have virtually no impact on the results of the education system in terms of quality of student performance. What this boils down to is that there are sound reasons for spending money on education to provide an appropriate level of education. However: an increase in spending is not necessarily reflected in an improvement in the quality of education. In other words: the quality of education can as a rule be secured with the help of structural reforms which do not, or at least do not always, require higher expenditures.

3. The supply of skilled labour is on the decline

As a result of demographic developments it is likely that in the long run the supply of skilled labour will decline at all qualification levels. However, in the medium term an excess supply of low-skilled labour could emerge while bottlenecks appear in the medium-skilled group and in some segments of the higher-skilled group. Structural measures which help to bring about an improvement in the quality of schooling and vocational training could be instrumental in lowering the share of low-skilled workers and raising the supply of medium-skilled labour.

4. Those willing to upgrade their skills are punished by regulated labour markets

Strongly regulated labour markets send wrong signals to economic agents. Even though there is generally acknowledged to be a link – in the area of the highest skills – between formal qualifications and related job opportunities, it is difficult to identify the job opportunities afforded by medium-range qualifications. A far-reaching drive to deregulate the labour markets and make them more flexible would enable those willing to upgrade their skills (students, employees and unemployed) to realistically assess the returns to be achieved from investing in education. This is a key prerequisite both for increasing the participation in education and for adapting individual education profiles to the demand for labour, especially for the medium-skilled level.



5. Education standards and performance controls can improve the quality of schooling

The results of several national and international studies suggest that the schools providing primary and secondary education have difficulties in achieving international performance standards, especially in mathematics and natural sciences. Maintaining quality standards in a decentralised school system is a task that meets many obstacles, which is why authorities at each and every school are fundamentally expected to pay attention themselves to the quality of their service. However, central performance controls at Länder (state) or federal level might ease the implementation of quality standards, namely by setting obligatory minimum standards. If the maintenance of minimum standards were ensured via central performance controls where results were published and suitable for comparative analysis, such standards could stimulate competition among the schools and Länder and contribute to quality control.

6. Private-sector initiative should not be crowded out of vocational training

The frequently observed demand overhang for apprenticeships over the past few years has repeatedly been met with sizeable help from the private sector. As long as this functions satisfactorily, government intervention is unnecessary. However, it appears as if it were becoming increasingly difficult to make available a sufficient number of apprenticeship positions, since the costs accruing to the companies in question are trending upward, while the companies' returns (on training measures) are stagnating or on the decline. Therefore, it cannot be ruled out that education policy action may need to be taken if the scope and quality of vocational training are to be maintained. Basically, two instruments would be conceivable: a scholarship for the apprentices which could partly substitute for company remuneration, and increased extramural training. An apprenticeship scholarship could allow companies to lower their training costs and gear their training programmes to company needs. Extramural training (for example in supra-company training facilities) could be made more attractive and widened in line with demand. An apprenticeship levy would be counterproductive in every respect: it would crowd out (voluntary) private-sector initiatives, create incentives to "buy one's way out of responsibility", burden the government with high administrative costs and generate neither additional apprenticeships nor higher government revenues.

7. Vocational training must be released from the skill trap

As a consequence of the accelerated pace of technological change and the increasing internationalisation of the economy, there is a growing risk that vocations which are too narrowly defined might turn into skill traps. For this reason, greater significance needs to be attached to broadly based fundamental training. The much too large number of vocations should be reduced and greater emphasis placed on the teaching of general cross-vocational content. Extramural training facilities and vocational schools could play a key role in providing the broadest fundamental training possible. Skill traps also lurk, though, in the requirement that any

craftsperson wanting to set up a proprietary business in Germany has to possess a “großer Befähigungsnachweis”, or detailed certification of his or her prowess: this blocks many German craftspeople from taking advantage of the opportunities offered by the single European market, especially of the freedom of establishment, in their own country (discrimination of domestic residents). Like other barriers to trade and investment, this requirement ought to be abolished.

8. No one is qualified for academic tertiary education unless selected by a university for enrolment

In some courses of study, state-run universities have to cope with excessive demand for enrolment. This demand could be rapidly reduced if the universities only admitted applicants with the highest qualifications. To this end, school-leaving certificates – regardless whether obtained in Germany or abroad – would have to be evaluated appropriately. The various evaluation problems with which a decentralised school system without national standards has to struggle could be circumvented by following the example of the private universities and introducing entrance examinations. The state-run universities should also allow applicants without a conventional high-school leaving certificate to participate in such examinations. The actual design of the test should be left to the discretion of the universities.

9. State-run universities are in need of new sources of funding

Against the backdrop of nearly empty public coffers the state-run universities must, on the one hand, become more efficient in the administration of their funds and, on the other, tap new sources of funding. To secure a more efficient use of funds, they ought to have greater autonomy, introduce commercial costing and accounting methods and be largely exempted from the straightjacket of civil-service employment requirements for human resources management. A regional specialisation of universities on individual focuses (medicine, economics, technology etc.) could raise the degree of financial efficiency. In the search for new financing sources, the state-run universities should increase their participation in the international competition for funds from third parties. Moreover, tuition fees could cover about one-third of the financing needs for the first course of studies. The fees would have to be differentiated by course of study. There should be a guarantee of equal opportunities to obtain a university education by using flanking measures (scholarships, savings accounts for education, credit guarantees, etc.). Universities could generate additional fee revenue by offering further education courses for graduates, a field which will likely gain importance in future.

10. Time is a precious resource; it should not be wasted on an overly long first education phase

Shorter life cycles for new technologies raise the risk that acquired skills could become obsolete. In order to make the most of the productivity potential offered by a shrinking and ageing population, the duration of the first education phase for young people should be shortened while implementing the concept of life-long learning. Basic education could be streamlined by upgrading the pre-school phase, lowering the school starting age to as early as possible



(on a voluntary basis) and exploring further potential for shortening the course. Since the successful completion of an initial education phase is no guarantee for a permanent job, the workers of all skill levels should update their knowledge at more or less regular intervals in the framework of in-house and extramural occupational training. However, this implies a deep structural change in the education system. By shortening the first phase and extending the scope of academic and non-academic training the entire education system could be much better adapted to the requirements created by demographic and technological developments.

11. As a supplier of education, Germany should liberalise foreign trade in education services

In the post-war period Germany has seized on the opportunities that came with membership of the World Trade Organisation (WTO) and the European Union (EU) in order to deregulate its domestic economy. Today it is one of the leading exporters of goods, benefiting from the abolition of trade barriers abroad. However, the WTO's fundamental principles do not seem to apply to education services in Germany: the argument voiced to protect the German market from foreign competition is that public education services would differ from those offered by the private sector. This is surprising considering that such differences have long since been abolished in other sectors in which government suppliers offer their services or used to hold a dominant market share. The reason: people realised that monopolies – especially those owned by the government – are often responsible for a poor level of supply in the market and for driving up the economic costs of providing goods and services.

The German education system is under reform pressure, regardless whether the education market is liberalised or not. However, a liberalisation pursuant to the provisions of the General Agreement on Trade in Services (GATS) would help deepen the international division of labour in the education market and thus contribute to the emergence of an internationally competitive education sector in Germany. This would foster foreign demand for German education services and would generally have a favourable impact on the overall economic rewards derived from education reforms.

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