

GERMAN LABOR MARKET REFORMS: WHAT DO WE LEARN FOR ITALY?

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HISTORY OF GERMAN LABOR POLICIES

In 1990, the **initial funding for activation measures and benefit** payments to the former German Democratic Republic had to be provided by West German social insurance.

Registered unemployment in East Germany has doubled from 10 per cent in 1991 to 20 per cent in 2004.

Western Germany, which had to bear a substantial part of the fiscal cost of German Unification, is also faced with high unemployment though the rate is considerably lower than in the East.

In response to exploding cost of unemployment, the German Federal Government has started the largest social policy reform in the history of the Federal Republic.

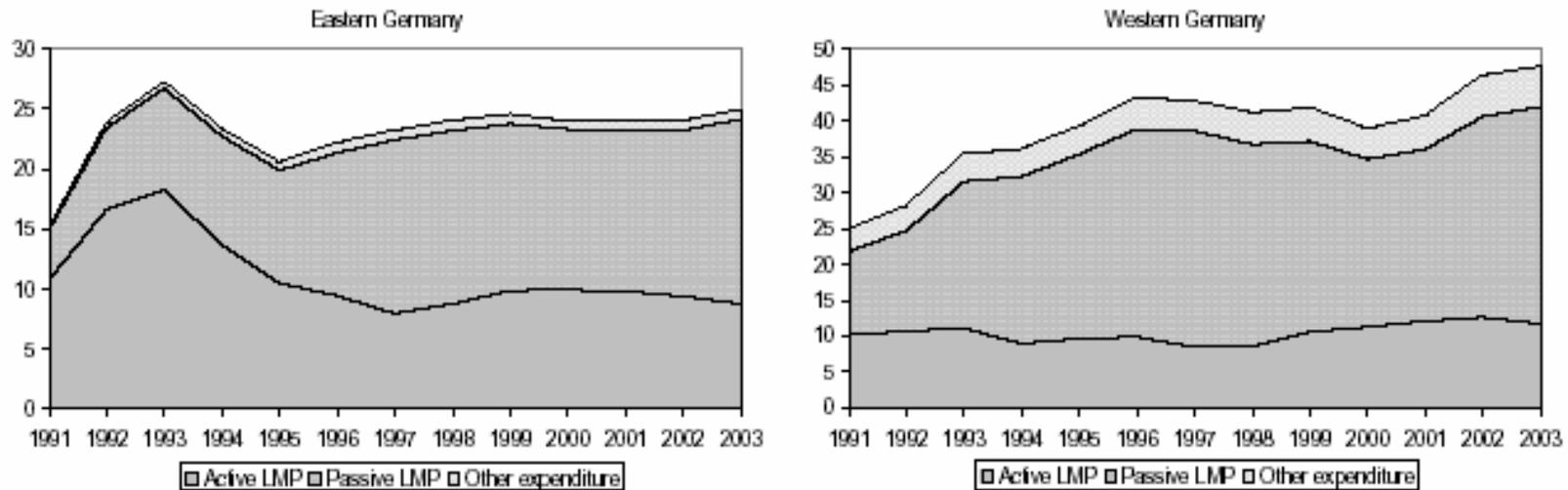
During East German transition, **active labour market policy** (ALMP) (mainly training and subsidized employment) has become one of the most important economic policy instruments.

In 1991, about one third of the East German labour force had participated in some ALMP measure.

Since 1991, the Federal Employment Office has spent **between 35 and 67 per cent** of its annual budget on ALMP with a disproportionately high share going to Eastern Germany that only makes up about one sixth of the German labour force.

In the period 1991 to 2002, Germany has spent between 1.2 and 1.7 per cent of its GDP on ALMP (OECD, 2004). Expenditure for income support during unemployment has risen to 2.1 per cent of GDP in 2002. In total, Germany has spent 3.3 per cent of its GDP on labour market policy in 2002.

Figure 3: Expenditure of the Federal Employment Agency 1991-2003 in billion €



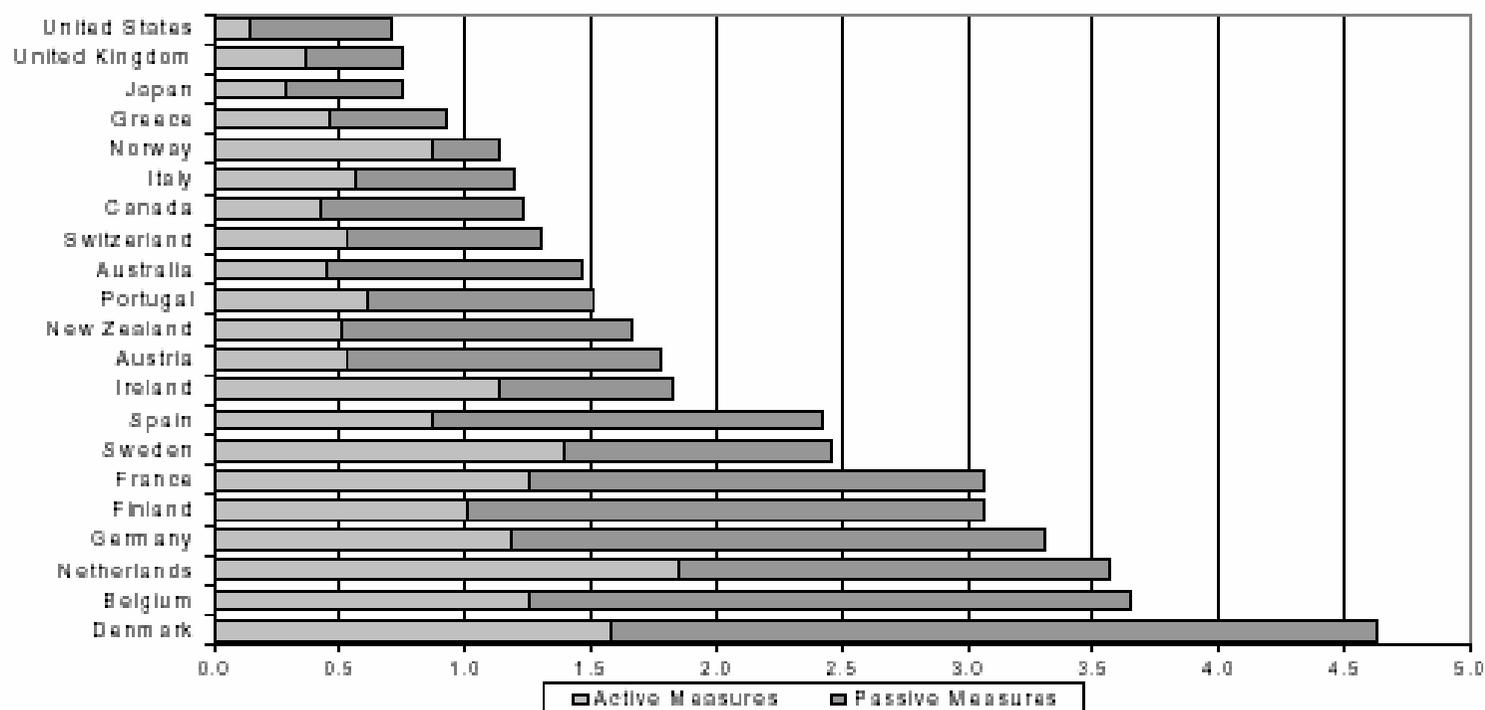
Source: BA (1992a-2004a).

DIFFERENCES AND SIMILARITIES WITH ITALY

Similarly to Italy: regional dualism with fairly similar structure of unemployment, women educated in the East.

Differently from Italy: expenditure for activation measures (training) and income support during unemployment is substantial and one of the highest among OECD countries.

Figure 2: Expenditure on active and passive measures in 21 OECD countries 2002



Note: Expenditure as a percentage of GDP. United States, Japan, Canada, Australia, New Zealand fiscal year 2001-02, United Kingdom 2002-03, Greece 1998, Ireland 2001.

Source: OECD (2004b).

Table 1: Selected economic indicators for Germany 1990-2004

Year	GDP growth ^a		Unemployment rates ^b		Productivity ^c	Gross wages ^d
	West	East	West	East	East/West	East/West
1990	5.7	-15.6	7.2	NA	NA	NA
1991	5.0	-19.2	6.2	10.2	32.9	57.5
1992	1.7	6.2	6.4	14.4	35.5	67.7
1993	-2.6	8.7	8.0	15.4	39.0	74.2
1994	1.4	8.1	9.0	15.7	41.4	77.1
1995	1.4	3.5	9.1	14.8	42.5	79.1
1996	0.6	1.6	9.9	16.6	43.4	79.5
1997	1.5	0.5	10.8	19.1	44.6	79.8
1998	2.3	0.2	10.3	19.2	66.9	80.1
1999	2.1	1.8	9.6	18.7	67.7	80.9
2000	3.1	1.3	8.4	18.5	68.5	81.3
2001	1.1	-0.5	8.0	18.8	69.1	81.2
2002	0.2	-0.2	8.5	19.2	69.9	81.2
2003	-0.1	-0.2	9.3	20.1	NA	81.2
2004	1.7	1.2	9.4	20.1	NA	NA

Note: All entries are in per cent. ^aGDP at constant 1995 prices. The numbers for 2004 are first preliminary estimates. ^bRegistered unemployment as a percentage of the dependent civilian labour force. ^cGDP per hour worked at 1995 prices. ^dGross wages per employee. NA: not available.

Source: Statistisches Bundesamt, BA (1992a-2004a), IAB (1998).

Table 2: Structure of registered unemployment in Eastern Germany 1991-2003

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Total number	1,029	1,111	1,159	1,041	1,033	1,100	1,375	1,381	1,472	1,448	1,487	1,502	1,554
Thereof (%)													
Women	60.0	64.7	65.4	66.9	63.7	59.6	58.0	54.2	54.2	51.9	50.7	49.1	49.2
Non-German	1.5	1.4	3.2	3.2	3.6	3.7	3.8	4.0	4.3	4.4	4.5	4.8	4.8
No degree	NA	NA	23.2	20.5	21.0	20.8	21.1	24.6	24.4	25.0	24.3	23.4	22.6
Age <25	NA	NA	11.8	11.3	11.0	11.1	11.6	12.4	11.7	13.2	12.9	13.6	12.3
Age ≥55	NA	NA	7.5	12.4	16.4	20.1	19.8	21.4	21.4	18.1	15.4	12.5	10.1
LTU	NA	NA	30.7	34.7	28.8	27.0	29.8	34.6	31.9	35.4	35.3	38.1	43.4
Health problems	NA	NA	9.9	11.7	13.8	15.7	16.4	18.1	19.4	20.4	21.1	20.8	21.3

Note: The first line states the total number of unemployed individuals in thousand. No degree: no formal professional degree. LTU: at least 12 months (long-term) unemployed. NA: not available.

Source: BA (1992b-2004b).

Table 3: Structure of registered unemployment in Western Germany 1991-2003

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Total number	1,610	1,784	2,288	2,452	2,488	2,749	2,933	2,584	2,472	2,237	2,256	2,440	2,653
Thereof (%)													
Women	47.9	46.6	44.5	43.9	44.1	43.5	44.0	45.3	45.8	46.3	45.6	43.9	43.2
Non-German	12.8	14.4	15.3	16.0	16.6	17.3	17.2	17.1	17.0	16.8	17.2	17.2	17.1
No degree	47.3	47.7	46.5	46.3	46.5	46.7	45.7	46.1	45.4	46.2	45.4	42.8	41.3
Age <25	15.2	14.8	14.1	13.3	13.0	12.9	12.4	11.7	11.1	11.4	12.3	12.7	12.2
Age ≥55	19.8	20.5	19.8	21.3	23.0	22.9	22.4	24.3	24.6	23.7	19.4	15.5	11.9
LTU	28.3	26.6	26.0	32.5	33.3	32.7	36.1	37.8	36.8	37.2	32.3	30.0	32.3
Health problems	NA	NA	26.5	26.2	26.3	25.6	25.3	27.1	28.4	29.8	29.2	26.7	25.2

Note: The first line states the total number of unemployed individuals in thousand. No degree: no formal professional degree. LTU: at least 12 months (long-term) unemployed. NA: not available.

Source: BA (1992b-2004b).

MAIN CHANGES OF HARTZ REFORM

Principles of the reforms since 1998:

Jobseekers have to use every opportunity to find employment and they have to **take up any acceptable job**. Requirements for independent job search and acceptability of jobs have been tightened.

Employers have to take measures to prevent layoffs and dependence of their employees on the welfare measures, and they have to **announce and fill vacancies** as early and as quickly as possible.

Employees, with the support of their employers, have to adjust their skills to changing requirements and **must not quit an acceptable job without having a new one** if they do not want to lose potential benefit claims.

The most important innovations of the new legislation are

- (i) Intensification of **job search monitoring** and placement efforts, in particular,
- (ii) Introduction of **qualitative profiling** to classify jobseekers by their individual strengths, barriers to employment and need for assistance immediately upon registration with the LEA
- (iii) **Written agreement** between the jobseeker and the local employment agency setting out the placement strategy and the associated obligations of both parties
- (iv) Hartz I has shifted the **burden of proof** from the LEA to the jobseeker. On the other hand, **sanction periods** are now different for different kinds of offences. Also, in contrast to the past, they are more rigorously enforced. As a result, the number of sanctions that actually have been imposed has almost tripled from 57,000 in 2002 to 153,000 in 2003.
- (v) More pre-emptive and more flexible use of ALMP, introduction of new ALMP measures and simplification of existing ones
- (vi) Measures to improve the labour market integration of youth and elderly people.

Effective since 2003, **Hartz I and II** aim at providing new foundations for faster and **lasting (re)integration of jobseekers** into the labour market by opening up new opportunities for temporary work, small jobs, self-employment and employment in private households.

Hartz III, which is effective since 2004, have the objective of establishing the legal foundations for the **restructuring of the Federal Employment Office from a bureaucratic public institution to a modern and efficient service provider**.

Affiliated to the Federal Employment Office are 180 Local Employment Agencies (LEAs) with about 660 branch offices that execute the labour market policy for the Federal Employment Office on the regional and local level. These can be broadly categorised into counselling and job placement services, labour market training, subsidised employment, support of self-employment, and payment of income support during unemployment.

HARTZ IV

January 2005: **Hartz IV** has established a **common basis for serving all jobseekers without unemployment benefit claims with respect to payment of income support as well as availability of and eligibility for ALMP measures.**

Before the reforms:

- 1) Unemployed individuals who had exhausted their UB claim could receive **unemployment assistance** (*Arbeitslosenhilfe*, UA).
- 2) Like UB, UA was proportional to previous earnings but with lower replacement rates than UB (57 per cent with and 53 per cent without dependent children). Benefit conditions and sanctions regarding registration, independent job search, take up and acceptability of employment as well as participation in activation measures had been essentially the same as for UB.
- 3) People who had **never been eligible for UB** could only qualify for **social assistance** (*Sozialhilfe*, SocA) which was a monthly flat-rate payment unrelated to previous earnings and, in general, considerably lower than UA.
- 4) Both UA and SocA had been means tested and paid from tax revenue. Also, **the duration of the UA/SocA claim had been potentially unlimited.**

- 5) While the ALMP measures provided by the previous legislation had been open to UA claimants, recipients of SocA had had access only in exceptional cases.

After the reform:

- 1) Needy individuals who are capable of working but do not qualify for regular UB receive so-called **unemployment benefits II** (*Arbeitslosengeld II*, UB II) as well as additional allowances for **accommodation and heating costs**. Their dependants who are living in the same household and who are not capable of working receive so-called **social benefits** (*Sozialgeld*) which are somewhat lower than UB II.
- 2) **Similar to former social assistance, both forms of benefits are means tested and paid monthly at flat rates** which are independent of previous earnings and unemployment insurance contribution.
- 3) In the past, people had had almost no incentive to take up a low-paid or part-time job because the additional income earned would reduce their benefits by the same amount (except for a small allowable deduction). After the reforms, recipients of UB II can receive a **monthly bonus** (so-called *Einstiegsgeld*) for up to 24 months when taking up insured employment or **becoming self-employed**. On the other hand, up to monthly gross earnings of 1,500 euros only part of additional income earned is deducted from the benefit payment.

THE INSTRUMENTS OF THE HARTZ REFORMS: VOUCHERS

The new legislation has enabled caseworkers in the LEAs to refer jobseekers to **external providers of placement**. Individuals who have been unemployed for at least six months have a legal claim for referral. The external provider can receive remuneration for his services from the Federal Employment Office. In addition, an explicit competitive element has been introduced. Jobseekers who have not been referred to an external provider by the LEA are - under certain conditions - entitled to financial assistance for private job placement in the form of a so-called **placement voucher**

The voucher is valid for three months and it entitles the placement agency, which has been chosen by the jobseeker to **receive a bonus of euros 2,000** for placement into insured employment of at least 15 hours per week. However, to prevent abuse, payment of the **bonus is performance-based: the first half is paid after six weeks of continuous employment and the rest only after six months.**

Since 2003, participants in further vocational training for which Federal Employment Office support is granted receive a so-called **training voucher** of potentially limited validity with respect to duration, regional area, or specific educational objectives.

As another part of the reform, **competitive contracting-out of reintegration** services for specific target groups has been enabled for the period 2003 to 2005.

Another instrument closely related to the idea of outsourcing of employment services is Federal Employment Office **supported temp-work**. Based on an **agreement between a temp-work agency (TWA) and the LEA**, the TWA can employ jobseekers proposed by the LEA to let them work for employers temporarily in need of workers. In times in which the jobseeker does not work for another employer during the term of the contract, the TWA is obliged to assist him in searching for a permanent job and to provide opportunities for further qualification.

THE INSTRUMENTS OF THE HARTZ REFORMS: UNEMPLOYMENT INSURANCE

Unemployment insurance is compulsory for all employees with more than a minor employment including apprentices in vocational training. However, civil servants, judges, professional soldiers, clergymen and some other groups of persons are exempted from contributions. Self-employed individuals are not covered by German unemployment insurance. The total unemployment insurance contribution is shared equally between employer and employee. The contribution is stable at 6.5 per cent.

A legal entitlement to UB can be acquired if the jobseeker has contributed to the unemployment insurance for at least twelve months within an entitlement qualification period of three years before the beginning of the unemployment spell. For seasonally employed individuals the minimum contribution period is reduced to six months. After exhaustion of UB, a new claim can be acquired if sufficient months of contributory employment have been accumulated in the meantime. **UB claimants receive 67 per cent of their previous average net earnings** from insured employment if they have at least one dependent child, and 60 per cent without children.

REDUCTION of UB

February 2006: UB entitlement will be made **considerably less generous**. The **minimum contribution period will be twelve months for all employees** including seasonal workers and the entitlement qualification period will be reduced to two years. In addition, the extended entitlement qualification period will be shortened from seven to only three years and the **maximum duration of UB** entitlement will be **reduced** substantially for the age group above 44.

In addition to previous contribution and age, participation in ALMP measures can have direct implications for the duration of UB entitlement as well.

Before the reforms: **wages received during participation in employment programmes** had been subject to unemployment insurance contributions and had therefore counted in the same way as regular non-subsidised employment for the accumulation of UB claims. Receipt of income support during Federal Employment Office supported training (so-called maintenance allowance, MA) affects UB entitlement. Under the previous legislation, **times of receipt of MA had counted in the same way as insured employment, thus contributing to the accumulation of UB claims.**

After the reform: **months in receipt of MA were no longer counted as equivalent to months of contributory employment**; they now only extend the entitlement qualification period by up to two years. Since 2003, however, receipt of MA reduces the total duration of UB entitlement by half of the duration of the programme and, since 2004; it no longer extends the entitlement qualification period. **Overall, the 2004 reform has almost eliminated incentives to participate in employment or training programmes for the sole purpose of accumulating UB claims.**

THE INSTRUMENTS OF THE HARTZ REFORMS: ALMP

ALMP can be categorised into counselling and job placement services, labour market **training, subsidised employment, support of self-employment**, and other measures.

The largest fraction of total expenditure on ALMP goes on **training**. The Federal Employment Office **supports labour market training by providing income support during participation and by bearing the direct cost of the programme such as course fees and study material, as well as additional expenses for child care, transportation and accommodation**. The training programmes differ largely in their human capital augmenting nature. Five groups of programmes can be distinguished: (i) short training, (ii) basic vocational training, (iii) further vocational training, (iv) retraining, and (v) German language courses.

New legislation sets the 70% rule: **only the 70% with best probability** of success (based on profiling interview) are put on training programmes. 80% of the unemployed were on some forms of training programmes. The 70% rule wants to reduce costs and improve success.

There exist two forms of **subsidised employment** in Germany: temporary wage subsidies and employment programmes. The wage subsidy compensates employers for the reduced work capacity during the first months in a new job. The target group for this measure are persons with barriers to employment like e.g. long-term unemployed individuals, elderly people and disabled persons. Usually, the subsidy is paid during the first six months in the new job.

Providers receive a fixed monthly subsidy for each employee, which is differentiated by education level of the participant. The maximum duration of the new subsidized employment programmes **is two years for employees below age 55, and three years otherwise**. Another important innovation has been the **exemption of subsidized employment from social insurance contributions**. In the past, participation in subsidized employment had counted as contributory employment for UB entitlement. The new legislation makes support of subsidized employment much more incentive compatible since it prevents abuse of subsidized employment programmes for the sole purpose of accumulating UB claims.

THE INSTRUMENTS OF THE HARTZ REFORMS: SELF EMPLOYMENT

Since 2003 recipients of income support during unemployment and participants in subsidized employment programmes that end their unemployment by starting their own small enterprise with expected yearly earnings of no more than euros 25,000 have a legal claim for a **fixed monthly payment from the** Federal Employment Office (*Existenzgründungszuschuss*, ExGZ). The support can be granted for up to three years but decreases each year.

For most ALMP measures, **there is no legal entitlement to** Federal Employment Office **support and it is the caseworker in the LEA who decides** whether or not an applicant who is eligible will receive financial assistance as well as in which specific measure applicants could participate. In contrast, some OECD countries use statistical classification methods to assist caseworkers in their decision.

THE MISTAKES OF HARTZ IV

- 1) Politics: to make the reduction in the UB benefits for the old look less cruel the government eased the accession requirements to welfare. The administration of welfare money was centralized also to overcome the resistance of local authorities regions and in towns. The result was a big increase in the application for welfare money. The expected outlays for UB II were 14 billion euros, the actual outlay is 25 billion euros.
- 2) Contemporaneous reform of public employment offices into Job-centres. Thousands of civil servants changed workplace, bosses and computer software. In the confusion the welfare applications could not be properly checked, they were just paid.
- 3) The reform of UB and welfare hit the old and favoured the young. This was intended but it did not take into account that if incentives problems are important for everybody, they are twice as important when the target are the young in the internet age. As soon as the rules were public, 1000 ways to trick the system appeared on the net: for the money, the rent and the incentives to become self-employed. In many cases the local offices have to cope with cases of threats and physical confrontation.

WHAT DO WE LEARN?

I take this discussion of the German case to make the case for very prudent and gradual reform in Italy.

- 1) An extension or better a reordering of UB and welfare in Italy is necessary but only keeping total expenditure constant. The German case teaches us that once UB benefits and ALMP are in place, they are very difficult to withdraw. When the expenditure on the instruments is too uneven across regions is politically untenable.
- 2) ALMP work only when they are not blunted by labor supply disincentives of UB benefits. If we want ALMP, better have little UB and welfare. Avoid introducing new ALMP, avoid the situation where voucher for vocational training and retraining become the next big business in South Italy. Better earned income tax credit targeted to second earners in the family with children. ALMP work better when they have an effect on wage determination.

The priorities are:

1) Two different wages (labor costs) North and South. Wages are the only and probably more effective instrument for development after the failure of last ten years of policy. The question is whether this objective cannot be better obtained with centralized wage setting rather than decentralized and with no changes in laws on union representation: i.e. three responsible unions decide that new contractual wages are different North and South because cost of living is different and because it is last hope of improving the North-South gap.

In Germany wages are set state by state (Figure 1) and there are opting out clauses and many more firms in the east opt out rather than in the West (Figure 2). Public sector workers are paid 90% of West German wages.

Schaubild 1: Relatives Tarifniveau in Ostdeutschland nach Tarifbereichen Ende 2004
(Index Westdeutschland = 100)

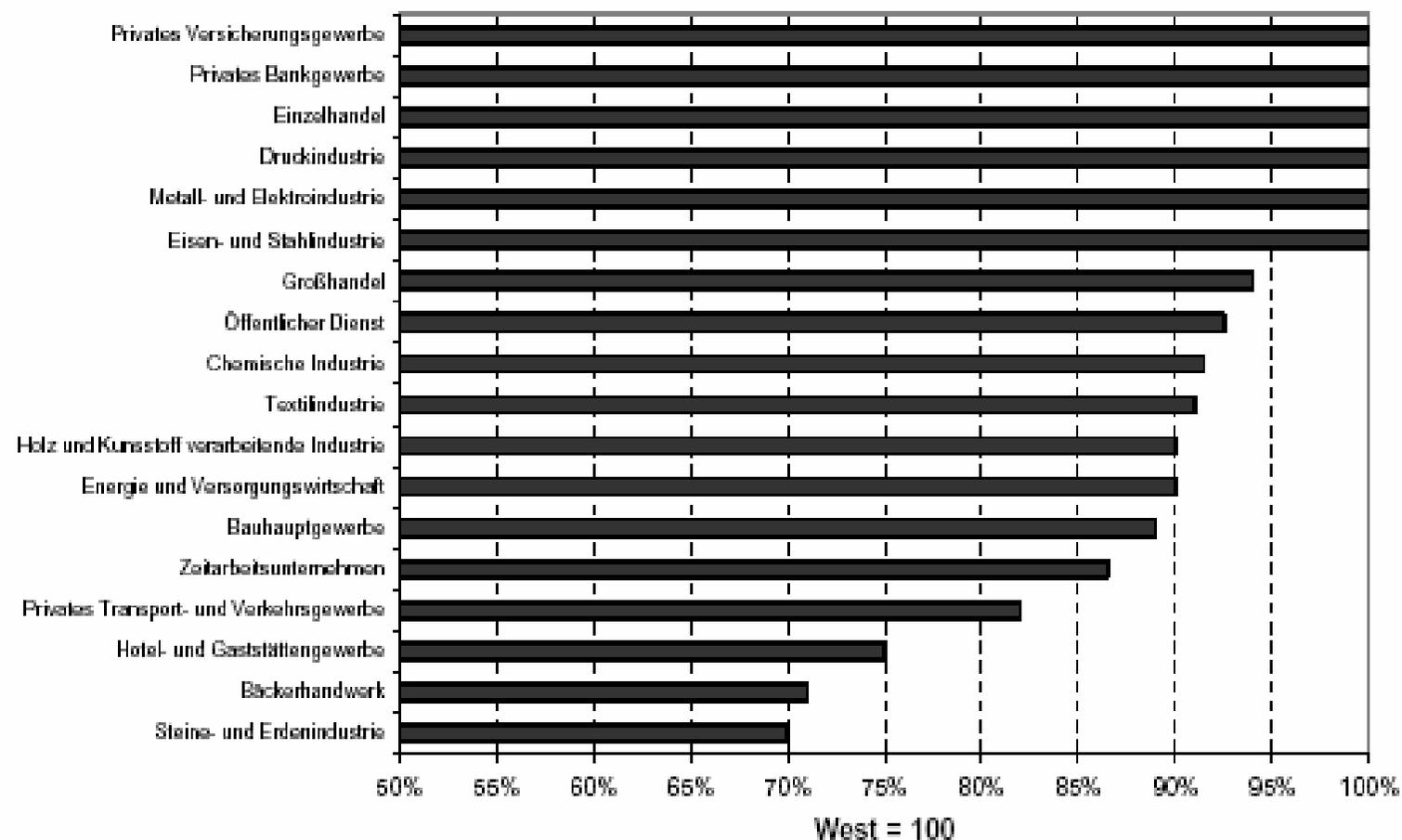
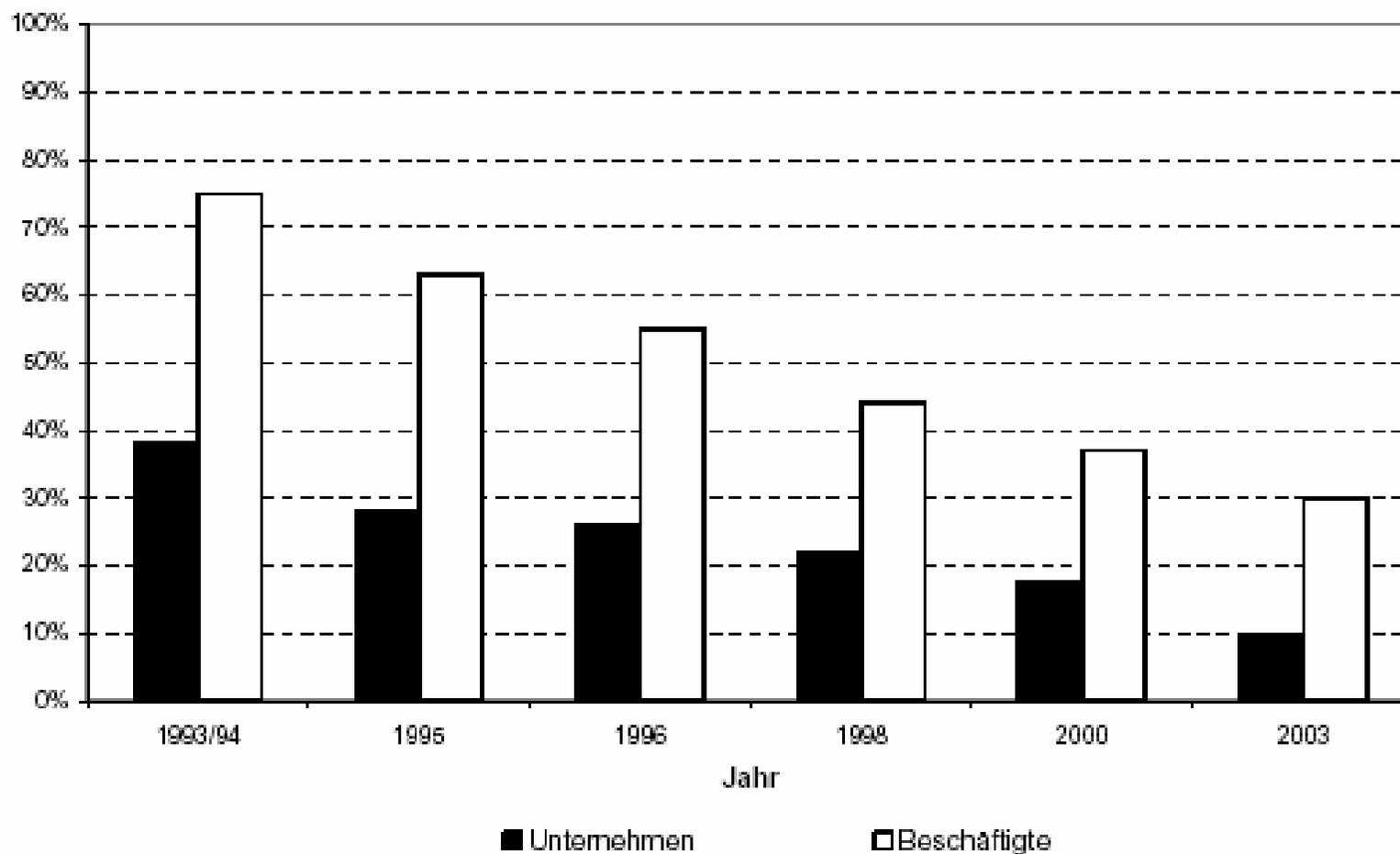


Schaubild 2: Ostdeutsche Industrieunternehmen nach ihrer Mitgliedschaft in einem tariffähigen Arbeitgeberverband



Anmerkung: Nur Unternehmen der Industrie. Quelle: Unternehmensbefragungen des DIW Berlin.

2) The simple withdrawal of fixed term contracts may be harmful for employment. Longer probation period and revision of individual dismissal rules (art. 18) are recommendable. Germany has individual dismissal rules which vary across firm size like us (10 instead of 15) and reintegration of unlawfully fired employees like us. Recently (within the Hartz reforms) the reintegration rule, which was seldom used, has been changed into the option of taking money (fixed amount) and renounce to reintegration right.