

O P I N I O N

The German Labor Market – Bound for Consistent Reform?



“On a trip to the Land of Cockaigne, a group of frogs jumped into a pail of milk and indulged themselves. Few of them noticed at first that they would not be able to get out easily because the walls were too slippery. One frog just barely managed to get out and began to wail loudly. The others, however, continued their self-indulgence without a care in the world. As the milk level dropped further, the walls became unclimbable. Suddenly, the frogs all started thrashing about and doing everything to stay afloat. After a while, some gave up and drowned. The others kept on struggling until they felt chunks of butter forming underneath their feet, which gave them a false sense of security. Only one of the frogs eventually summoned the courage to take a forceful leap to safety.”

This fable has a lot in common with the problems of the German labor market. In the 1960s, labor market problems seemed solved. Full employment was defined as an unemployment rate of close to zero. Economic growth – at an impressive average of four percent – guaranteed a high standard of living and encouraged the creation of a comprehensive social welfare system on the basis of seemingly secure growth prospects. Early warnings that this was merely a fair-weather system were ignored. Even as global crises and impending demographic changes caused the first disruptions of the system in the 1980s, nothing was done to change course. Distracted by the subsequent positive trend in global economic development, and later by German reunification, labor market policy has been dominated by social policy objectives throughout the past two decades. The “Christian socialism” of the Kohl era continued to shape national policy during Schröder’s first term. Under the Schröder administration, the fall turned into a nosedive, which resulted in the shattered reputation of the Federal Employment Services (Bundesanstalt für Arbeit) in Nuremberg.

In this kind of situation, marginal changes in labor market policy are useless. The only way out of the current dilemma is a complete reorganization of labor market policy and the social security system. This can only be done, however, if the government initiates the necessary steps during the first year of the administration’s four-year term. The closer election day comes, the smaller the chance of achieving reforms, because voters tend to punish governments for painful reform measures even before the programs begin to produce benefits. As the time window is about to be closed again, our policymakers must take swift action. Against this background, IZA has designed an action program for improving the economic framework to increase employment.

The new administration has once again declared unemployment as the main focus of government activity. Although several details of Schröder’s new course of action may be flawed, at least he has summoned the courage to initiate the right steps. These include combining the political responsibility for economics and labor in one ministry, improving macroeconomic conditions through a reinterpretation of the European Stability and Growth Pact, encouraging female labor market participation by the establishment of all-day schools, and implementing key proposals of the Hartz Commission. The planned merging of unemployment aid and social assistance will lead to a reduction of transfer payments to the unemployed. This is a painful but inevitable first step out of the crisis.

The labor market problem can only be solved, however, with a consistent long-term approach to combat the causes of unemployment. This includes the development of the low-wage sector and the deregulation of health services as well as child care and long-term care for the elderly. We must provide more work incentives by turning away from the single wage-earner model and abolishing the subsidization of early retirement. The reorganization of unemployment insurance according to market-based criteria must go even further than proposed by the Hartz Commission. Active labor market policy, which needs to be subjected to thorough scientific evaluation, should focus exclusively on an effective reintegration of the unemployed into the labor market. The responsibility of the collective bargaining parties for unemployment must become more institutionalized, and agreements within individual companies should receive a larger weight. The lack of labor market flexibility has become a symbol of Germany’s inability to undertake reforms. To achieve more flexibility, a legally governed system of severance pay should replace our rigid system of layoff protection. Furthermore, we should encourage competition among our educational facilities, improve the efforts to reform our pension system, raise the retirement age, and allow more immigration to prepare our country for the demographic changes ahead.

IZA’s “Seven Proposals for Modern Active Labor Market Policy” are meant to stimulate our policymakers to take decisive action – not only in the interest of the unemployed, but also for the sake of Germany’s future as a business center.

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