OPINION

Turnaround in German Labor Market Policy?

The new year has failed to bring any prospects of increased employment in Germany. Although there is some hope that the U.S. economy will pick up in 2003, economic growth in the EU remains sluggish. Germany could even face continued stagnation as the expected boost from the upturn in the global economy may prove too weak to provide the necessary stimulus to domestic demand. If growth in Germany remains far below the threshold that would trigger an increase in employment, the German unemployment rate is likely to climb beyond 4.2 million by the end of the year.

U.S. macroeconomic policy has come up with adequate responses to the global economic crisis for quite some time: Loose monetary and fiscal policies have helped cushion the downturn of the U.S. economy. It is also fortunate that the Federal Reserve has long been aware of its responsibility for economic growth, and that a stable budget has provided ample scope for fiscal policy. European monetary policy, in contrast, has not fully exploited its potential. At the same time, many European governments find their fiscal hands tied by the budgetary requirements of the Stability and Growth Pact.

Nonetheless, there is hope that an adequate reinterpretation of the stability goals could achieve not only sound budgets but also sustainable employment growth over the medium term. Ultimately, the realization of these two objectives will rely on substantial economic growth. A balanced budget is certainly beneficial to economic growth, but the rewards can only be reaped in the medium run. A tight fiscal policy in times of crisis or stagnation will slow down this growth potential. This is especially true if spending cuts are not confined to subsidies and personnel costs but also affect investments in infrastructure, education, research and innovations.

If this fact is ignored, German stagnation may turn into a permanent crisis that could eventually spread throughout Europe. This is why our policymakers must take decisive action to counter this trend. The year 2003 will be the "year of fate" for German economic policy. Political necessities require that effective reforms must be implemented now. The window of opportunity for courageous and painful initiatives will be closed as soon as the next election year approaches. One of the first steps must be to set medium-term rather than short-term budgetary goals. Wage demands must continue to be moderate. In this context, it is worth noting that the German labor unions are cooperating quite constructively in comparison to their European counterparts.

The recent wage agreement for German public service employees, however, is far too generous in light of the already strained public coffers. Since the additional wage costs will further reduce the fiscal scope, particularly for the eastern German states and the municipal governments, the planned reform of municipal government funding must be given high priority. An additional problem is the proceeding east-west wage convergence in the public service sector. The state government of Berlin, given its current budget crisis, has already dropped out of the nationwide wage agreement. This step is an important signal of Berlin's willingness to work its way out of the financial crisis that has gripped the nation's capital, and to recognize the broader economic context.

Although some of the decisions by the new federal government are certainly debatable, a few initiatives are noteworthy: The process of implementing the labor market policy proposals made by the Hartz Commission has been remarkably fast. Among the measures that took effect on January 1, 2003, are the following: The establishment of "personnel service agencies" to support the local employment offices and speed up job placement, the promotion of temporary work, the removal of restrictions on tax-exempt low-paid work, and the individual reduction of unemployment assistance based on an improved enforcement of entitlement requirements. Further plans include an extension of shop opening hours, a liberalization of the Crafts Code regulations, and the reduction of red tape. All these initiatives deserve praise.

However, this can only be the beginning, not the end of the reform efforts. None of the implemented programs has the potential to deliver a powerful blow to the unemployment problem. Some bring more hope than help. This is true, for instance, for the reform of the "mini-jobs." As these will mainly attract secondary wage-earners, housewives, retirees, and students, the deadweight loss for the government will be substantial. Labor market flexibility may be increased, but unemployment is unlikely to be reduced in the process. In other words, a sweeping reform of the German labor market has yet to occur. Still, there is a good chance for the reform train to finally start moving – it is high time that this chance be seized.

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IMPRESSUM

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