Germany’s Labor Reforms in Perspective

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The intuition and motivation behind the Hartz IV reforms

• One near universal recommendation circa 2002: improve labor supply incentives
• Problems of an insider-outsider labor market
• Analogy to US Welfare Reform circa 1996
  – *Gott sei Dank* that recovery means job openings
• Pushing the excluded (women, people of color, low-skilled and low-wage) into labor force participation
  – Unemployment hits them disproportionately
Evaluating the impact of the Hartz IV reforms

- The key reforms were cutting the duration of unemployment benefits and conditioning benefits on accepting work if offered
- Did they increase German employment?
- Did they come at a cost of increased income inequality in Germany?
- Did they contribute to sustainable growth?
- What happens after the current upswing ends? What reforms if any come next?
Something changed for the better…

Unemployment Rate in Germany, 1992-2007

Note: 1/ Yearly averages.
2/ Rise in 2005 is influenced by inclusion of recipients of social assistance who are able to work.

Source: Deutsch Bundesbank
Reform + Recovery
= Lower Unemployment

Figure 3. Germany: Labor Market Developments

Employment, specially full-time employment, is growing...

Total Employment and Growth Contributions From Full and Part-Time Employment (In millions and percent)
- Full time employment
- Part time employment
- Total employment (left scale)

Long and Short-Term Unemployed (In millions)
- Long-term
- Short-term

Mostly full-time jobs

Reduced LT joblessness

Source: Carara and Mody, IMF
Unemployment has not been equally distributed in Germany

Unemployment Rates For Native and Foreign Born Populations, 2003

NOTE: Multiples of:
African American to White US Unemployment in 2003: 2.1;
Asian to White Unemployment: 1.1;
Hispanic to White: 1.3

Source: OECD Trends in International Migration 2004 and Bureau of Labor Statistics
Bringing in the low-skilled formerly excluded

Unemployment is concentrated among the low skilled...

...and older workers tend to exit the labor force earlier than elsewhere.

Source: Carara and Mody, IMF
Lacking skills may be part of the increase in inequality.

Share of Population With Tertiary Education, By Age, 2005

Increased youth/female labor participation may be part of the increase in observed inequality.

Unemployment Rates 1/
(As a percentage of labor force for each age group)

<table>
<thead>
<tr>
<th>Year</th>
<th>Age Group</th>
<th>Germany</th>
<th>EU-15</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>15 to 24</td>
<td>16.0</td>
<td>14.0</td>
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<tr>
<td>2005</td>
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<tr>
<td>2006</td>
<td>15 to 24</td>
<td>14.5</td>
<td>13.0</td>
</tr>
<tr>
<td>2004</td>
<td>25 to 49</td>
<td>12.5</td>
<td>11.0</td>
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<tr>
<td>2005</td>
<td>25 to 49</td>
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<td>25 to 49</td>
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<tr>
<td>2004</td>
<td>50 to 64</td>
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<tr>
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</tr>
<tr>
<td>2006</td>
<td>50 to 64</td>
<td>7.5</td>
<td>7.0</td>
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</tbody>
</table>

Labor Force Participation Rates 1/ (Percent)

<table>
<thead>
<tr>
<th>Year</th>
<th>Age Group</th>
<th>Germany</th>
<th>EU-15</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>55 to 64</td>
<td>60.0</td>
<td>55.0</td>
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<tr>
<td>2005</td>
<td>55 to 64</td>
<td>55.0</td>
<td>50.5</td>
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<tr>
<td>2004</td>
<td>Women</td>
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<td>65.0</td>
</tr>
<tr>
<td>2005</td>
<td>Women</td>
<td>65.0</td>
<td>60.5</td>
</tr>
<tr>
<td>2006</td>
<td>Women</td>
<td>60.5</td>
<td>56.0</td>
</tr>
</tbody>
</table>

1/ EU-15 excludes Germany.
German union representation externalizes unemployment (as seen during reunification)

(chart from Jacob Kirkegaard, PIIE)
There is no automatic trade-off between increasing labor supply and income equality (only the US has vast inequality)

The Economic Models of Mars and Venus

- **Social Justice/Equity Parameter**
- **Inequality**
- **Leisure**
- **Work Effort/Labor Input Parameter**

- **Equality**

- **Annual Hours/Per Capita 2006**

Source: Conference Board; OECD; US Census; Swiss Federal Statistics Office. Adopted From Sapir
There is no automatic trade-off between increasing labor supply and productivity growth (even with the US out of the comparison).

Productivity and Labor Utilization 2004

Note: Observed Productivity (GDP per Hour Worked on X-axis) has been adjusted for country differences in employment rates and working time. Source: OECD; Eurostat
Labor supply improvement is not enough for sustained growth

Tracking Unemployment in Germany, Coeff = 0.55

Source: Eurostat
The direct impact of the Hartz IV reforms

- Changing labor supply incentives reduced unemployment just as predicted
  - once a recovery occurred to make jobs available
- Those German citizens disproportionately unemployed – youth, women, low-skilled, and foreign-born – got back into the workforce
  - Older native males suffered some income losses
  - Unlike in US, income loss does not mean loss of health insurance, pension, child’s college access...
- Some rise in income inequality was due to skill mix of new workers and to global trends
The limited meaning of the Hartz IV reforms

• Labor supply expansion is not a path to sustainable growth in per capita income

• Productivity growth declined in Germany
  – The one-time addition of 1.5 million below-average productivity workers cannot account for continuing efficiency declines in a total workforce of 43 million

• Compressing wages diminished German domestic demand and did not lead to investment commensurate with rising profits

• Further structural reform is needed, but of the corporate and financial sectors, not of labor