

## A Turning Point in the Job Market (April 12, 2005)

### Abstract

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A well-known economist comments on the labor-market reforms of the SPD-Green coalition that sought to make the German economy competitive again by pruning back some welfare state provisions and creating a low wage sector.

### Source

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*Purposeful support for and activation of labor is the new guideline for job market policy. When strictly implemented, this will reduce chronic joblessness and assure full employment.*

#### Introduction

For those involved with job market reform, there's no time to rest. At the beginning of 2005, the number of unemployed rose again to well over 5.2 million, calculated by German statistical standards. Unfortunately, nobody is interested in the fact that this is a misleading statistical byproduct, an increase engendered largely by the new practice, within the Hartz IV reforms, of including employable recipients of social welfare benefits in the unemployment statistics. A panic reaction among the public and politicians leads to a confusing spectacle, shaped more by the needs of media society than by actual constraints and foresight. Emotions are running high, and opinions are obviously more in demand than coolheaded understanding. Some are asking for more and more decisive changes, others for the reversal of the reform process. As a result, we need insights and perspectives to ensure that the "correct" decisions will be made in respect to job market policy in the future as well.

It's true that too little has been done too late. Beginning in the 1970s, the baseline rate of unemployment rose from one economic low point to the next. In light of this, the fact that this increase has not yet resumed after three years of stagnation from 2001 to 2004 should be seen as real progress. In contrast to most other industrial countries, the reduction in unemployment in an economic recovery phase was, however, weaker than its increase during the economic crisis. Moreover, the risk of unemployment is not uniformly distributed. In most cases it affects less qualified and older workers. This means that all too often, becoming unemployed means permanent unemployment.

Unemployment worldwide is the result of structural changes, since low-skilled workers are laid off owing to technological changes and the increase in the international division of labor. Unemployment caused by economic conditions can also result in lasting structural effects: in an economic crisis, low-skilled workers are more likely to become unemployed. Without work, the value of their human capital rapidly diminishes, they become demotivated, their confidence dwindles, and they have difficulty finding another permanent job.

The primary sources of structural problems are disincentives coming from job market institutions. The establishment of the welfare state during periods of high economic growth and lower unemployment rates resulted in numerous well-intended protective rights. But because of this, the state often neglected to ensure that the actors involved in the job market— workers, the unemployed, businesses, unions, and politicians— were making decisions in keeping with the common good. For example, the push to employ more older people will come to nothing if the state aids in removing older workers from companies via early retirement programs. Jobs in the low-income sector cannot be created if welfare benefits are more financially attractive for low-skilled workers than legitimate employment. Moderate wage increases

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cease when the state is prepared to offset the negative employment impacts of exaggerated wage policies through labor market policy measures.

It may seem paradoxical that the job market is characterized by chronic unemployment among low-skilled workers and at the same time by a shortage of highly skilled workers. The limited capacity of labor markets to adapt to increasing qualification demands is responsible for this. Modern job markets and production cycles require an intensive deployment of human capital, which has increasingly proven to be the most important production factor. As a result, low-skilled workers face a steadily decreasing number of jobs, while highly qualified workers are becoming a scarce commodity. Within this widening gap between people's life opportunities lies a highly explosive social and political situation.

For decades, labor market policy in Germany, supported by all political forces, was above all social policy. Before and after unification, it was a matter of securing the established standard of living, or of bringing the standards up to those in West Germany. In the context of low unemployment and high economic growth, this had little economic impact. Faced with an ongoing crisis in growth and escalating financial burdens due to constantly increasing unemployment figures, the need to rethink the problem became inevitable. Placing people in employment had to be the focal point of all labor market policy deliberations. Purposefully promoting and activating labor became the new guideline for job market policy. Helping an individual to find and accept a job is the just thing to do. Since then, job market policy has focused on three key themes: increasing the incentives to get a job, improving placement efforts, and creating new jobs. The necessary jobs will only emerge on a permanent basis within a dynamic, innovative national economy with a developing low-wage sector.

Starting with the introduction in early 2002 of the "Job AQTIV Law" (AQTIV = Motivation [*Aktivieren*], Qualification [*Qualifizieren*], Training [*Trainieren*], Investment [*Investieren*], Placement [*Vermitteln*]), labor market policy was clearly ready to follow a new direction for the first time. The central components of this law— improving the quality of job placement, setting up job seeker profiles, actively involving job seekers in the placement process, augmenting vocational training for unskilled or older workers— offered a very promising way forward. This was supposed to initiate the long overdue shift from purely reactive unemployment management to a job placement service that prevents unemployment. The principle of "promoting and activating" prescribed by law was to enter active labor market policy.

Through earlier and more intensive mentoring and counseling of the unemployed, employment offices should not only improve the chances for more rapid placement, but at the same time also succeed in motivating job seekers. This should be supported by a "reintegration agreement" between the employment office and the unemployed person, specifying the actual services performed by the employment office and the obligations of the job seeker, while also stating the expectations of job seeker self-initiative. In addition, the development of an individual profile listing strengths, weaknesses, and job market opportunities is planned. It is especially important that this "profiling" be carried out at the very beginning of unemployment, in order to facilitate the fastest possible reintegration into the job market. This was an implicit admission that standard practice thus far had led to much valuable time being wasted in this respect, and that new legal procedures were obviously required in order to spur the labor administration into action.

Following parliamentary elections in 2002, the far-reaching proposals of a reform commission (Hartz proposals) were quickly drafted as legislation, further concretizing the concepts of "promoting and activating." Among the first measures in January 2003 (Hartz I and Hartz II) were the establishment of personnel service agencies to support the employment offices in order to push for more rapid placement, the upgrading of temporary agency work, the lifting of restrictions on limited employment, the promotion of self-employment for the unemployed, and the expansion of the possibilities for reducing unemployment benefits on an individual basis when individuals did not accept the work offered. From the beginning of 2004, Hartz III regulated the integration of the labor administration within

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the Federal Employment Agency. Job placement was to become a customer service and shed its bureaucratic character, making job placement the main focal point.

The farthest-reaching and most difficult stage in the reform process was implemented at the beginning of 2005 through Hartz IV, which reduced the entitlement period for unemployment benefits from 32 months to 12 months (for older job seekers 18 months). Both unemployment and social welfare benefits were combined in the new Unemployment Benefit II, which generally offers lower benefits than the old unemployment compensation. This reform measure was intended to end the inefficient and expensive redundancy of federal job agencies and municipal welfare offices in favor of more intensive counselling for job seekers by personal case workers. Job seekers are now to receive an individually tailored job-hunting strategy either through a job center, a working group composed of the local municipality and an employment agency, or one of 69 approved community agencies nationwide.

In reality these stages of reform, in particular Hartz IV, are nothing less than a “revolution in installments.” Society’s solidarity with the unemployed and those who are needy but capable of working is tied to the obligation to work for this support as far as possible. This ended a system that was not only increasingly less viable financially, but also offered too few incentives for unemployed persons and social welfare recipients to take up employment. Previously, the long-term unemployed were seen primarily as victims. Their marginalization began to divide society. Now society and the unemployed are collectively responsible for finding solutions. Those who speak glibly about a cold society should realize that social benefits are always primarily financed by the “common folk,” and that the resulting high non-wage labor costs lead to job reduction, causing yet more social suffering.

This means that a large number of reform initiatives have been tested out in real life. It doesn’t matter if individual elements of this comprehensive reform package prove to be less successful; the fundamental concept behind the new job market policies is inevitable and correct. That being said, this course of action must be embraced by the responsible institutions and rigorously implemented. Yet this is still lacking. And there is still insufficient understanding that such extensive changes require substantially more time on the operative than on the legislative level. For this reason, we cannot expect immediate, resounding success in reducing unemployment. A lack of success should also not be used as a reason to clamor for the withdrawal of this reform. The instruments must be given a chance to develop and prove their effectiveness. For the first time, in any case in the history of German labor market policy, the implementation of measures will be comprehensively investigated by different independent groups of researchers using modern evaluation methods. This is also a vast improvement that will assist in permanently and conclusively establishing the effectiveness of the chosen instruments.

Since the beginning of this year, employable recipients of welfare benefits have been registered in the unemployment statistics; this has led to an inflation in the number of unemployed. The agitated and sanctimonious debates sparked hereby have impaired job market reforms by prematurely casting doubt on their effectiveness. Welfare recipients were also included before the statistics were adjusted, but not among the unemployed. Aside from this, it is likely that a significant number of the welfare recipients thus incorporated are incapable of working. On the other hand, amidst the public uproar the introduction of another new statistic was not taken into account: the number of unemployed measured according to the standards of the International Labour Organization, which since February has been submitted monthly to the German Federal Statistical Office and now stands at just under four million. In this case, those without jobs who are otherwise employed, or who are not available to the labor market at short notice, are not included in the statistics. Moreover, there are people from the hidden reserve who are willing to work. It would help Germany’s reputation in the world if we focused more on this distinction.

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Source: Klaus Zimmermann, "Eine Zeitenwende am Arbeitsmarkt," Bundeszentrale für politische Bildung, April 12, 2005. <http://www.bpb.de/apuz/29100/eine-zeitenwende-am-arbeitsmarkt-essay>

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