GERMANY’S LABOUR MARKET MIRACLE: New evidence of the impact of the Hartz reforms

Labour market reforms that reduced unemployment benefits, improved public job intermediation and relaxed regulations on temporary help agencies or marginal employment have been key to the German labour market ‘miracle’. That is the conclusion of research by Michael Burda and Stefanie Seele, to be presented at the annual congress of the European Economic Association in Geneva in August 2016.

These policies – known as the Hartz reforms – were introduced between 2003 and 2005, and were aimed at encouraging more people into work. Since that date, employment has risen 10% and unemployment declined by half, even though there has been a global economic crisis. But many argue that Germany’s flexible labour market institutions were the most important factor in the country’s continued employment growth.

The authors show that Germany’s employment growth has been almost entirely due to people entering the workforce, not simply more hours worked. They conclude: ‘The Hartz reforms were essential because they mobilised inactive workers and reallocated a relatively stable level of working hours across a shrinking working age population.’

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This study offers new evidence on the origins of Germany’s labour market ‘miracle’. Since 2005, employment has risen by about 10% and the unemployment rate has declined by half, despite the Great Recession and the challenges of increased trade integration with Eastern Europe and Asia. Germany has reversed a trend – common to large European countries since the 1970s – of rising average unemployment rates after every successive business cycle.

The researchers find a qualitative change in the behaviour of wages and employment surrounding the years 2003-5, especially in western Germany. They conclude that the Hartz reforms, which occurred during this time, were essential because they mobilised inactive workers and reallocated a relatively stable level of working hours across a shrinking working age population.

The causes of Germany’s labour market performance as well as its transferability to other European countries are the subject of heated debate. Some have argued that the labour reforms – which strengthened incentives to participate in the labour force and to accept job offers – were instrumental, while others claim that the flexibility of labour market institutions, especially collective bargaining, was most important, and that the Hartz reforms were only secondary or even irrelevant. Both sides agree that an increase in wage inequality is an important feature of the German success recipe.

First, Burda and Seele show that the strong German employment growth since 2005 is entirely attributable to increases in employed persons and not hours worked. Total aggregate hours in 2014, including those in ‘precarious’ forms of employment, was only 0.4% higher than in 1993 – despite a cumulative increase in real GDP of 33%. In effect, the 11.4% rise in employment over the same period was due to a marked reduction in average hours. Until 2011, all of the net increase was due to an unprecedented expansion of part-time employment.
Second, the researchers confirm that compensation, measured as gross hourly or daily pay of wage and salary of employees, rose unevenly across different types of labour, leading to a significant increase in wage inequality in the West German labour market. This increase in wage dispersion began in the upper half of the wage distribution in the mid-1990s, but in the lower half only since 2004. This finding is already established for full-time workers. By applying an imputation procedure, the researchers show that socially insured part-time workers face even more wage dispersion.

Third, Burda and Seele show that the strongest increases in employment occurred where wages grew the least. To this end, they apply a technique originally designed to study the evolution of US wage inequality during the 1980s.

Put simply, if shifts to labour demand predominate over a particular period, wages and employment should move in the same direction across groupings of workers; if supply shifts predominate, wages and employment should move in opposite directions.

Primarily, the Hartz reforms represent an increase to labour supply given the working-age population – by reducing unemployment benefits, improving public job intermediation, relaxing regulations of temporary help agency and marginal employment.

The authors find that especially in West Germany and in the market for part-time employment, wages and employment move in opposite directions, but only after 2004, when the reforms were implemented. Moreover, labour force participation for groups with negative wage developments tended to increase, despite an ageing society.

These findings suggest that more individuals are willing to participate in the labour market due to the labour market reforms. Employment in East Germany evolves differently, probably reflecting sustained structural change over the period, including long-run economic convergence.

ENDS

‘No Role for the Hartz Reforms? Demand and Supply Factors in the German Labour Market, 1993-2014’ by Michael C. Burda and Stefanie Seele


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