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GERMANY'S RESPONSE TO THE CRISIS

Solid growth to recession

Before the global financial crisis hit Germany in the second quarter of 2008, the country was experiencing solid economic growth and declining unemployment. Gross domestic product (GDP) expanded by 3.2 per cent in 2006, 2.5 per cent in 2007 and 1.6 per cent in the first quarter of 2008, compared with the previous quarter. The crisis changed this situation rapidly, however, with the collapse in global demand proving especially damaging to Germany's export-reliant economy. Modest declines in GDP in the second and third quarters of 2008 were followed by much steeper contractions of 2.4 per cent in the fourth quarter of 2008 and 3.5 per cent in the first quarter of 2009. Output shrank by 4.9 per cent in 2009 compared with a 1 per cent increase in 2008.

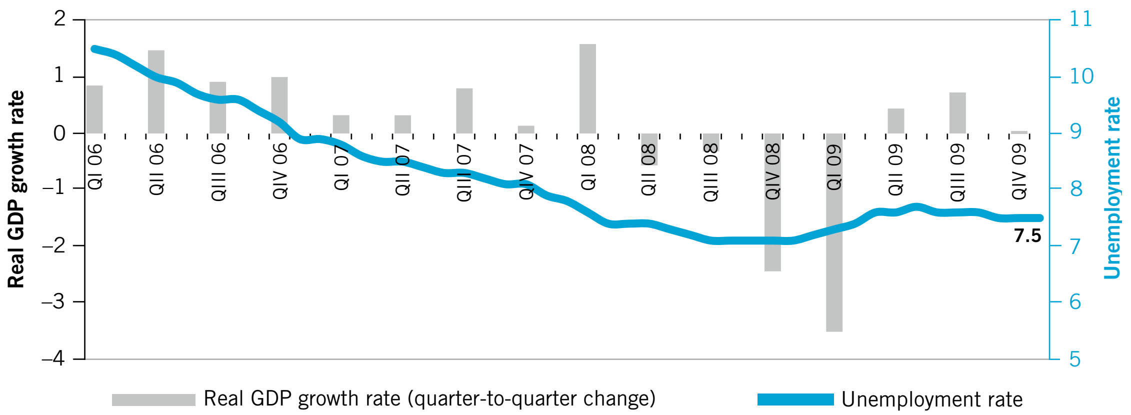
Taking into consideration the severity of the decline in output, the labour market remained relatively resilient. In 2009, the unemployment rate rose 0.2 percentage points from its 2008 level to 7.5 per cent, still well below the recent peak of 10.7 per cent in 2005. Labour market adjustment primarily has occurred through a decline in working hours in virtually all sectors of the economy, with total hours worked falling by 2 per cent on average between the first and third quarters of 2008 and 2009. This was particularly the case for manufacturing, where the 4 per cent decline on average over the same period reflected extensive use of working time reductions, in particular through the short-time working scheme described in this country brief.

Stimulus package

Germany reacted to the crisis with a total of four stimulus programmes and some additional measures, adopted between October 2008 and November 2009.[1]

Size: The stimulus measures taken together totalled €100 billion (between US$135 billion and US$150 billion[2]) estimated at 4 per cent of 2008 GDP. International comparisons usually take into account only the two stimulus programmes of November 2008 and January 2009. Estimates on these vary between US$110 billion and US$130 billion, corresponding to between 3 per cent and 3.6 per cent of GDP. As a percentage of GDP, the German stimuli are estimated to represent the tenth largest stimulus package among OECD countries and the eighth largest among the Group of 20. In absolute terms, the package was the

Figure 1. Monthly unemployment rate and quarterly real GDP growth rate, by quarter, 2006–2009 (percentage)



Source: EUROSTAT and official country information. Seasonally adjusted data.

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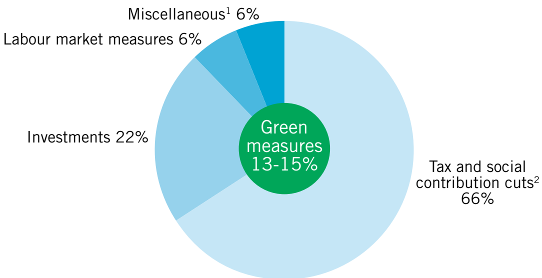
second largest among 22 OECD countries according to the OECD. In addition, Germany adopted support measures for the financial sector estimated at about 20 per cent of GDP.

Composition: Cuts in taxes and social security contributions (including a smaller amount of direct transfers) accounted for about 66 per cent of the stimulus package, with the remaining going for government expenditure. This included investments, labour market measures and measures for the automotive sector, such as tax cuts for new cars and a €5 billion cash-for-clunkers scheme. Green measures, which covered energy efficiency and transportation, were estimated at about 13 to 15 per cent of the stimulus package. Labour market measures, most notably short-time working, an extension of training and the hiring of 5,000 new employees for the country's Public Employment Services, accounted for an estimated 6 per cent of the stimulus package (figure 2).[3]

In addition to the discretionary programmes under the stimulus package, the German welfare and tax system provides for automatic stabilizers that are estimated to have a fiscal impact of 2.5 per cent of GDP in each of the years 2009 and 2010.

Figure 2. The elements of the stimulus programmes (as a percentage of expenditure)



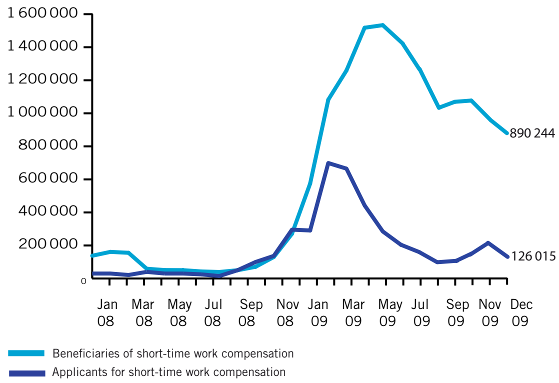
[1] Cash-for-clunkers scheme and tax reduction for new cars.
[2] Including some direct transfers such as higher child allowances.

Kurzarbeit: Reducing working hours to retain employees

Germany traditionally has responded to temporary economic downturns with a short-time work compensation scheme that was first used in the mining industry in 1910. Known as *Kurzarbeit*, this became countrywide in 1927, was reaffirmed in the country's 1969 employment promotion law and used to differing extents during economic crises since then. Under the scheme, the government provides subsidies that allow people to work fewer hours without suffering a commensurate drop in earnings. The number of workers receiving short-time working compensation reached what likely was a historical peak of over 2 million in early 1992 during the process of German reunification.

In the wake of the financial crisis, the government introduced temporary changes to the scheme to extend its impact, at an estimated cost of €2.3 billion, about 40 per cent of the costs for all labour market policy measures in the stimulus. The number of workers covered rose to more than 1.5 million in May 2009, and has since begun to decline. Towards the end of 2009, applications by firms to use short-time work temporarily increased again, partially due to bad weather. Nevertheless, the number of workers receiving short-time compensation declined to 890,000 in December 2009, a reduction of almost 50 per cent from the peak in May 2009 (figure 3). Under the basic rules of the scheme (before the recent temporary changes described below), companies seeking to benefit must apply to the Federal Employment Service (*Bundesagentur für Arbeit*) and prove that the shortage in working time is temporary and severe. At least a third of their workers must be affected by the reduction in hours, and workers' pay must decline by 10 per cent or more. Maximum duration is six months, with a break of at least three months between spells, temporary workers are not included and training is not covered. Employers also must continue to pay social contributions for those on the scheme. The government compensation does not make up for full wages – on average workers face a 10 per cent to 12 per cent cut in pay for a 30 per cent drop in working time. This, however, is sometimes made up by the employer, especially in bigger firms. Although the scheme can be used in situations like bad weather in the construction industry and in cases of company restructuring, 99 per cent of short-time working compensation is currently linked to downturns in the business cycle.

Figure 3. Short-time work compensation 2008–2009



The social partners are involved in the scheme. For example, as a general rule workers' representatives at company level (usually union members) have to provide written consent in the company's application for short-time working compensation. There are also regional sector-wide collective bargaining agreements regulating short-time working, such as in the metal industry in Baden-Württemberg, which make short-time work less costly for firms.

Extension to combat crisis

Given the severity of the financial and economic crisis, Germany introduced a series of temporary changes in *Kurzarbeit*, mainly as part of its stimulus programmes. Most are valid until the end of 2010. These include:

– It is no longer necessary to have at least one-third of staff on reduced hours. A 10 per cent pay reduction is sufficient for claiming short-time work compensation.
– The government gradually has extended the maximum *Kurzarbeit* period. As of June 2009 it became 24 months, provided the application was made before the end of 2009. For all applications made in 2010, a maximum of 18 months applies (government decree of 8 December, 2009).
– Temporary agency workers and other workers on fixed-term contracts can be included, as can apprentices.
– The Federal Employment Service has stepped in to reduce employers' social security contributions for workers on shorter hours. Initially this covered half of contributions, but since July 2009 full coverage exists for workers after six months on the scheme and for those enrolled in training measures.
– The scheme now covers time spent in training (see next section on training).

Impact – Fewer unemployed

An in-depth analysis[4] shows specific features of short-time work in June 2009, when 1.43 million people worked short time in total, of which 1.42 million did so because of the recession. There was an average reduction in working time of 30.5 per cent, corresponding to about 432,000 full-time equivalent jobs. A loss of that number of jobs would have added about one percentage point to the unemployment rate. This hypothetical figure does not reflect workers who might have found other jobs, workers who may have been put on short time without subsidies and early retirements.

There was strong sector concentration in the engineering and metal industries, which were particularly hard hit by the decline in exports. More than 35 per cent of those employed in metal manufacturing, almost 25 per cent of workers in machine tools and more than 20 per cent in the electric equipment and automobile industry worked reduced hours under the scheme. In total, these industries account for more than half of the stock of short-time workers. Because of this sector distribution, male workers accounted for 78 per cent of all short-time workers.

This industry concentration reflects the way in which retaining employees through short-time working is especially suited to sectors and economies that depend for long-term competitiveness on a skilled workforce. This can also be true for training (see next section).

Training for recovery

Another traditional feature of German labour market policy is public support for training. The country's response to the crisis has included an expansion of existing measures as well as the introduction of new schemes, with total additional spending estimated at €1.97 billion, or 36 per cent of the labour market part of the stimulus. As part of the second stimulus programme, the government revived a scheme used briefly during German reunification known as "training instead of dismissals" (*Qualifizieren statt entlassen*). This subsidizes training during non-work hours for people covered by *Kurzarbeit*. In such cases, the employment service pays full social security contributions and training costs. The European Social Fund (ESF) substantially contributes to funding the scheme. Training is organized by certified organizations as well as the companies themselves. The scheme is valid through 2010.

Other schemes that have been expanded include training for employed workers (*WeGebAU*). This was formerly only available for those aged over 45 and working in a small or medium-sized enterprise, but has now been extended to all employees who have not participated in publicly funded training during the previous four years. The scheme also covers temporary agency workers. Participants receive vouchers that usually cover training fees and also may receive allowances for travel and accommodation. Their employer continues to pay their full salary.

These training schemes cover both low-and high-skilled workers. Relevance of training to the labour market is among the conditions for receiving public subsidies. Administrative procedures foresee that both workers and employers can ask for training, but in practice employers and the works council negotiate on the adoption of a "train rather than dismiss" company policy, especially in bigger firms.

A recent case study of 12 companies showed that the effectiveness of the new training schemes was closely linked to the degree of cooperation between management, the works council and unions, the public employment services and the training organizations. The 12 cases point to a variety of types of training – from formal training leading to certificates for those without vocational training degrees to specific, brief modules adapted to high-skilled workers. The case studies found that the publicly funded training is helping to address skills shortages that were present before the advent of the crisis.

While such training for the employed is growing, most German schemes traditionally are geared to the integration of the unemployed into the labour market. Figures show increased training, for both the employed and unemployed. For example, the number of people in further training increased between 2007 and 2009 (figure 4).

Another important element in Germany's training landscape is its apprenticeship system, which provides industry with qualified workers. Although the numbers of apprentices and initial training slots have decreased since the crisis, there are also fewer young

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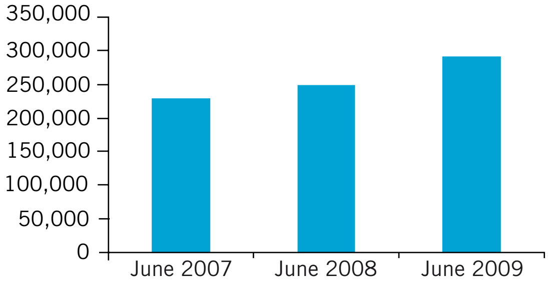
Figure 4. Number of people in training, June 2007 – June 2009*



Source: Federal Employment Service.
**Qualifizierunmassnahmen* (skills training measures), including ESF-financed training for short-time workers in Germany.

people seeking such posts, because of demographic developments and the continuing trend towards higher education. Meanwhile government subsidies for apprenticeships grew during the crisis. As a result, the ratio between supply and demand has narrowed to one training slot for every 1.12 person searching.

Impact – Building skills during crisis

The strong focus on job retention and training has seen the number accessing training while on short-time schemes grow from virtually zero to over 130,000 between January and November 2009. They remain, nonetheless, a small share of all short-time workers. Indeed, despite the financial incentives available, it is difficult to set up training courses quickly, both for firms and training providers. Bigger firms, especially if they have their own training facilities, participate to a greater extent in the scheme than smaller firms.

There has yet to be an overall evaluation of the specific training efforts since the crisis. It appears that a "training offensive for job retention" is backed by a wide coalition across the political spectrum, particularly employers and unions. Social partners have concluded agreements on the issue, mostly in company collective bargaining agreements. And while observers note that the training offensive falls short of expected results, it has helped temper large decreases in training that are usually observed during economic crises and has helped to prepare workers for the recovery.

Outlook and challenges

Economic growth has begun to pick up in Germany and GDP is forecast to grow by 1.4 per cent in 2010. The unemployment rate, however, is expected to rise from 7.6 per cent in 2009 to above 8 per cent in 2010. This reflects the fact that the labour market upturn traditionally lags economic recovery. However, given that the labour market remained unexpectedly resilient in the past year, there is uncertainty about its future prospects.

With short-time working expected to decline in 2010, a challenge will be to ensure that most of those no longer on short-time work remain integrated in the labour market. Another concern is the high incidence of long-term unemployment, given that about 30 per cent of those currently without jobs have been out of work for more than a year. While youth unemployment has risen above 10 per cent due to the crisis, this rate is among the lowest in the EU and demographic factors could help to keep it down.

Labour market developments will also reflect the sources of economic growth, which for the moment is driven by the export industry rather than domestic demand. Reviving domestic demand will be a key challenge in the recovery period, particularly given fiscal constraints.

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[1] *Entlastungspaket* (Fiscal easing package), October 2008; *Konjunkturpaket* I and II (Stimulus programmes I and II, November 2008 and January 2009) and *Wachstumsbeschleunigungsgesetz* (Law on speeding up growth), November 2009.

[2] Estimates vary with the dollar-euro exchange rate used.

[3] Estimates of the breakdown vary widely depending on the source.

[4] Federal Employment Service, October 2009.