

Could Germany's labor reforms work elsewhere?

In the early 2000s, Germany's unemployment rate surpassed the eurozone average, yet by 2012 it had lowered its jobless rate to near full employment.

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In the decade until 2012, Germany underwent a second economic miracle, lowering its jobless rate to near full employment.

This time it had nothing to do with an injection of foreign aid as occurred under the Marshall Plan after World War II. Instead, it was the fruit of a series of labor reforms, which is making other European nations, like Spain, stand up and take notice.

After the fall of the Berlin Wall in 1989, Germany found itself saddled with a jobless rate of 19.5 percent, as Western Germany sought to assimilate the formerly Communist East, which was suddenly plunged into free market realities.

Then-chancellor Gerhard Schroeder set up a special commission, led by Peter Hartz, the HR director of Volkswagen, whose recommendations led to the passage of four key laws.

As IESE Prof. [Sandalio Gómez](#) explains, the underlying thinking was that people needed to take matters into their own hands if they were going to avoid unemployment.

Making work the better option

Starting in 2005, unemployment benefits were means tested and linked to services offered by the federal employment agency, city governments, labor unions, charities and private entities trying to help those find work.

The maximum benefit, as of 2012, was 375 euros a month. This was available for the lowest wage earners. People who made between 100 and 800 euros a month could claim 20 percent of the benefit; those who earned more than 800 euros, 10 percent. In this way, people were always better off working than claiming benefits.

To encourage unemployed people back into work, people had to accept the job offers made to them, with a few exceptions.

So, if an unemployed person wanted to keep receiving benefits, he or she had to accept a job offered by an employment agency, even if the salary was considerably lower than what he or she was earning before.

However, during the first three months of unemployment, a person could reject the job if the wage was 20 percent lower than his or her previous pay; from the fourth to the seventh month, the percentage rose to 30. From the seventh month onward, the unemployed person could turn down a job offer only if the net income was equal to or less than the unemployment benefit.

New kinds of job contracts were created, with wages that started at 400 euros a month (mini jobs) or 800 euros a month (medium jobs). Medium jobs were useful for moving people up into higher positions.

If a worker had more than one mini job, and the salaries did not add up to 800 euros a month, then lower social security withholding taxes were applied. These schemes created many jobs in the health and services sectors.

Compensation jobs, or part-time jobs paying just one euro per hour, were also devised for the long-term unemployed. These accounted for 96 percent of the jobs created in 2005.

Under this scheme, employers paid 30 percent of the total salary to the government in the form of 15 percent to retirement, 13 percent in workers' compensation and 2 percent in taxes. Workers did not have to pay any income tax or social security, but they did have to help contribute to their pension funds.

Unlike mini jobs and medium jobs, it was found that compensation schemes generally did not help people find their way into higher paid, full-time jobs, but rather weakened their prospects and lowered their standard of living.

Subsidies for special groups

Another tool used to encourage hiring was the use of subsidies. The German government opted for the following:

- *Vocational Training.* The unemployed person received a voucher permitting him or her to work as an intern. In turn, the company received significant tax breaks.
- *Workplace Integration.* Companies received subsidies for hiring people who found it harder to find work, such as those over 55.
- *Self-Employment.* This was particularly popular among women, and helped create many new companies. The aid was equivalent to the last unemployment check the person received, along with an amount equal to the social security withholding payments, for a maximum period of three years.

Germany's turnaround from sick man to dynamo is attributed to the cumulative effect of all these reforms. Perhaps some of these ideas might work if adapted to other eurozone countries that are suffering from high unemployment, such as Spain, says the author.

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