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**The European Employment Strategy and
employment policy in the UK and Germany**

**Brian Ardy
London South Bank University**

and

**Gaby Umbach
University of Cologne**

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Brian Ardy¹ & Gaby Umbach²

Abstract

The Amsterdam Treaty of 1997 provided for an employment policy for the European Union. This policy could not operate by the normal EU method of common harmonized legislation. The sensitivity of employment policy and the very substantial policy differences, reflecting different traditions and philosophies, made this impossible. So the European Employment Strategy (EES) pioneered a new method of policy making, the Open Method of Coordination (OMC). This paper explains the nature of the OMC, as it applies to the EES, and considers the impact the policy has had on the employment policies of Germany and the UK. A comparison of the UK and Germany is of particular interest with regard to the EES, because it sheds light on how two countries, with very different institutional settings, are adapting to EU policy under the OMC. There is little evidence of an impact of the policy on employment policy. Until recently employment policy changed more in the UK, despite its very flexible labour market. German employment policy is now being modified, but in response to domestic unemployment and budgetary policies, rather than as a result of the EES. The EES has only been in operation for a limited time (since 1998) and its impact is perhaps more subtle. Rather than influencing policy directly, it is probably more important in shaping the attitudes of policy makers and advisers.

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Key Words: European Employment strategy; Employment Policy; Open Method of Coordination; Labour Market Reform.

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¹ School of Business Computing and Information Management, London South Bank University, ardybm@lsbu.ac.uk

² Jean-Monnet Chair, Institute for Political Science and European Studies, University of Cologne

1. Introduction

The overall situation of low employment and high unemployment masks an enormous variation in national performance within the EU, both in terms of the levels and the changes in employment. There is also has a very wide range of employment policies and industrial relations systems, which have their origins in national histories and ideologies, and are thus rooted to the society in which they exist. Moreover, evident national sensitivities over employment policies effectively rule out harmonized Community policy in this area. The heterogeneity of policy and outcomes does, however, suggest that co-operation in the employment field could be productive. The experience of other member states is a potential source of new policy initiatives, provides evidence of their effects and benchmarks by which to compare performance. The immersion of national officials and politicians in this experience could be a powerful mechanism for molding a consensus on appropriate policies and encouraging their implementation. The successes in other countries and the advocacy of the European institutions could also be useful in encouraging the acceptance of difficult changes in employment policy.

In this context the European Employment Strategy (EES) a new EU framework for promoting employment was created by the Amsterdam Treaty. The EES is implemented through what is known as the ‘Luxembourg process’, using the so called ‘Open Method of Co-ordination’ (OMC) it pioneered ‘soft’ policy co-ordination. This made possible the reconciliation national ‘ownership’ of the policy area with supranational co-ordination.

2. The European Employment Strategy

The EES process 1997-2002

Under the Luxembourg process the EES fixes guidelines for the EU member states, specifies timetables for the achievement of the set goals and provides general and specific quantitative and qualitative indicators, and benchmarks. Additionally, it requires the translation of the European employment guidelines into national and regional policies, as well as periodically monitoring, evaluating and peer reviewing the success of the implementation.

At the centre of the Luxembourg process stands the establishment of employment guidelines (EGs) at the European level. The EGs are the “central EU

policy document that deals on a regular basis specifically with labour market issues” (European Commission, 2002a, p. 28), which shall be consistent with the Broad Economic Policy Guidelines adopted according to Art. 99(2) Treaty Establish the European Community (TEC). The main function of the EGs is to set out orientations for policy actors in EU member states by providing measures for the assessment of policies in the context of continuous monitoring by the Commission and the Council and incentives for compliance. Since 1999 there has been provision for addressing recommendations to the EU member states (Council of the EU, 1999a) and with this mechanism peer pressure and multilateral surveillance have been strengthened, even if non-compliance involves no (pecuniary) sanctions. Nevertheless, multilateral surveillance, calibration and the setting of common comparable targets put potentially strong political pressure on the Member States.

From 1997 until 2002 the European Council annually considered the employment situation in the EU and adopted conclusions on the EGs on the basis of the joint annual employment report of the European Commission and the Council. Based on this European Council conclusion, the Council drew up employment guidelines and non-binding recommendations for the member states, after consultations with the European Parliament, the Economic and Social Committee, the Committee of the Regions and the Employment Committee. The Member States mapped out how they would attempt to fulfil the guidelines in National Action Plans (NAPs) on employment policy. The Council, based on these reports and after receiving the opinion of the Employment Committee, carried out an annual examination of the implementation of the employment policies of the Member States. The appraisal by the Commission, both of the plans and their outcomes, as well as the amendment of the guidelines followed. Based on the outcome of the assessment, the Council of Ministers and the European Commission established a Joint Employment Report (JER), commenting on the situation in the EU and on the implementation of the EGs by the Member States. The annual cycle could be characterised as a permanent monitoring and review process through the Joint Employment Report, the recommendations to the member states and peer review of policies. This cycle was accompanied by a multi-annual (medium-term/5 year) evaluation of the defined common objectives.

The EES process from 2003 onwards

With the interim evaluation in 2002 the EES and the EGs were revised for the period 2003 to 2010. To structure the revision, the Commission in 2002 identified “...four major issues for the EES reform: (a) the need to set clear objectives in response to the policy challenges, (b) the need to simplify the policy guidelines without undermining their effectiveness, (c) the need to improve governance and partnership in the execution of the strategy and (d) the need to ensure greater consistency and complementarity with respect to other relevant EU processes, notably the Broad Economic Policy Guidelines” (European Commission, 2002g; p.3). Based on these priorities and on the decision of the 2002 Barcelona European Council, the synchronisation of the Luxembourg process with the BEPG and the Internal Market Strategy (IMS) was proposed by the Commission in September 2002 in order to reinforce the implementation of the Lisbon targets and to put more emphasis on the medium-term aspect of the EES (European Commission 2002g, 2002h). According to the Commission the “Employment package will thus benefit from being more directly related to the overall policy approach ... [and from improving] the complementarity and mutually supportive character of the two sets of instruments” (European Commission, 2002g: 21).

Under the new arrangement that apply from 2003 onwards, the Commission presents the implementation evaluation of the BEPG, the EES and the Internal Market Strategy (IMS) at the same time each year in January. In April, after the Spring European Council, the Commission then presents the guidelines on economic and employment policy. This synchronisation should strengthen policy co-ordination in the socio-economic area. Within the Council, the delegations “...emphasised the importance of maintaining the autonomy of both processes, in particular the leading role of the Employment, Social Policy, Health and Consumer Affairs Council in deciding on the employment guidelines” (Council of the EU 2002c: 49).

The new EES splits the Employment Package. The first part (the Joint Employment Report), is presented by the Commission together with the implementation reports on the BEPGs, the EES and the IMS as part of the *implementation package* in January each year before the Spring European Council Summit. The second part (the Commission proposals for EGs and the recommendations) is then submitted after the Spring Council as part of the *guidelines package* together with the BEPG in April. The Council adopts the guidelines in June

after the European Council meeting and the NAPs are then to be submitted in October, followed by the Commission's Joint Employment Report in mid-January (European Commission 2002i: 10; 2002h).

The increased complexity of the EGs over the years has led to a situation where "...the hierarchy of priorities in the Employment Guidelines has become blurred, and the pillars have lost part of their intrinsic coherence" (European Commission 2002g:19). Thus the new guidelines were to be simplified, and in principle are to remain in place until the next mid-term review in 2006. This is to shift attention from the annual preparation of guidelines to monitoring of implementation to enhance the application of the EES.

The objectives of the guidelines are to be consistent with and complementary to the BEPG's, to respond better to the demands of an enlarged EU. Instead of the rather vague pillars of the old policy there are now three clearer overarching objectives and ten policy areas (See Section 3.1.2). This greater clarity of the new EES was welcomed by all the actors involved e.g. the European Parliament (2002). The EG's and the BEPGs will only be fully reviewed and amended every three years and, therefore, the 2003 guidelines cover the period until 2006 (European Commission 2002j:2). In the intervening years they will only be changed if necessary (European Commission 2002i: 4). Nevertheless, annual proposals for guidelines will be kept as required by the treaty (*ibid.*: 6). The 2003 EG's concentrated on anchoring the key aspects of the Lisbon strategy (full employment, quality and productivity of work; cohesion and an inclusive labour market) into the EES, on the adoption of the medium-term targets for 2010 and a new mid-term review in 2006 as well as on the clarification and simplification of the policy objectives and priorities and a stronger result orientation.

The annual reports of the member states on employment policy (NAPs) will be submitted jointly with the national reports concerning the BEPGs and the IMS in October each year. A full report is required only every three years. The intermediate reports will concentrate on new policy developments and focus on the implementation aspect. Thus, the next full NAPs are due in 2006. It is arguable how much of a change this represents in practice, since the EGs have not changed very much from year to year (see Section 3.1.2). In addition the NAPs already concentrate on new policy developments and implementation.

3. The Objectives of the European Employment Strategy

The Objectives of the EES 1998-2002

The goal of “a high level of employment” provided for in the Amsterdam Treaty, was given greater precision by subsequent European Councils, notably Lisbon 2000 and Stockholm 2001. The overarching goals established at the Lisbon European Council (European Council, 2000), are the achievement of an overall employment rate of 70% and a female employment rate of 60% by 2010. Intermediate targets for January 2005, of employment rates of 67% in total and 57% for women, were decided at Stockholm in 2001. In addition a new 2010 target of a 50% employment rate for men and women aged 55-64 was added (European Council 2001). Besides being a nice round number, 70% was chosen as an achievable objective for the EU 15. The employment rate was above 68% in the early 1960s³ and female participation in employment has increased since then. The 70% figure represents a challenging target for the EU as a whole since the employment rate was only 63.9% in 2001⁴. For the worst performing EU countries, Italy, Greece and Spain with employment rates of 54.8%, 55.4% and 56.3% respectively in 2001, the target looks unattainable. Similar problems exist for the other targets, for example in 2001 the female employment rates was 50.9% in Greece and the 55-64 year old employment rate was only 24.1% in Belgium.

From 1998-2002 policies to achieve these goals were grouped around four pillars: employability, entrepreneurship, adaptability and equal opportunities. This paper will concentrate upon the employability pillar, because this gives rise to most of the measurable policy objectives. Since 1998 five objectives have been promoted under this pillar of the employment strategy, the 1999 employment guidelines added one and the 2001 guidelines another two. This means that there were eight aims of the employability pillar:

1. Reducing youth unemployment
2. Prevention of long-term unemployment
3. Encouraging partnership in employment measures: this is not associated with outcomes but to means. This aim reflects the desire to include a wide range of social partners in drawing up the measures, to improve their acceptability and efficiency.

³ Statistics from European Commission 2001.

⁴ 2001 employment rates from European Commission, 2002b.

4. Easing the transition from school to work: this again is a means to achieve a reduction in youth unemployment. The difficulty of entry into the labour market is one of the major reasons for the high rate of youth unemployment.
5. Promoting a labour market for all: this reflects the growing interest in social inclusion and relates to disadvantaged groups generally, particularly the disabled and ethnic minorities.
6. Developing policies for active ageing: this relates both to the need to raise the employment rate of older workers, as well as to the need to encourage a more active retirement, with hopefully fewer demands on health and social welfare services among the elderly.
7. Active policies to develop job matching: some unemployment is the result not of a lack of jobs, but of the inability to match the unemployed with the available jobs (vacancies). Thus employment rates can be raised and unemployment rates reduced if the matching efficiency of the labour market is improved.
8. To prevent and to combat emerging bottlenecks: with structural change a fact of life in production and employment, it is important that the labour force has the skills and training required for the jobs which are available.

The second pillar, entrepreneurship and job creation aimed to create and support new businesses, new sources of employment and certain sectors of the economy, particularly services. These aims relate to the general improvement of employment performance of the economy, and so do not have particular targets related to employment.

The third pillar was adaptability: modernising the work organisation was concerned with the reconciliation of contractual/working arrangements with the needs of a more competitive and knowledge intensive economy, or in other words flexibility with job security. Thus although there are minimum standards of employment protection, employment security is seen more in terms of functional flexibility, achieved through high quality training and lifelong learning. Again this pillar is concerned with improving employment performance and the quality of work, rather than with specific i.e. numerical employment objectives.

The fourth pillar, equal opportunities between men and women is related directly to the 60% employment rate target for women. Although the target is set in terms of the employment rate of women, it can also be seen as means of reducing

female unemployment. The increased employment does, however, also imply increased female participation, the desirability of which is not really considered. Participation is to be raised by policies to reconcile work and family life, such as childcare and parental leave. The quality of female employment is also important and this is to be assessed primarily in terms of the pay gap between men and women. Thus this becomes an additional objective of employment policy.

For the purposes of this analysis therefore the objectives of the European Employment Strategy over the period 1997-2002 can be distilled into the following seven measurable objectives:

1. An increase in the overall employment rate to 70% or more.
2. An increase in the female employment rate to 60% or more.
3. An increase in the overall employment rate for older workers to 50% or more.
4. A reduction in the rate of youth unemployment.
5. A reduction in the level of long term unemployment
6. An improvement in the relationship between unemployment and vacancies
7. The reduction in the pay gap between men and women.

The Objectives of the EES 2003-

This somewhat complex approach has been simplified with the 2003 reform of the EES and with the guidelines (European Commission, 2003a; 9) with three overarching and interrelated objectives of the new EES:

1. Full employment
2. Improving quality and productivity at work
3. Strengthening social cohesion and inclusion

These are to be achieved by policies in ten areas:

- a. help unemployed and inactive to find a job, prevent long-term unemployment
- b. encourage entrepreneurship and improve climate for business start-ups
- c. promote adaptability of workers and firms to change
- d. provide more and better investment in human capital
- e. increase labour supply and promote active ageing
- f. promote gender equality in employment and pay

- g. combat discrimination against disadvantaged groups
- h. improve financial incentives to make work pay
- i. reduce undeclared work substantially
- j. promote occupational and geographical mobility “

(European Commission 2003a).

This revised approach of the new EES has greater clarity, with three clear objectives for policy, rather than the somewhat obscure pillars previously used. Similarly the policy areas are more transparently delineated. Whether the policy itself has been simplified is questionable, as it is still characterised by a multiplicity of targets and indicators.

4. The Policies of the European Employment Strategy

In order to achieve these objectives the EES encourages Member States to develop a range of policies. The Employment Guidelines outline the policies but the details of the measures and their implementation are left to the discretion of the Member States. The policies of course correspond to the objectives of the EES, but it is more illuminating to consider them in relation to the institutional factors identified by economists as influencing employment and unemployment. These were the factors discussed in Section 2 above and are as follows:

1. Social Security Benefits.
2. Taxation particularly of labour.
3. Employment protection
4. Wage bargaining/trade union strength
5. Mobility: occupational and geographical
6. Labour force education, training and skills/active labour market policies
7. Job matching

This section considers the situation of Germany and the UK in relation to these policies, and the way in which the policies have changed during the lifetime of the EES.

Social Security Benefits

The EES has put increasing emphasis on making benefit and tax systems more employment friendly. This applies to the overall tax burden, which is to be gradually reduced, to taxes on labour and other non-wage costs, and to poverty and

unemployment traps resulting from the operation of the tax and benefit systems. (European Council, 2002).

The complexity of social security systems makes comparison difficult but the OECD provides regular comprehensive comparative data (OECD, 2002a). With taxation of earnings, selective assistance for those not qualified for UA/UI and other benefits, a general measure of the generosity of benefits is required. This is measured by the Net Replacement Rate (NRR) the income of the jobless as a percentage of their previous income in work. The Unemployment Insurance benefits (UI) in the UK are unusual, they are flat rate rather than proportional⁵, and are only available for 6 months⁶. Germany's UI was not that generous by EU standards at a payment rate of 60% of previous gross earnings available for 12 months. Once UI is exhausted the unemployed become dependent upon means tested unemployment assistance (UA) if this is available. In the UK again UA is flat rate but there is no limit on its duration. Germany stood out by offering UI at a rate related to previous net income, this was available without a limit on its duration. NRR's had been reduced significantly in the UK⁷, but only marginally in Germany (European Commission, 2002d, p.11-12). The German system of benefits was not particularly generous by European standards, where it was unusual was in offering open ended earnings related insurance, which for older workers can finance early retirement.⁸

Table 3.1. Net Replacement Rates 2001¹

	APW level			66.7% APW level		
	Single	Married couple	Couple 2 children	Single	Married couple	Couple 2 children
	Short term benefits after one month's unemployment					
Germany	60	56	70	67	65	75
UK	46	46	49	66	64	54
USA	58	60	57	59	59	49
	Long term benefits after 60 months unemployment					
Germany	54	52	65	63	61	71
UK	46	57	80	66	80	88
USA	7	12	46	10	17	59

1. After tax including unemployment insurance/assistance, family and housing benefit.

Source: OECD, 2002a.

⁵ Ireland is the only other EU country with flat rate UI.

⁶ In the EU only Italy and the UK have UI duration this short, for most countries it 12 months or more.

⁷ The generosity of benefits for those with children and those on low incomes have been improved, albeit with tight eligibility criteria.

⁸ The Agenda 2010 have substantially changed this situation see Section 3.3

Measures of the generosity of benefits give no indication of the stringency of the requirements for the receipt of benefit. Such stringency is, however, difficult to measure, which is unfortunate because this is probably crucial in determining the effect of benefits on work incentives. The UK has been tightening up the requirements for the receipt of benefits for the unemployed with mandatory participation in the New Deal process for the unemployed aged under 50. Changes in German have been marginal, until recently.

The other side of the equation is the real incomes of people in work, this is where UK reforms have been concentrated with the Working Families Tax Credit (WFTC) and the National Minimum Wage. The WFTC introduced in 1999 considerably improves the take home pay of low income families with children, increasing work incentives in this group. The National Minimum Wage also increases the incentives for the low paid to work or to remain in work rather than depend upon benefits. There had been only marginal changes in Germany (European Commission, 2002d, p.12).

The taxation of labour

From the outset the EES guidelines have advocated the reduction of the tax burden on wages. In 1997 the UK already had a relatively low level of taxation on labour, which has been reduced still further, particularly for lower income groups. This has occurred as a result of changes in National Insurance Contributions, Working Family Tax Credit, Employment tax credit and Child Credit. These changes have substantially raised the real income of low paid workers and reduced the high rates of tax/benefit withdrawal. Employers NIC rose by 1% in 2003. Despite the relatively high level of taxation on labour, as result of heavy social security contributions, the reductions in labour taxation in Germany have been less than those in the UK and German labour remains heavily taxed.

Table 3.2. Structure of the tax wedge in 2001 and change 1997-2001¹

	%							
	Income tax		Social Security Contributions				Total	
	2001	97-01	Employee		Employer		2001	97-01
	2001	97-01	2001	97-01	2001	97-01	2001	97-01
Germany	16.6	-1.4	16.5	-0.5	16.5	-0.5	49.6	-2.4
UK	14.2	-0.8	7.0	-1.0	7.0	-2.0	28.3	-3.7
EU 15	13.2	-0.7	11.2	-1.1	19.2	-1.2	43.5	-3.1
US	15.5	-1.5	7.0	0.0	7.0	0.0	29.5	-1.5

1. Single person at APW wage level, no children.

Source: European Commission, 2002d.

Employment Protection

EES guidelines on employment protection reflect the ambivalent attitude of European countries on this issue. Member States are required to: “examine the possibility of incorporating in national law more flexible types of contract, and ensure that those working under new flexible contracts enjoy adequate security and higher occupational status, compatible with the needs of business and the aspirations of workers.”(European Council, 2002) Flexibility in employment terms has to be reconciled with security and occupational status. Germany’s traditionally high level of employment protection has remained largely intact. Flexibility has been introduced within rather than between jobs, so that employers adjust to changed economic circumstances by varying the hours of the workforce, rather than the size of the workforce. Such an approach undoubtedly has merit in response to temporary shocks but it may slow adjustment to permanent economic change. The UK has maintained its low level of employment protection, the lowest in the EU (IMF, 2002: 44).

Table 3.3. Employment Protection Legislation

	Late 1980s		Late 1990s	
	Regular employment	Overall	Regular employment	Overall
France	2.3	2.7	2.3	3.0
Italy	2.8	4.1	2.8	3.3
Netherlands	3.1	2.7	3.1	2.1
Germany	2.7	3.2	2.8	2.5
UK	0.8	0.5	0.8	0.5
USA	0.2	0.2	0.2	0.2

Scale 0-6 from least to most restrictive

Source: IMF (2002: 44)

Wage bargaining

The guidelines do not consider wage bargaining co-ordination or trade union strength. Germany and the UK lie close to the EU average in terms of union membership, within a wide EU distribution. Membership levels vary from around 70%+ in Denmark, Finland, Sweden and Belgium to 15% or less in Spain and France. Union membership has fallen over recent decades but in Germany the decline has recently slowed and the UK has even shown a slight reverse. In the UK trade union strength is particularly concentrated in the public sector.

Table 3.4. Trade Unions and Wage Bargaining in Germany and the UK

			%
	Trade Union Density	Trade Union Coverage	Dominant level of wage bargaining

Germany	29.7	67	Sectoral
UK	29.0	36	Company
EU 15 average	30.4		

Source: EIRO (2002c)

Despite similar levels of union membership the number of workers covered by collective agreements is much higher in Germany, because of the process of agreement extension (European Commission, 2002e; pp.39-47). Sectoral bargaining allows for some flexibility because deals can vary between sectors and the wage levels agreed are minima. These contractually specified minimum wage levels can represent problematic binding floors for the less skilled. Sectoral bargaining between large unions and employers organisations means that although Germany's wage bargaining is not centralised there is in practice a high level of coordination. This is the result of pattern bargaining, with influential agreements becoming benchmarks, and since 1998 tripartite discussions between trade unions, employers' associations and the Federal Government in the 'Bündnis für Arbeit'⁹ In the UK with bargaining predominantly at the company level extension does not take place. While both these systems have achieved wage moderation, there does seem to be some compression in German wage structure particularly at the lower end of the scale (European Commission, 2002c: 86-87).

Occupational and geographical mobility

The Member States are required to promote occupational and geographical mobility within each Member State and within the EU (European Council, 2002). The major mechanisms to encourage mobility are mutual recognition of qualifications,¹⁰ improved education/training¹¹ and enhanced information. The low and falling level of migration within Europe indicate the difficulties faced in trying to raise migration (Braunerhjelm et al, 2000: 47). Falling Southern to Northern Europe international migration is familiar but there is also declining interregional migration in the EU. In Germany before unification gross migration flows between the Länder fell from 18.4 per thousand people in 1979, to 13.0 1975-80 and 10.5 1984-88 (Livi Bacci et al., 1996). After large net outflows of migration 1989-90, migration from the new Länder to West Germany has been very small, only 0.35% of the population in 2000 (European Commission, 2002c: 21). Thus the potential for migration as an adjustment

⁹ Alliance for jobs, which is currently suspended.

¹⁰ Plus other measures to remove impediments to movement.

¹¹ Since geographical mobility rises with the level of education.

mechanism in Germany is extremely limited. The UK's gross migration level seems on a par with the US and levels of commuting are very high. Net migration is however much lower so for the UK migration provides only limited adjustment potential.¹²

Table 3.5. Labour Mobility

	1980	1990	1995	1998	Commuters % of employed 1998
	Ratio of gross internal migration to population %				
Germany	1.29	1.34	1.24	-	8
UK	-	-	-	2.30	17
US	2.79	3.32	2.22	2.40	3

Migration level 1 regions, commuting: districts US, level 2 regions UK, Germany)

Source: OECD, 2000

Education, training and skills

Where the guidelines are particularly thorough is in relation to education, training and skills. The long term unemployed¹³ are to be offered the opportunity of “training, retraining, work practice, a job, or other employability measure, including, more generally, accompanying individual vocational guidance and counselling.” (European Council, 2002:7) Active employment measures should be made more generally available to the unemployed. The education system should ensure that young people have the basic skills required for employment and lifelong learning. Illiteracy is to be reduced. Lifelong learning is to be encouraged. Tax reforms should encourage investment in human capital.

Table 3.6. Public expenditure on education

	1995	1996	1997	1998	1999	2000
	% GDP					
Germany	4.7	4.8	4.7	4.7	4.7	
UK	5.0	4.8	4.7	4.6	4.6	4.9
EU 15	5.2	5.2	5.1	5.0	5.0	5.1
EU Highest: Denmark	7.7	8.1	7.9	8.2	8.0	
EU Lowest: Greece	2.9	3.1	3.4	3.5	3.7	3.5

Source: European Commission, 2002f

Table 3.7 Early school leavers

	1996	1999	2000	2001
	%			
Germany	13.3	14.9	14.9	13.5
England ^a	na	na	28.6	28.8
EU 15	21.6	20.6	19.6	19.3
EU lowest: Sweden	7.5	6.9	7.7	7.7
EU highest: Portugal	40.1	45.5	43.1	45.2

^a no Eurostat data available for UK.

Source: European Commission, (2002f: 30; DFES, 2002).

¹² Generally within Europe migration is also seen as problematic on social grounds.

¹³ Long term in this context means 6months for young people and 12 months for adults.

Public expenditure on education in Germany and the UK has been stable as a % of GDP¹⁴ a little below the EU 15 average (See Table 3.6.). Although with GDP increasing this means increasing real expenditure, but the limited scope for productivity improvement implies little real improvement in funding¹⁵. There are indications that private expenditure on education is expanding although the data is patchy. Participation rates in education and training are also rising but these are heavily concentrated on the lower age groups and the better educated. Educational attainment is rising with the proportion of 25-64 year olds in the EU having at least upper secondary education increasing from 52.0% in 1995 to 60.3% on 2000. Germany and the UK comfortably exceed this average with rates of 76.7% and 70.0% respectively.

With higher unemployment rates for workers with lower educational qualifications one of the objectives of the EES is to raise the number of children staying on at school. The number of early school leavers in the EU 15 has been falling, although not in Germany but the proportion is still well below the EU average. In England the proportion leaving school early is high on a par with Southern rather than Northern Europe.

Table 3.8. Educational Performance of 15 year olds

	Reading	Mathematics	Scientific Literacy	Overall
Germany	484	490	487	487
UK	523	529	532	528
EU highest: Finland	546	536	538	540
EU lowest: Greece	474	447	461	461
USA	500	493	499	497

Source: OECD, 2002b

It is difficult to measure the performance of educational systems but the OECD with its Programme for International Student Assessment (PISA) has tried to achieve comparative measurement of this performance. There is some relationship as would be expected between educational performance and GDP per capita in PPS. The results indicate a good performance for the UK but only an average performance for Germany.

Job Matching

¹⁴ UK public expenditure on education is planned to rise.

¹⁵ Falling school roles in Germany means higher expenditure per pupil.

Job matching seeks to ensure that the unemployed are paired with vacancies as rapidly as possible. This of course requires that the labour force has the appropriate education, training and skills. The matching function is concerned with the provision of information and the process of pairing workers with jobs. The guidelines require member states to modernise their public employment services, to develop the job matching capacities of employment services and the use of databases/information technology.

The scandal over the Federal Employment Service have led to rather belated action in Germany (EIRO, 2002a), which have led to the Hartz Commission proposals, which the government is implementing (EIRO, 2002b). In the UK reform of the employment service has been ongoing and has been combined with measures to link the receipt of benefits to job search.

5. German labour market reform 2002/03

In 2002/03 Germany began to seriously tackle some of the rigidities of its labour market with the Hartz and Agenda 2010 reforms. In March 2002 the German government established the Committee “Modern Services on the Labour Market” (*“Moderne Dienstleistungen am Arbeitsmarkt”*, the so called ‘Hartz Commission’ named after its chairman Peter Hartz), to reform the German employment policy and the Federal Employment Service (FES). The German FES became the focus of public attention in February 2002 with the revelation of over inflated job placement figures and considerable mismanagement (Thiel 2002: p.14). The Hartz Commission presented its report (the so called ‘Hartz Concept’), which can be regarded as the core of the reform of the German employment policy, on 16th August 2002.

The concept aims to reduce the number of unemployed from nearly 4 million to 2 million until 2006, to diminish the period of job placement from 33 weeks to 22 weeks and to decrease spending on earnings-related benefit and unemployment benefit from €40 to 13 billion. The instruments to achieve these aims are (1) stronger incentives for quick job placement, (2) targeted support for self-employment and (3) a stronger use of temporary employment.

There are seven key areas of reform:

1. Restructuring the Federal Employment Service.
2. Tightening up of social security for the unemployed.
3. Encouraging additional employment by lower tax and social contributions.

4. Improvements in education and training.
5. Stimulating establishment and the expansion of new businesses.
6. Control of expenditure on health and pensions, to reduce the current and future level of contributions necessary to fund the system.
7. A reduction of income tax.

Furthermore the concept proposes *13 modules of innovation* to decrease unemployment and reform of the FES (Report of the commission “*Moderne Dienstleistungen am Arbeitsmarkt*”, Schmitthenner 2002, European Commission, 2003b).

The first two of the Hartz I to IV “Laws for modern services in the labour market”, came into effect 1 January 2003 and April 2003, and the remaining Hartz proposals along with the bulk of Agenda 2010 were agreed on 14 December, 2003 (European Commission, 2004: 16).

The Federal Employment Service in Germany has traditionally been concerned with the administration of benefits, but the reforms switch the emphasis to helping and encouraging the unemployed to find jobs. The new structure of the Federal Employment Services and its job centres with a privatised management structure should support a stronger service and customer orientation including closer relations to companies. The new employment offices in Germany, like Jobcentre plus in the UK, merge employment services with social security offices, youth welfare departments, housing offices and addiction and debt counsellors. New public sector ‘personnel service agencies’ (*PersonalServiceAgentur*) have been formed to employ the jobless and hire them out to private firms. Concentrating especially on temporary employment, these ‘personnel service agencies’ are attached to each of the 181 job centres. These agencies will hire unemployed people to companies for a restricted period. Unemployed not willing to work for these agencies will suffer cutbacks in unemployment benefit after a period of 6 months unemployment. By introducing temporary employment, unemployment should decrease by 780 thousand. The initial numbers involved were small but the scheme can grow (Economist, 2003a). One factor in their favour is that they are able to pay considerably below trade union agreed rates.

Procedures relating to job placement and entitlement to benefit have been tightened up in various ways. In the future when an employed person receives notice

to leave their current job they will be required to notify the FES of their potential future unemployment ('Quick job placement'). Failure to notify will lead to cuts in unemployment benefit. Companies who avoid dismissals will get discounts on their contributions to unemployment insurance. The principle under which it is deemed reasonable to refuse a job offer will be changed. The unemployed will have to demonstrate that the job is unreasonable for them rather than the FES having to prove that it is reasonable. Young single people in addition can be obliged to move to other cities to find jobs and they will also have to accept lower wages. These revised eligibility criteria seem to have had an impact with the number of unemployed stabilising in 2003 despite falling employment (European Commission, 2003a: Graph 3.1. p. 16).¹⁶ Older persons can be removed from job placement at their own request. Instead of unemployment benefit they would then receive a payment, which would take into consideration their social security contributions.

The reforms of the unemployment insurance/assistance system with stricter eligibility requirements are reinforced by reductions in the length and generosity of benefits. The immediate changes in effect until 2006 are a reduction in the period of earnings related unemployment benefit to the first 6 months of unemployment ('Unemployment benefit I')¹⁷. After this period only the newly defined welfare benefit ('Unemployment benefit II') will be paid¹⁸, which will be less than the current unemployment assistance, but more than the current welfare benefit. Changes that come into effect in 2006 include restriction of unemployment benefit (*Arbeitslosengeld*) to 12 months¹⁹, and once entitlement to unemployment benefit is exhausted a new benefit will replace unemployment assistance (*Arbeitslosenhilfe*). This new benefit will be flat rate and means tested, part of this benefit will continue for a period if the individual enters employment. Additionally unemployment benefit and income support will be merged in order to remove disincentives to work.

As to low wage employment, the current €325 'mini-jobs' will be restructured. Employees earning no more than €500 will get state subsidies to their health and pensions insurance. Social security contribution will be decreased to 10 % and these compulsory contributions to social security will start with an income of € 200. In the

¹⁶ This implies that inactivity is rising, but if these individuals were not really actively engaged in the labour market it is not really additional hidden unemployment

¹⁷ This period can be extended to 32 months for older workers.

¹⁸ Financed by general taxation.

¹⁹ 18 months for people aged 55years and over, down from 32 months.

future only one of these 'mini-jobs' will be allowed per person. In addition workers can earn up €400 a month without having to pay welfare contributions or tax. This has resulted in legalisation of informal economy jobs and some new jobs being created.

Little change has been made to the wage bargaining system. The *Günstigkeitsprinzip* remains in place, this is the legal restriction that allows enterprise level deviations from industry wide wage agreements, only if they are no less favourable than the collective agreement. In practice some employers particularly in East German are paying below the industry norm. Private sector agencies have reached agreement with the unions to pay 10-15% below collective agreement norms. So some de facto wage flexibility is emerging.

The quality of schooling is to be addressed by a boost to all-day schools in the federal programme from 2004-2007. An independent Agency for Standards and Evaluation is to develop national educational standards, and a committee of experts is to report on education. Steps are to be taken to improve the quality of teaching. Some initiatives are to be introduced to raise the quality of vocational education. Improvements in education are dependent upon the Länder for the implementation of reform measures, since education remains primarily a Länder responsibility.

Health care reforms aim to shift costs from the state to patients rather than to reduce costs. For example, patients will pay more for dental care and receive less sickness benefit. These changes are estimated to reduce the joint employee/employer health contributions by 0.7% in 2004 rising to 1.3% in 2007.

Short term provisions to reduce the burden on the state of the pension system are a postponement of the 2004 pension adjustment, and higher pension contributions. Further steps have been taken to reduce the future burden of pensions. An increase in the mandatory pension age is to be phased in, by one month a year from 2010, so that by 2034 the pension age will have risen from 65 to 67. A 'sustainability factor' is to be introduced into the calculation of pensions and this will lower future increases in pensions. This change together with simplified supervision should provide some encouragement to the development of private pensions. As with most other pension reforms in Europe this short term fix does not resolve the long term sustainability problem.

Tax cuts will interact with reductions in social security contributions²⁰ and changes in the benefit system to improve incentives for workers at all income levels. Tax reform has not, however, begun to unravel the complexity of the system. In addition to €6.5 billion tax cuts already approved for 2004, another €16.5 billion was approved in December but as a result of negotiations with the opposition, they will be phased in over two years from 2004 to 2005. Given the high level of German taxation these should be at least partially self funding through supply side effects. Other funding comes from increased debt and the privatisation of Deutsche Telekom and Deutsche Post should raise €5.3 billion, but reconciling these measures with Germany's Stability and Growth Pact commitments will be difficult.

The excessive regulation of German business is one factor limiting the establishment of new businesses and the further development of the service sector. Various measures aim to improve this situation by easing of employment regulations for small firms; introducing special arrangements for one person businesses; liberalising the regulations of craft businesses; extending shop opening hours. The protection against dismissal has been reduced but only for small firms employing up to 10 workers.

Service sector activity has been encouraged by reductions in taxation and in red tape. The self-employed now benefit from a scheme that cuts tax and administrative requirements for one person businesses, earning less than €25,000; with for example a tax will be levied at a flat rate of 10%. It is hoped that unemployment will decrease by 500 thousand through the development of these '*Ich-AG*' ('I-Inc.') and '*Familien-AG*' ('Family-Inc.') companies, moonlighting should also become less attractive. By the middle of 2003 33,000 of these businesses had been registered, some no doubt switching from previous undeclared activity, but still a positive development (Economist, 2003a). Under previous legislation 94 crafts required a master craftsman certificate (*Meisterbrief*) to establish a business. Since these certificates are time consuming and expensive²¹ to obtain, this regulation represented a considerable restriction on enterprise. The certificate will no longer be required in 53 of the 94 recognised crafts, however 90% of craft based companies are in the remaining 41 trades (Williamson, 2004). Trained staff without the *Meisterbrief*

²⁰ The significance is another matter "this may not do much more than prevent a rise in non-wage labour costs for the moment and perhaps reduce them by 1 to 2% ...and even then only from 2006 or 2007." (Schröder and Walter, 2003).

can, however, establish a business if they have six years experience including 4 in a senior capacity.²² Restrictions on shop opening were one of the regulatory factors limiting the creation of employment in the service sector. Previously shops had to shut at 4 pm on Saturdays, but now they can stay open to 8pm. Petrol stations with even longer opening hours, have stretched the definition of travel provision, which they are allowed to sell. These changes only represent a marginal change to the restrictive regulatory environment of German business.

These reforms seem to be driven by German domestic considerations, notably the need by the government to be doing something about the unemployment problem. Views vary on the outcome of these reforms, all are agreed that further reforms are needed but some see these reforms as good beginning (Posen, 2003), others as limited and inadequate (Schröder and Walter, 2003, Economist, 2003b). The emphasis on the treatment of the unemployed is important because this one of the crucial factors influencing employment and unemployment (de Koning et al, 2004). The reforms have been limited by the weakness of the German government, the need to placate opposition within the SPD and the compromise resulting from negotiations with the FDP to achieve Bundesrat approval. The reforms can be seen as being inadequate in tackling German over regulation of product, the wage setting mechanism and labour regulation (Munchau, 2004). A more profound criticism is that the reforms are aimed at the wrong target, the fundamental problem of the Germany economy being low investment, so reform of public sector banking, regulation of venture capital markets and the general underdevelopment of the capital market should be tackled first (Munchau, 2003). Another problem was that these complex reforms of the healthcare, unemployment benefit and pension systems created considerable uncertainty over their effects on disposable incomes. Uncertainty worsened by the suggestion that the reforms would be ongoing.²³ This uncertainty combined with a lack of clarity over the reform process and its aims, undermined popular support and contributed to the continuing weakness of German consumer demand. These reforms aim to adjust the welfare state to one that Germany can afford, rather than raising growth so the economy can finance the society German's want.

²¹ Up to €50.000.

²² In 6 of the 41 trades the *Meisterbrief* is still required.

²³ Given the weakness of the current government this is now unlikely, although the FDP are committed to further reform.

6. Conclusion

The Open Method of Coordination as exemplified by the European Employment Strategy, seeks to achieve convergence of EU employment policies, by persuading national governments that policy should be modified. This persuasion can take various forms: increasing awareness of successful policies, setting targets and benchmarks, naming and shaming states that fail to achieve these targets. This study indicates the limited effect of the policy thus far. Germany with policies less consistent with the Strategy and with greater employment problems, modified its policies less than the UK where policy was more successful and congruent with the EES. Even when the German government did decide to reform employment policy in 2002, there was no appeal to the EES as a justification for the introduction of unpopular changes. This does not of course mean that coordination will not be achieved. It may be that over the long term the constant interaction of employment policy networks of Member States, and the awareness of the success and failures of national policy, will lead to a convergence of opinion and eventually of policy. It is also apparent that the very large differences in policy between countries reflect different traditions, institutions and attitudes, which limit the possibility of transferring policies across national boundaries.

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