

# NO SURRENDER TO ENTRENCHED UNEMPLOYMENT

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### **References**

This is a translated version of the original German-language chapter "Keine Kapitulation vor der verfestigten Arbeitslosigkeit", which is the sole authoritative text. Please cite the original German-language chapter if any reference is made to this text.

## SUMMARY

**Employment** in Germany is currently at an **historic high**, and **unemployment** at the **lowest level** since reunification. The key reasons for this change for the better are likely to have been the market-oriented labour market reforms of the Agenda 2010 and the wage restraint experienced until the middle of the last decade. The increase in employment and decrease in unemployment have contributed to **domestically-driven growth momentum** of a remarkable scale in international terms.

But labour market policy still faces challenges. The aim is to reduce the deeply entrenched (long-term) unemployment, and to integrate migrants into the labour market. In the past few years, people receiving basic security benefits for jobseekers, and in particular the long-term unemployed, have struggled to find work despite the healthy economic environment. One reason for the **high entrenched unemployment** is that those often affected have an unfortunate combination of the qualities important for labour market success. **Labour market measures** are likely to have only a limited effect on the reduction of entrenched unemployment.

The key factor for many workers with low productivity thus remains access to a **low-wage sector** with sufficient advancement opportunities. More **regulation of the labour market** and an increase in the minimum wage rather have a negative effect on the low-wage sector's capacity to absorb.

Germany has a **large low-wage sector** compared with other countries. In the past few years it has helped to boost women's employment and absorb the rising numbers of migrants. However, the **opportunities for advancement** to better-paid positions have been relatively limited to date. The rising average age of workers in the low-wage sector exacerbates this development, as the risk of remaining in the low-wage sector increases with age. Therefore, the objective of labour market policy should be not to obstruct access to more demanding and better paid work by further increasing regulation of the labour market.

# I. LIGHT AND SHADE ON THE LABOUR MARKET

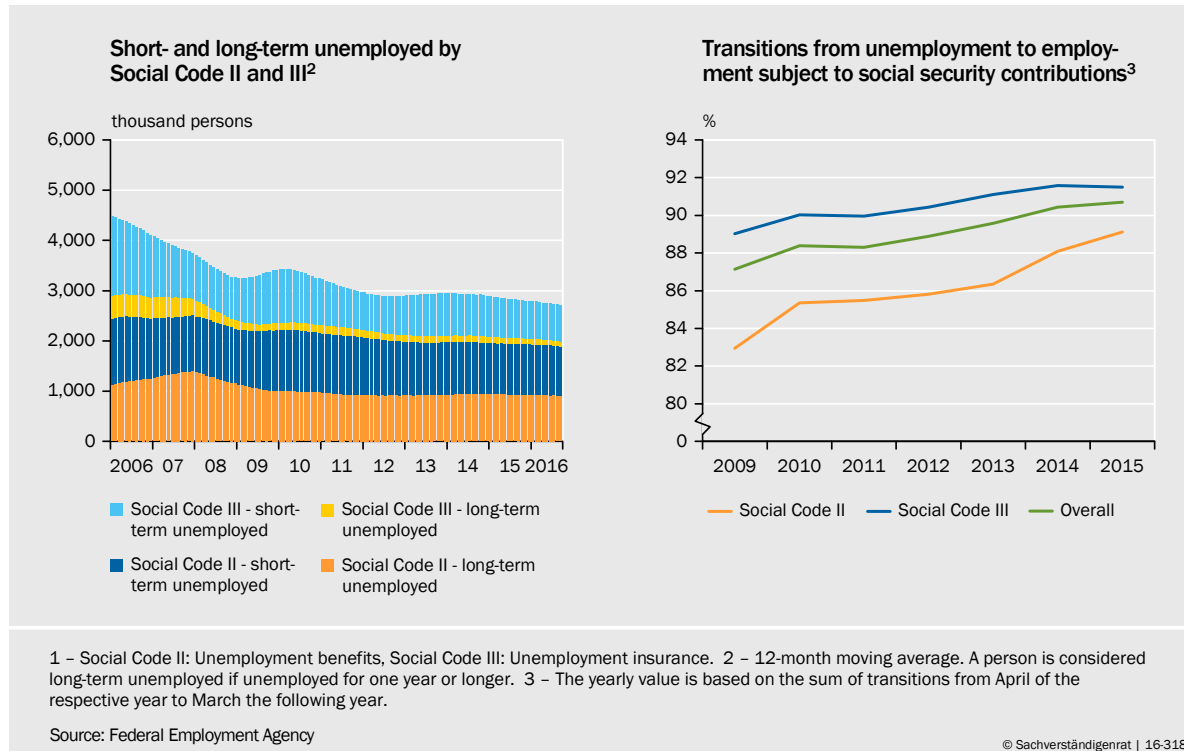
730. The labour market situation in Germany remains positive. At this August's figure of 43.6 million, there were more **people in work in Germany than ever before**. The number of unemployed has declined by approximately two million over the past ten years. Moreover, the high rate of employment helps to prevent income inequality from rising further. [↘ ITEM 821](#) This is due not least to the change in labour market policy in implementing **Agenda 2010**. A shortage of skilled workers in some sectors already indicates excess demand for them, which is likely to rise further in the next few years as a result of demographic change.
731. Nevertheless, **2.6 million people remained unemployed** in August 2016. There is in particular a large number of long-term unemployed who are not participating in the employment upturn. In light of these facts and with a view to the task of integrating a large number of recognised refugees into the labour market [↘ ITEMS 702 FF.](#), the **absorbing capacity of the low-wage sector** is of major importance. This capacity is limited, however, due to structural employment obstacles, such as restrictive dismissal protection, a high wage replacement rate, and a high ratio of minimum wage to median wage. The Federal Government should set the course for improving employment opportunities for workers with low productivity in the next legislative period.

## 1. Achievements in reducing unemployment

732. Unemployment initially declined dramatically following the Hartz reforms. It then experienced a brief rise as a consequence of the Great Recession of 2008/09, followed by further moderate decline. The number of registered unemployed has decreased over this ten year period from five million to less than three million people. At 5.9 % in September 2016, the **unemployment rate** reached its **lowest level since reunification**. Youth unemployment has fallen even more dramatically. Only 240,000 people under the age of 25 were unemployed in 2015. This rate of 5.3 % is very low by international standards.
733. Particularly the **number of persons receiving unemployment insurance payments** (in accordance with Volume III of the German Social Code (*Sozialgesetzbuch III – SGB III*)) **decreased** in the period from 2005 to 2015. The number of persons receiving unemployment insurance payments under SGB III for fewer than twelve months fell heavily at the start of this period. The number of long-term unemployed receiving unemployment insurance fell continuously. [↘ CHART 95 LEFT](#) The decline in persons receiving unemployment benefits for jobseekers in accordance with Volume II of the German Social Code (*Sozialgesetzbuch II – SGB II*) was much less pronounced. Consequently, the ratio of persons receiving unemployment benefits for jobseekers under SGB II to the total number of unemployed increased tangibly from 57 % to almost 70 %.
734. Economic literature noted several different reasons for the **marked decline in unemployment**. The main reasons are the Hartz reforms (GCEE Annual Re-

↘ CHART 95

Unemployment by provisions of Social Code (SGB)<sup>1</sup>



port 2014 item 535; Krebs and Scheffel, 2013) and the employee wage restraint observed over the past decade. The latter was a major contributing factor in reducing unit labour cost, thereby improving companies' competitiveness and enabling employment growth (Dustmann et al., 2014). Increasing flexibility in working hours also played an important role – the growth in part-time work above all (Burda and Seele, 2016). The **prioritisation of employment growth** reflected in these changes was, however, accompanied by relatively low average wage growth.

**735.** In line with this rise in employment, **integration of the unemployed** into the labour market **increasingly improved**. Whereas only 83 % of the unemployed receiving unemployment benefits for jobseekers under SGB II entered employment subject to social security contributions in the period from April 2009 to March 2010, that percentage steadily rose to almost 90 % during the following six years. This rate therefore almost equalled the annual percentage of persons transitioning from receipt of unemployment insurance under SGB III to employment subject to social security contributions. ↘ CHART 95 RIGHT

**736.** The reduction in unemployment **significantly decreased** the **underemployment** figure (including short-time work) from 5.8 million persons on average in 2006 to 3.7 million persons in 2015. Underemployment statistics also include, in addition to registered unemployed individuals, those who are not deemed unemployed within the meaning of section 16 SGB III because they are participating in active labour market measures or have special labour market-related status. This decrease in underemployment was due, on the one hand, to fewer participants in job opportunities of SGB II (so-called one-euro jobs), subsidised employment and wage subsidies. On the other hand, fewer persons re-

ceive benefits because of partial retirement or initial financial support to help benefit recipients enter self-employment.

737. Moreover, the **hidden reserve** of 1.9 million people on average in 2006 was **significantly reduced** to fewer than one million in 2015 (Bach et al., 2007; Fuchs et al., 2016). This is primarily due to a decrease in the hidden reserve in the narrower sense. This group includes people who would be prepared to accept a job under certain conditions but who are not registered as unemployed. These comprise people seeking marginal employment (“mini jobs” or 450-euro jobs), in addition to jobseekers with no claim to unemployment benefits. The hidden reserve in the narrower sense of the term decreased from 1.2 million people in 2006 to about 300,000 in 2015.

The hidden reserve also includes participants in **further training programmes**. Their numbers initially rose to 920,000 in 2010, but have since fallen again, to near the 2006 level (680,000 in 2015). The **increase in employment of women** played a major role in the decline of the hidden reserve (Fuchs and Weber, 2010).

## 2. Entrenchment of long-term unemployment

738. Despite tangible achievements and the large number of labour market policies, **deeply entrenched unemployment** persists. This is manifest primarily in the high number of long-term unemployed, i.e. persons who have been registered as unemployed for at least one year. The ratio of **long-term unemployed** to the total number of unemployed fell from 46 % to 37 % between 2007 and 2015. This makes Germany the only EU country to experience a considerable decrease in long-term unemployment since the start of the financial and economic crisis. However, the number of long-term unemployed receiving unemployment benefits under SGB II remains, at almost one million people, almost unchanged since 2009.

Furthermore, long-term unemployment is concentrated in certain **regions** of Germany. Consequently, the percentage of long-term unemployed to the total number of unemployed is as high as 60 % in some cities in North Rhine-Westphalia and particularly high in rural areas in eastern Germany (IAB, 2016).

739. A closer look at the characteristics of the unemployed population also shows how entrenched unemployment is. Many unemployed workers face **multiple obstacles** to employment. Next to having received unemployment benefits for an extended period, these include an advanced age, low skills, language barriers and health restrictions. The probability of an unemployed person finding work within a prescribed period is reduced by 50 % for almost every additional risk (Achatz and Trappmann, 2011). A frequently occurring combination is health restrictions, advanced age and having already received unemployment benefits under SGB II for an extended period.

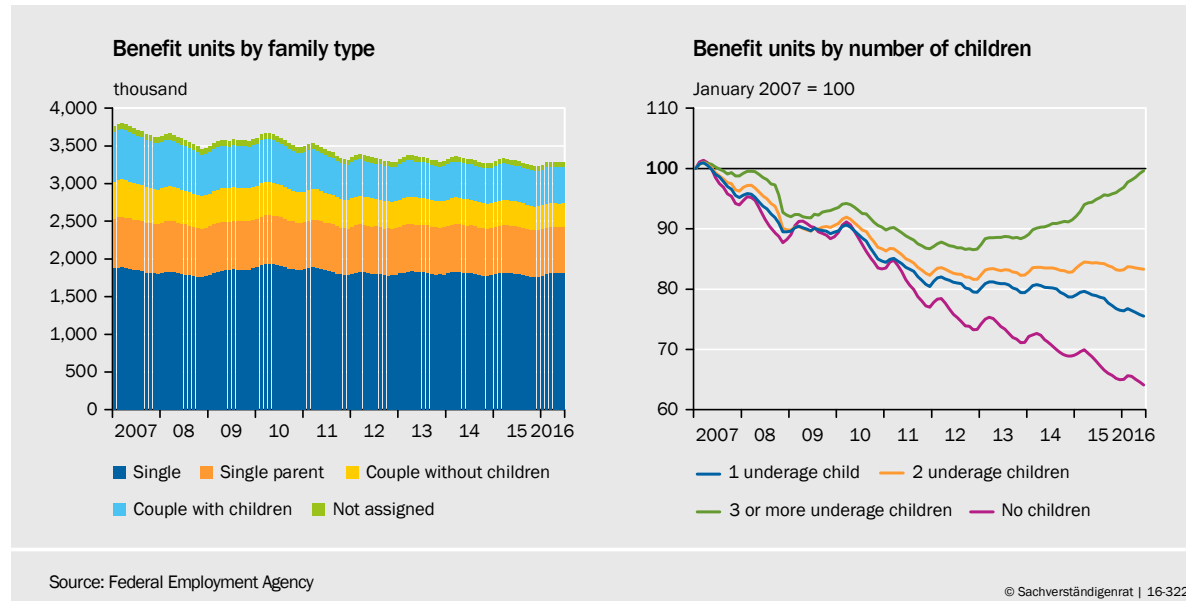
740. In comparison with other European countries, long-term unemployed individuals in Germany are relatively old and have been without work for particularly long periods. More than one in every four long-term unemployed persons are **over 55 years of age** in Germany, while only 13 % belong to this age group on average in the EU. Two thirds of Germany's long-term unemployed have already been **without work for more than two years**. The reason that countries such as Sweden and Austria have considerably lower percentages in this category is partially due to the laxer requirements there for the unemployed to claim early retirement or reduced earnings capacity benefits (Duell et al., 2016). In Germany, in contrast, these individuals are more frequently placed in extensive integration programmes to reintegrate them into the labour market (Konle-Seidl, 2016).
741. These structural features and the persistent low placement rate of the long-term unemployed thus indicate, despite all the achievements of the past few years, that further reducing long-term unemployment will prove to be anything but an easy task. The labour market's **imminent digital transformation** could create even more obstacles to jobs for such long-term unemployed individuals, as the digitisation of the work environment will place high demands on workers to continually upgrade and expand their skills (GCEE Annual Report 2015 items 545 ff.). As a consequence, the demand for workers with obsolete skills or who are completely unskilled can thus be expected to further decline.
742. Issues relating to household structure frequently present obstacles to job placement, when, for example, provision of care to a family member impedes employment. Children tend to make it more difficult for mothers to participate in the labour market. Fathers in partner benefit units (*Bedarfsgemeinschaften*) are, on the other hand, apparently more strongly motivated to enter the labour market rather than live on unemployment benefits (Achatz and Trappmann, 2011).

The **socio-demographic structure** of households receiving **unemployment benefits** has changed over the past years. The decreased number of benefit units since 2007 is due to a decrease in partner benefit units. [↘ CHART 96 LEFT](#) However, the number of partner benefit units with three or more children rose again since 2012. [↘ CHART 96 RIGHT](#) This development is against the trend towards fewer families with three or more children in the overall population. In benefit units with three or more children, an especially large number of people depends on benefits.

743. The sociopolitical consequences of entrenched core unemployment are dramatic. About 6.2 million people in benefit units for unemployment benefits under SGB II cannot provide the means for their sociocultural minimum subsistence despite the positive labour market situation in September 2016. It is particularly difficult for those who are not capable of work but receive benefits – such as spouse and children – to escape benefits dependency; they are frequently **long-term benefit recipients**. According to statistics by the Federal Employment Agency (*Bundesagentur für Arbeit* – BA) as of the end of 2015, almost 2.6 million people had been receiving benefits for more than four years.

↘ CHART 96

**Benefit units as of Social Code II by family type and number of children**



744. The problems addressed here will likely increase as a result of the recent developments in **migration**. Perhaps the most noticeable change in the composition of the unemployed population during the past three years was the higher proportion of non-German individuals eligible to receive benefits under SGB II. That figure had been relatively stable at around 20 % until 2013, but rose to 28 % by April 2016. The high level of migration in recent years can be considered a major factor.

Given the large number of recognised refugees, we can expect to see a slight rise in unemployment in the near future. ↘ [ITEMS 262 F](#). By the end of 2017, recognised refugees could constitute almost 10 % of Germany's unemployed. This further change in the composition of the unemployed population may necessitate other labour market measures. **Support to jobseekers**, above all, is likely to gain in importance.

### 3. Limits to labour market policy

745. A combination of different causes is responsible for the incapacity of many long-term unemployed finding work. The respective combination varies considerably from case to case. The **wage gap** between unemployment benefits plus the housing benefit and the market wage that a worker can potentially earn is likely too narrow as an incentive to take up employment for many of the long-term unemployed.

The **level of unemployment benefits** reflects society's sociopolitical idea of the minimum level of income needed to live and is thus tied to the structure of the respective benefit unit. The average minimum subsistence level plus the housing benefit of a single person benefit unit in June 2013 was €683 per month, according to the BA. For couples with one or two children, that amount was €1,537 or €1,871 respectively. In contrast, based on own calculations using

data by the German Socio-Economic Panel (SOEP), 20 % of all full-time employees earned a net monthly wage of less than €1,163 in 2013. It should therefore come as no surprise that some unemployed individuals in benefit units with children prefer to receive the benefits than to accept a job for low pay.

746. The average minimum subsistence level of single parents was €1,277 in June 2013. The proportions of single parents to all benefit units (6 % in 2015) and to all households (12 %) remained nearly unchanged in the last five years. **Single parents** are subject to a gradual obligation to work: They are **not obliged to take up employment** with children up to three years old or more than one child between three and six years old. Long absence from the labour market is yet likely to reduce the chance for a job. A partial reduction of these exemptions to the obligation to work might counteract this problem.
747. Within the meaning of the reintegration of unemployed into the labour market, unemployment benefit payments might be cut in the case that the unemployed do not take verifiable employment opportunities. Diverse studies analysed how the incentive problem of a narrow wage gap can be tempered by imposing **sanctions for unemployed benefit recipients**. These studies show that a temporary cut in benefits can accelerate the transition into employment (Müller and Steiner, 2008; Hofmann, 2012). A credible system of thorough checking the requirements on unemployed people and, if necessary, imposing sanctions increases their probability to take up employment subject to social security contributions (Lalive et al., 2005).

A sanction under SGB II involved an average benefit cut of 19 % in 2015. Thereby, a failure to report at the job center was decisive in 77 % of all cases. By 4 % the proportion of the two million unemployed under SGB II that are actually sanctioned is low.

748. However, announcing and imposing sanctions can have undesirable consequences; quicker job placement generally results in a worse job fit and thus in **unstable employment relationships** (Hofmann, 2012, for sanctions pursuant to SGB III; Arni et al., 2013, for Switzerland; Van den Berg and Vikström, 2014, for Sweden). A strict sanction policy for the unemployed in receipt of unemployment benefits would thus not likely contribute significantly to ensuring long-term participation in the labour market.
749. It would also be insufficient because it does not address the problem of low wages potentially paid by the market. The considerable reduction in unemployment over the past few years is likely to have resulted in a less favourable **structure of the unemployed population**. Individual (re-)employment opportunities depend just as much on a number of factors that are not recorded by statistics, such as motivation, perseverance and self-efficacy, as they do on those that statistics can readily capture, such as age and professional qualifications.

Primarily those workers who demonstrated a relatively favourable combination of such job market-relevant skills tended to successfully re-enter the workforce in recent years. By contrast, those unemployed individuals whose skill set is rather unfavourable and potential market wage therefore low tended to remain



without work. As a result, the shrunken gap between unemployment benefits and market wages has probably further entrenched unemployment.

750. Targeted labour market measures could be one means of raising potential market wages. The implementation of **active labour market policy** measures was actually a factor in the successful reduction of unemployment in the past few years. The positive effects of these measures can be seen particularly in periods of high unemployment (Lechner and Wunsch, 2009) and in the placement of short-term unemployed workers (Kluve, 2010). The most effective and cost-efficient type of measure consists of providing jobseeker support, which is primarily directed at “newly” unemployed individuals.

However, active labour market policy, on the basis of present knowledge, can only play a **secondary role in reducing entrenched unemployment**. In particular, active labour policy measures make only a minor contribution to reducing long-term unemployment (Kluve, 2013). This sobering view is reflected in the declining number of participants and expenditure for different labour market measures of the Federal Employment Agency. The number of people participating in labour market measures has decreased disproportionately compared to the number of unemployed since 2009. [↪ BOX 26](#)

[↪ BOX 26](#)

#### Active labour market policy measures

Active labour market policy measures can be broken down into **four different types**. [↪ TABLE 30](#) Measures, objectives and effects were presented and discussed in detail in an expertise for the German Council of Economic Experts (Kluve, 2013). The first type consists of **measures to support job search**. These frequently have positive effects, particularly in the short term, on the transition to regular employment (Jozwiak and Wolff, 2007). With around one million people fewer participating in 2015 than in 2006, the influx into this type of measure decreased considerably. Costs per participant are higher for the new schemes for activation and job integration than they were for the former training measures.

[↪ TABLE 30](#)

#### Overview on different types of active labour market policy

Type	Measures (example)	Entries		Costs	
		2006 <sup>1</sup>	2015	2006 <sup>1</sup>	2015
		Thousand Persons		Million Euros	
Support for job search	Schemes for activation and job integration	3,606	2,569	839	929
Training and qualification measures	Promotion of professional training	165	315	1,061	1,693
Employment in the private sector	Wage subsidies	490	238	3,576	952
Employment in the public sector	Job opportunities	824	233	2,047	338

1 – Without approved municipal carriers.

Source: Federal Employment Agency

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Until a few years ago, a high number of participants was also recorded in **training and qualification measures**. These comprehensive measures typically have only minimal effects at first, which then become positive in the medium run (Biewen et al., 2014; Bernhard and Kruppe, 2012; Wunsch and

Lechner, 2008). Therefore, once participation in measures is concluded, it takes a certain amount of time before investment in the long period of measures yields improved employment opportunities. Participation in training and skills-acquisition measures has increased from 165,000 in 2006 to 315,000 people.

Active labour market policy promotes private sector employment primarily in the form of **wage subsidies** which are paid out to the employer or directly to the employee. The direct effects of such measures appear largely positive (Jaenichen and Stephan, 2011; Boockmann et al., 2012). This applies not least to migrant participants (Butschek and Walter, 2014). However, little is known about indirect, unintended effects. Wage subsidisation is accompanied by the risk of windfall gain effects resulting from employers which would have hired the person in question anyway. Despite the positive employment effects, wage subsidies may be ineffective for employment overall in that they reduce employment opportunities for nonsubsidised persons (Bell et al., 1999; Blundell et al., 2004).

The number of participants in such measures has decreased considerably in the past few years. Self-employment, in particular, was promoted less, which has heavily reduced costs. In the next few years, 23,000 long-term unemployed people are to be integrated into the labour market via wage subsidies (BMAS, 2016). A central component in this effort will be a **coaching concept**, whereby once long-term unemployed individuals have been placed in a job, they will be encouraged to stabilise the employment relationship.

The fourth type comprises employment in the public sector, which includes **job opportunities**. These measures, among them “one-euro jobs”, are aimed at simplifying re-entry of SGB II unemployed into the primary labour market by means of temporary, additionally created employment. Such measures have generally no, or in many cases even negative, employment effects (Hohmeyer and Wolff, 2012). Participation in the measures worsens jobseekers' chances of employment compared to their situation had they not participated. One explanation for such consequences may be that participants in such measures are frequently stigmatised. However, participants who were previously unemployed for more than three years can improve their very low chances of employment through such job opportunities (Wolff and Hohmeyer, 2008). Subjective satisfaction among participants in the measures is also greater than for unemployed persons (Knabe et al., 2016).

The use of this type of measure by the Federal Employment Agency has decreased markedly in the past few years, from 824,000 to 233,000 new participants. Discontinuing the expensive job creation schemes has significantly reduced the costs per participant.

751. Thus, **improved integration** of the long-term unemployed and workers with low productivity into the labour market can only be achieved in the next few years if **a sufficient number of jobs are available in the low-wage sector**. Previous experience supports the idea that entry into the low-wage sector can serve as a means of exiting long-term unemployment. For example, many unemployed people with below-average productivity have found new jobs in the low-wage sector in the past (GCEE Annual Report 2015 item 600).

Moreover, marginal employment of up to 15 hours per week, which is frequently low-paid, can enable unemployed persons to maintain a certain **proximity to the labour market** until they find a job with more hours. In fact, long-term unemployed individuals who take up marginal jobs have a higher probability of transitioning into regular employment than long-term unemployed persons with no marginal employment. The employment relationship is also more stable (Caliendo et al., 2016). A similar effect can be observed with temporary em-

ployment. For example, non-German unemployed persons who accept work in the temporary employment sector find another job relatively frequently (Jahn, 2016).

## II. LOW-WAGE SECTOR FACES MAJOR CHALLENGE

752. The low-wage sector faces a **major challenge** in many aspects over the next few years. On the one hand, it could pave the way to employment for many long-term unemployed and migrants – a path which would otherwise remain inaccessible to them because of the many obstacles to employment they face. It has helped, not least, to boost women's employment and absorb the rising numbers of migrants in the past few years. On the other, it represents **dead-end** employment for many workers instead of a **stepping stone** to other jobs as labour market policy intends. Labour market policy should therefore not obstruct access to more demanding and better paid work by further increasing regulation of the labour market.

### 1. Limited opportunities to leave low-wage sector

753. According to the definition by the Organisation for Economic Co-operation and Development (OECD), a job is deemed low-wage if the wage earned is less than **the low-pay threshold of two-thirds of median earnings**. The median wage in Germany was €14 per hour in 2013, based on SOEP data. By this definition, all people whose **gross hourly wage was lower than €9.30** were thus classified as low-wage earners. In 2013, 8.1 million people, or 24.4 % of all employees in Germany, earned below this threshold (Kalina and Weinkopf, 2015). Low-wage employment is particularly prevalent in services, as well as in agriculture, private households and the hospitality sector. More than one third of the employees in these sectors earned below the low-wage threshold by the end of 2015, according to BA.



Some analyses of this chapter are based on BA process data. The **Sample of Integrated Labour Market Biographies (SIAB)** is a 2 % random sample of the population drawn from the Integrated Employment Biographies (IEB) of the Institute for Employment Research (*Institut für Arbeitsmarkt- und Berufsforschung*, IAB), i.e. of all employment relationships subject to social security contributions and marginal employment including periods of unemployment. The special characteristic of the Integrated Employment Biographies is the daily observation of employment and unemployment periods. However, as the exact working hours are not recorded in SIAB data, hourly wages cannot be precisely calculated and low-wage sector studies using SIAB data typically focus on full-time employment subject to social security contributions. SIAB data is on record for 1975 to 2014; for eastern Germany from 1992. The IAB's **Linked Employer-Employee Data (LIAB)** is based on a dataset from an annual survey by the IAB Establishment Panel that is linked to data on all employees

during the 1993 to 2010 observation period. The longitudinal model is used, which includes data on employment changes between company survey dates as well (LIAB LM 9310).

754. The low-wage sector made a stable contribution of around 15 % of the workforce until the mid 1990s, then grew gradually. The **increase in low-wage sector employment** was primarily a **western German phenomenon**. Low-wage employment has stagnated since 2007. In eastern Germany, where the percentage of persons employed in the low-wage sector is considerably higher due to the lower wage level, the sector's share has hovered around 40 % since reunification (Kalina and Weinkopf, 2015). [↘ CHART 97 LEFT](#)

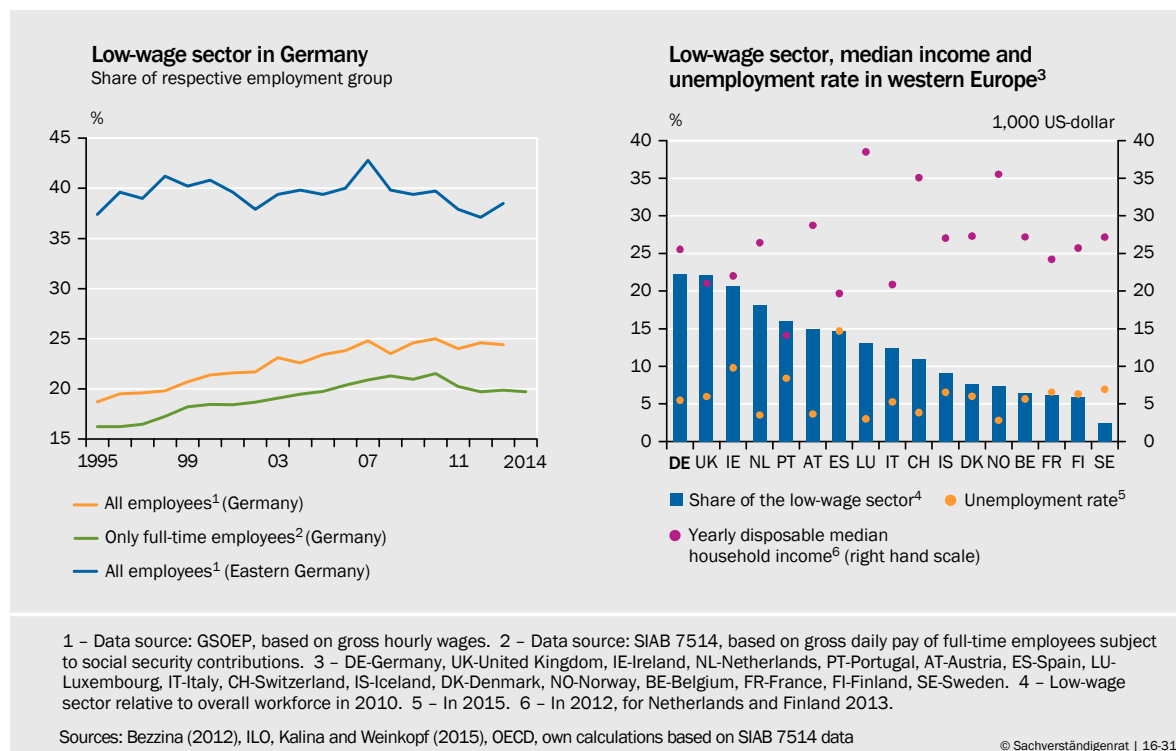
According to calculations by the German Council of Economic Experts based on SIAB data, full-time employees subject to social security contributions are less frequent in the low-wage sector than part-time or marginally employed people. However, the rise in the number of full-time employees in Germany's low-wage sector has followed a similar pattern to that of all employed persons. [↘ CHART 97 LEFT](#) Full-time employment in the low-wage sector has contracted slightly over the past few years.

755. Germany has, however, a large low-wage sector **compared with other countries**. Among other western European countries, only the United Kingdom and Ireland reported a similarly high percentage of low-wage sector employment in 2010. The percentage of people employed in the low-wage sector in France, Belgium and the Scandinavian countries amounts to less than 10 %. There is no obvious cross-national relationship between the size of the low-wage sector and the unemployment rate. The same is true for median income. [↘ CHART 97 RIGHT](#)
756. Many previously unemployed people have found jobs in the low-wage sector in recent years. The increasing employment of women, rising numbers of migrants and the ageing society are changing the structure of the labour force and thus also the structure of the low-wage sector.

- **Form of employment:** More than one in two people were employed full time in 1995, with that figure dropping to 41 % by 2013. During that same period, the percentage of marginally employed people rose from 28 % to 39 % (Kalina and Weinkopf, 2015), and temporary employment doubled its figure from 11 % to 22 %. [↘ CHART 98 UPPER LEFT](#)
- **Nationality:** The percentage of foreigners grew from 9 % in 1995 to 13 % in 2013. Approximately one in three foreigners earned less than the low-wage threshold in 2013, nearly twice as many as in 1995 (Kalina and Weinkopf, 2015).
- **Age structure:** Employees under the age of 25 still accounted for over 40 % of all full-time employees in West Germany's low-wage sector in 1984. That figure fell by more than 50 % by 2014, resulting in a rise in the average age of low-wage sector employees from 32 to 39 between 1984 and 2014, a greater increase than that of the overall population, from 38 to 42 years of age. [↘ CHART 98 UPPER RIGHT](#)

↘ CHART 97

### Size of the low-wage sector



757. The **ageing** in the low-wage sector negatively impacts average advancement opportunities for better paid jobs. Young employees are more likely to be paid less, but their prospects of advancing to higher pay are good. Older employees, in contrast, are less likely to earn low wages but then generally remain at low-wage level. According to calculations by the German Council of Economic Experts for 2009, nearly one in two low-wage earners under the age of 25 who remained employed full time five years later were still in the low-wage sector. This percentage amounted to 86 %, however, for those over 55. ↘ CHART 98 LOWER LEFT

758. The **risk of remaining in the low-wage sector** condenses the development of wage mobility into a single indicator: the risk rose over time but has declined again in the past few years. While 40 % of full-time employees at the end of the 1980s continued to earn a low wage five years later, this figure peaked at over 70 % in 2002. ↘ CHART 98 LOWER RIGHT The risk of remaining in the low-wage sector rose considerably in western Germany and to a greater extent in eastern Germany, particularly in the years following reunification.

**Wage mobility** plunged accordingly in western and especially eastern Germany in the 1990s. The probability of moving to another wage quintile four years later declined from 50 % to 30 % between 1992 and 2006. Wage mobility has since evened out at a low level in eastern and western Germany (Riphahn and Schnitzlein, 2016). This result is in line with the observation of a relatively stable distribution of net household income. ↘ ITEM 815

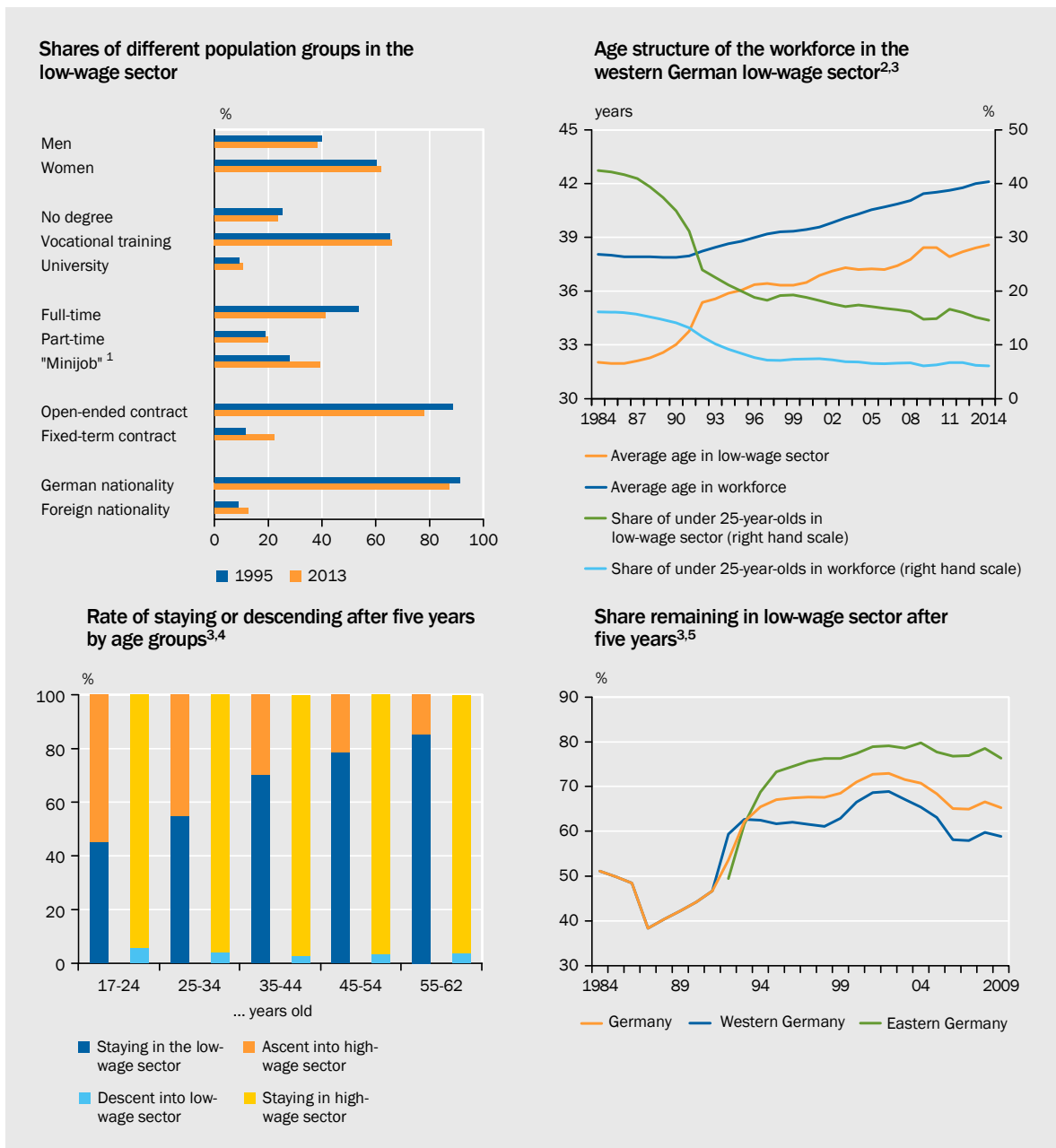
759. Empirical evidence indicates that around 50 % of the heavy decline in wage mobility in eastern Germany is attributable to structural shifts in this type of statistically recorded characteristics. **Rising employment stability** and changes in

employment characteristics, such as shifts in sector structure and a decline in job changes between occupations and sectors, prove to play a greater role than changes in personal factors, such as age or skill structure (Riphahn and Schnitzlein, 2016). The finding of greater employment stability is particularly relevant to wage mobility, as wage increases frequently accompany a change in jobs (Gottschalk, 2001).

- 760. Low wage mobility is associated with less **opportunity of advancement** to more demanding jobs. For example, a low-paid job can indeed serve as a stepping stone to a better-paid job, particularly for low-skilled individuals and those

▸ CHART 98

Developments in the German low-wage sector



1 – Up to 450 euro per month. 2 – Only full-time employed subject to social security contributions from age 17 to 62. 3 – The cut-off date is June 30 in the respective year. 4 – Base year: 2009; only full-time employed persons in both 2009 and 2014 are considered. 5 – Only full-time employed persons in both t and t+5 are considered.

Sources: Kalina and Weinkopf (2015), own calculations based on SIAB 7514 data

with longer periods of unemployment (Knabe and Plum, 2013). Many returnees to the labour market thus consciously seek a low-paid position as a means of labour market entry.

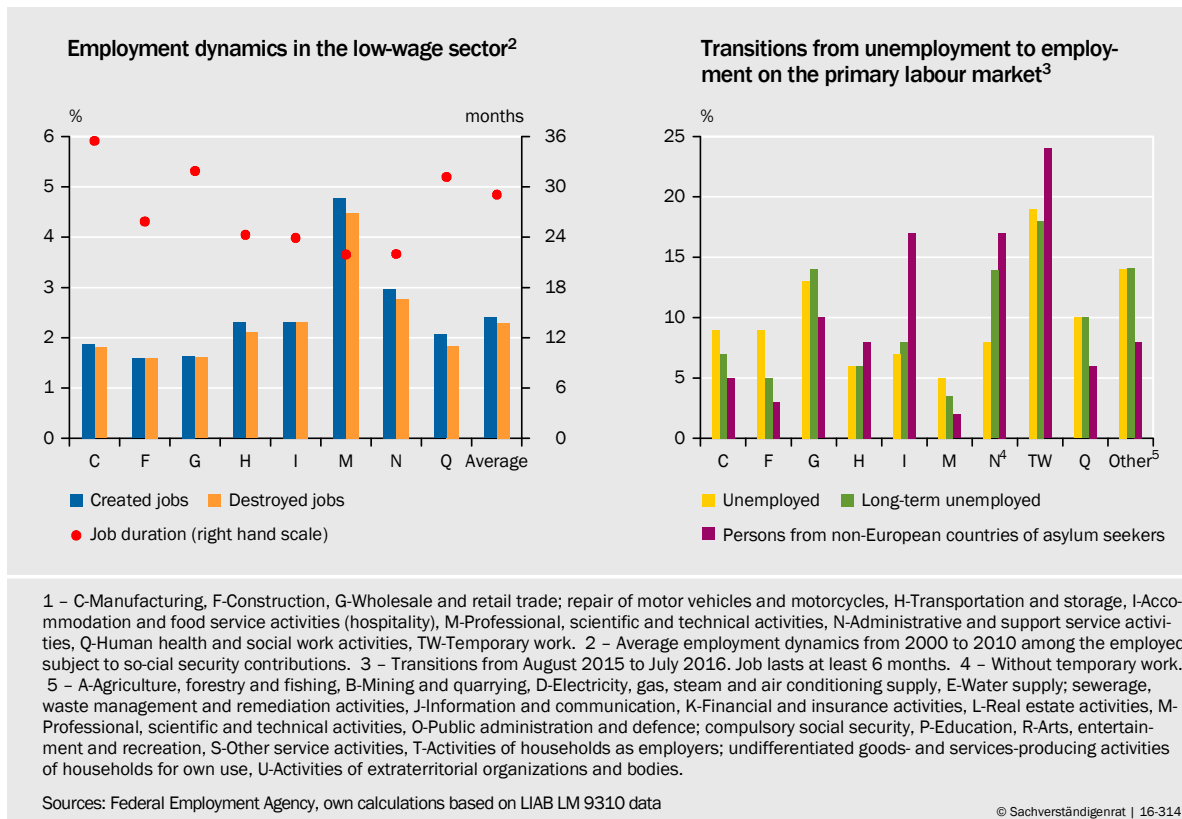
However, the mere fact of belonging to the low-wage sector may result in **stigmatisation** and thwart upward mobility (Aretz and Görtzgen, 2012). Low-paid employment may be a **dead-end** in occupations with low pay and low-skill requirements as well as in small enterprises and companies that employ a high percentage of low-paid workers (Knabe and Plum, 2013; Mosthaf et al., 2011). This catch-22 situation threatens to become more relevant the more heavily increased labour market regulation obstructs such workers' access to better paid and more demanding jobs.

## 2. Employment dynamics is key

761. The opportunity of advancement to higher pay is less relevant to reducing entrenched unemployment than the transition from unemployment to employment, in particular. This therefore raises the question of how well the low-wage sector can absorb the previously unemployed and how stable their new employment relationships are, since a lasting “**no pay low pay cycle**” would not result in the desired employment stability (Uhlendorff, 2006; Mosthaf et al., 2014).
762. **Employment opportunities** for the unemployed, particularly the long-term unemployed and the unemployed from non-European countries of asylum seekers, are often closely tied to the absorption capacity of the low-wage sector. Obtaining employment thus strongly depends on employment dynamics and is not only determined by the training and skills level of unemployed persons. **High employment dynamics** enables fast transitions from unemployment to employment, particularly for the long-term unemployed and the unemployed from non-European countries of asylum seekers.
763. The issue of which sectors, occupations and regions exhibit high employment dynamics is particularly key to the **absorbing capacity of the low-wage sector**. The dynamics can be determined on the basis of job creation and job destruction, and in this way explains the probability of companies hiring or dismissing employees. The average rates of companies' job creation and job destruction are very stable over time and stand at around 2.4 % per month according to own calculations based on LIAB data. [↘ CHART 99 LEFT](#)
764. There are, however, major differences between the sectors. A low rate of employment dynamics is reflected in a longer **job duration**. A comparatively high average employment dynamics and thus a low average job duration was recorded for the period from 2000 to 2010 in the provision of services (4.8 % new jobs per month) and other services (3 %). The construction (1.6 %), retail (1.6 %) and manufacturing (1.9 %) sectors exhibit particularly low employment dynamics and long average job durations.

↘ CHART 99

**Employment dynamics and transition probabilities by selected sections of economic activity<sup>1</sup>**



- 765. Sectors with high employment dynamics** are often the first point of call for the jobless. Almost 20 % go from unemployment to temporary work. Other key target sectors are manufacturing, retail and construction, although these exhibit less employment dynamics. The picture is somewhat different for the long-term unemployed, who disproportionately often find work in retail and hospitality, but less often in manufacturing and construction. The sector with the highest dynamics, i.e. the provision of liberal professions, academic and technical services, is barely affected by transitions from unemployment. ↘ CHART 99 RIGHT
- 766. Persons from the eight non-European countries of asylum seekers** Afghanistan, Eritrea, Iraq, Iran, Nigeria, Pakistan, Somalia and Syria find work in similar industries as other unemployed people. The largest share (24 %) moves from unemployment to temporary work (Weißbrodt, 2016). Non-European former asylum seekers are disproportionately likely to find work in hospitality and other commercial service sectors, each at 17 %. ↘ CHART 99 RIGHT
- 767.** Many unemployed and low-skilled people fear greater competitive pressure due to increased migration. There is, however, **no conclusive evidence of long-term displacement** of domestic workers by migrants. Although quasi experimental studies indicate negative short-term effects on employment (Glitz, 2012; Dustmann et al., 2016), other empirical studies do not reveal any major displacement in the labour market (Dustmann et al., 2013; Kerr and Kerr, 2011).

An exogenous supply shock caused by migration may also bring about positive displacement effects. Foged and Peri (2016) examined the effects of an increase of refugees with a low level of education, performing primarily manual work, on



the employment situation of the low-skilled domestic population in Denmark. They discovered an **upward movement in the task structure**, with domestic workers transitioning from manual tasks to more complex ones and thereby earning higher wages.

768. A study of the experience gained by the European Union during the Balkan Wars concludes that an increase in the proportion of foreign nationals by 10 % causes a reduction in the labour force participation rate of domestic citizens of 0.2 to 0.7 percentage points. The estimated displacement effects are much more marked in EU countries with **rigid labour market institutions**, including restrictive dismissal protection, high wage replacement rates and a high ratio of minimum wage to median wage (Angrist and Kugler, 2003).

Institutions that cause fewer new jobs to be created and thus keep employment dynamics low make it difficult for migrants to integrate, even if they do not crowd out people already in employment. Despite drastic reforms, the **German labour market** is among the most regulated in the world (GCEE Annual Report 2013 item 452), which was compounded by the introduction of the minimum wage.

### 3. Effects of the minimum wage

769. The introduction of a national minimum wage was a watershed moment for the low-wage sector in 2015. In June 2016, the Federal Government accepted to increase the minimum wage from €8.50 to €8.84 as of 1 January 2017 upon the recommendation of the **Minimum Wage Commission**. In the United Kingdom, policy acted in accordance of the recommendations of their Low Pay Commission for more than a decade. But recently, policy makers articulately deviated upwards. ↘ [BOX 27](#)
770. The effects of a minimum wage cannot be clearly determined theoretically, as they depend, among other things, on the productivity of the labour force and the market power of employers. However, this is not the only reason that the overall very positive labour market development should not lead us to the conclusion that the minimum wage has no effect on employment. The minimum wage considerably **limits the wage formation process in the low-wage sector**.

#### ↘ BOX 27

##### Experience with the Low Pay Commission in the United Kingdom

When the UK introduced its national minimum wage in 1999, the Low Pay Commission (LPC) was set up, whose voting members, unlike in Germany, include not only employer and employee but also academic backgrounds. Similarly to the German commission, the **LPC is an independent body** which submits annual recommendations on the future level of the minimum wage rate – which the government generally acts upon.

The UK's national minimum wage is graded up to the age of 21. This ensures that entry hurdles to the labour market are not too high, particularly for young people. When it was introduced, the **minimum wage** for adults was £ 3.60 an hour, which was around **40 % of the median wage in the UK**.

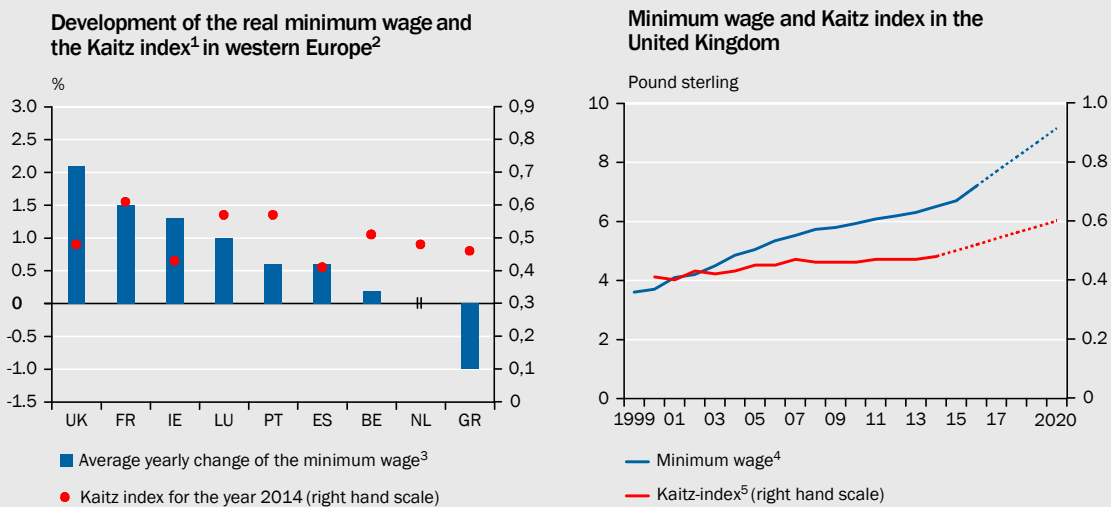
Germany's minimum wage was equivalent to around 50 % of its national median wage when it was introduced. Starting from a low level, the UK carried out the highest annual real minimum wage increases of all western and southern European countries between 2001 and 2012 (Schulten, 2014). This has meanwhile placed it around the middle of the Kaitz index, the ratio of the minimum wage to the median wage, by international standards. [↘ CHART 100 LEFT](#)

The government has now turned away from the LPC's recommendations, with the introduction of the **National Living Wage** for those aged 25 and over in April 2016. Currently £ 7.20 an hour, this new minimum wage is due to rise to a maximum of over £ 9 for those aged 25 and over by 2020. The minimum wage will then equate to 60 % of median earnings (Low Pay Commission Report, 2016). [↘ CHART 100 RIGHT](#) This ratio is currently only higher in France and Turkey. This would effectively eliminate the low-wage sector for adults in the UK, which, similarly to Germany, employs 20 % to 25 % of workers.

On the one hand, this medium-term target means the government is deviating from the strategy of adjusting the minimum wage on an annual basis. On the other, the planned increase is equivalent to an annual average rise of over £ 0.40 until 2020. This **far exceeds the wage adjustments generally recommended by the Low Pay Commission** (Low Pay Commission Report, 2016). The Brexit vote recently buoyed critics of the National Living Wage (FT, 2016). Overall, the introduction of the National Living Wage highlights that political decision-makers often ignore economic arguments.

[↘ CHART 100](#)

#### Minimum wage development in the United Kingdom and western Europe



1 - Ratio of minimum wage to median wage. 2 - UK-United Kingdom, FR-France, IE-Ireland, LU-Luxembourg, PT-Portugal, ES-Spain, BE-Belgium, NL-Netherlands, GR-Greece. 3 - Adjusted for price changes; in the period of 2001 to 2012. 4 - Minimum wage for persons aged 25 and over. For the years 2017 to 2020 according to estimations by the Low Pay Commission Report (2016); linear projection from 2017 onwards. 5 - Kaitz index of 0.6 in 2020: Target value of the British government; linear projection from 2014 onwards.

Sources: Low Pay Commission Report (2016), OECD, Schulten (2014)

**771.** According to the Structure of Earnings Survey, there were some 5.5 million jobs remunerated at less than €8.50 in April 2014, shortly before the statutory minimum wage was introduced. Of these, 1.5 million were legal exceptions from the minimum wage, primarily apprentices, interns and the under 18s. The remaining **4 million jobs** paid below the minimum wage level. This equates to around 11 % of all jobs affected by the minimum wage.

At 22 %, the share in eastern Germany was much higher than in western Germany, where it was 9 %. Of the jobs affected by the minimum wage, **55 % were**

**marginal employment relationships**, while the remainder were equally divided between full and part-time jobs.

772. More than half of workers in the restaurant/catering, gambling, betting and lottery, and taxi industries earn the minimum wage. At an average of 7.2 %, hourly earnings in the **20 sectors most affected** rose more sharply in 2015 than in previous years and other sectors – particularly in eastern Germany (Minimum Wage Commission, 2016).
773. The average gross hourly wage for jobs affected by the minimum wage was €7.20 and the average working week 19.2 hours in April 2014, before it was introduced. A rough calculation thus reveals **gross salary increases** due to the introduction of the minimum wage of a total of €431 million per month, without considering additional labour costs (Federal Statistical Office, 2016).

This calculation is based on the assumption that firstly, the minimum wage is actually paid for all jobs, and secondly that there are no job losses or adjustments, such as to working hours, as a result of the minimum wage. However, initial assessments indicate that wages above the minimum wage were also raised to preserve the wage hierarchy (Minimum Wage Commission, 2016).

774. **Working hours** have also **decreased** in certain employment categories. For example, part-time workers in eastern Germany worked an average of 37 minutes fewer per week in the first quarter of 2015 than in the prior-year quarter; in western Germany this figure was nine minutes (Minimum Wage Commission, 2016). One reason for this may be that workers had to work less to earn their salary than before due to the minimum wage; another may be that the working time regulation has been more strictly enforced. The reduction in working hours or work intensification is named by businesses as the most frequent reaction to the minimum wage (Bellmann et al., 2016).
775. Minimum wage-related adjustments were also discovered in consumer prices. For example, these increased at an above-average rate in sectors heavily affected by the minimum wage, most notably in the taxi sector with 12 % (Minimum Wage Commission, 2016). However, these **price increases** are not necessarily reflected in higher wages for workers if businesses increase their profit margins or bypass the minimum wage. There are ways to avoid the minimum wage, such as through unpaid overtime or by reducing additional wage components.
776. As recently as April 2015, around one million jobs, or 2.7 % of all jobs, were remunerated below the statutory minimum wage. Therefore, the **control over the implementation of the statutory minimum wage** is meaningful; it lies with the customs authorities. A total of 1,600 new jobs were approved for this purpose by the German Bundestag, but given the refugee migration situation, the majority of these employees were transferred to the Federal Office for Migration and Refugees (*Bundesamt für Migration und Flüchtlinge* – BAMF) and the federal police (Minimum Wage Commission, 2016). The reason for the relatively small number of investigation cases relating to the statutory minimum wage (fewer than 3,000 in 2015) is that breaches were not penalised during the introductory period, but instead awareness training was provided.

777. There is already evidence of structural adjustments that can be attributed to the introduction of the minimum wage. Seasonally adjusted, the number of exclusively marginally employed fell by 94,000 people (2 %) month-on-month in January 2015. The **decline in the number of marginally employed** is likely to be somewhat larger overall. For example, operational adjustments in anticipation of the minimum wage were observed in some cases even before it was introduced (Bossler, 2016; Bellmann et al., 2015; Kubis et al., 2015).

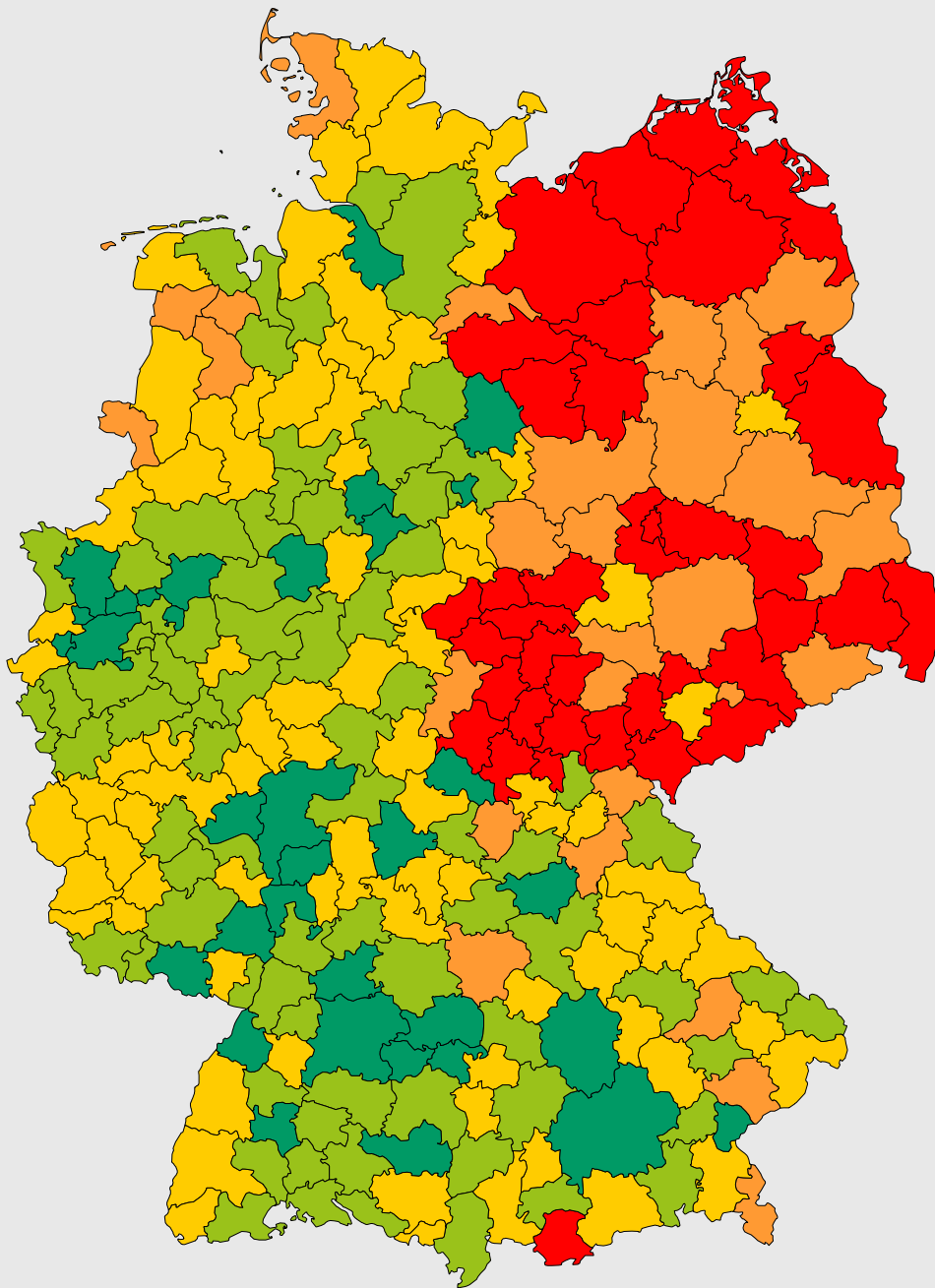
A little more than half of the decline is attributable to the affected people moving directly to employment subject to social security contributions. A further 40 % of people left the labour market, and it is not clear the extent to which they may have become self-employed, commenced a course of study or switched to illicit work. In this group it is evident that reduction of working hours was not a primary factor, and a transition to unemployment likely also played only a minor role (Vom Berge et al., 2016a).

778. The most common method of estimating **causal effects of a minimum wage** is the difference-in-differences approach (GCEE Annual Report 2015 Box 18). However, the introduction of a nationwide statutory minimum wage has limited the applicability of this approach as it is difficult to find a control group not affected by the minimum wage. New studies are based on the differing extents that regions, sectors and businesses are affected by the minimum wage. For instance, there are significant differences in the extent labour market regions are affected.
779. The minimum wage is high compared to the average wage in many labour market regions in eastern Germany, even with consideration for regional differences in rent. ↘ [CHART 101](#) In examining the differing regional effects of the minimum wage, Garloff (2016) concludes, using the difference-in-differences approach, that the minimum wage has as yet **neither reduced total employment nor raised unemployment**. However, he only considers people between the ages of 30 and 54, which is an age group affected below-average by the minimum wage.
780. The variation in the effect of the minimum wage can also be exploited at company level. For example, Bossler and Gerner (2016) use a difference-in differences approach to determine an increase in average wages of 4.8 % and a **slight decline in employment** of 1.9 % for businesses affected by the minimum wage. They conclude that on this basis, 60,000 additional jobs would have been created without the minimum wage.

The decline is primarily due to **hiring restraint**. Employment dynamics has also decreased. Whereas this is welcome from the point of view of those in work, it may also reduce the opportunities for the jobless to find work. In its Annual Report 2014/15, the GCEE assumed in its outlook on the employment trend that around 140,000 fewer jobs would be created than without the minimum wage (GCEE Annual Report 2014 item 192).

▾ CHART 101

Relative level of the minimum wage<sup>1</sup> with consideration of regional rent price levels by labour market regions<sup>2</sup> in 2014  
%



© GeoBasis-DE / BKG 2016 (adjusted data)

■ Below 40 % ■ 40 % to below 45 % ■ 45 % to below 50 % ■ 50 % to below 55 % ■ 55 % or higher

1 – Monthly minimum wage (1 473 euros for full-time employment) in % of the average pay of full-time employed; purchasing power adjustment for regional differences in rent prices. The correction is made for 23.4 % of the gross earnings. This share results from the fact that according to the realtor's association IVD, 35 % of the household's net income in 2010 was paid for rents and utility costs (SZ, 2010) and the net pay according to the OECD (2015) is 66.9 % of gross earnings. The regional quoted rents (net excluding services) for the year 2014 originate from the housing market monitoring of the Federal Institute for Research on Building, Urban Affairs and Spatial Development (BBSR). 2 – Monthly gross earnings contain no data of public services in the sectors "Public administration and defence; compulsory social security" and "Education" because regional mapping was not possible below the level of the federal states.

Sources: Federal Statistical Office, IVD, OECD

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781. In addition to adjustments in business operations, there is also evidence of **increased labour supply**. For example, the statutory minimum wage may cause people previously not active in the labour market to decide to enter it. It may also persuade people already employed to increase the number of hours they work. Especially the high level of migration to Germany in recent times will increase the labour force anyway – particularly in the low-wage sector. This may be a factor in rising unemployment and growth of the informal sector, which is likely to have shrunk in recent years (Schneider and Boockmann, 2016).

### III. CONCLUSION: DON'T LEAVE THE LONG-TERM UNEMPLOYED BEHIND

782. Although the labour market has shown very positive development over the past few years, the upturn has passed by many of the jobless. A lot of them exhibit **multiple obstacles** to employment, in particular an extended period without work. Labour market policy measures have proved fairly ineffective in reducing this entrenched unemployment, because the only promising measures for this category of the unemployed are ones that are closely tailored to individuals' situations. Moreover, competition in the labour market has actually increased further for the long-term unemployed recently, due to the decline of the hidden labour force and increased migration.
783. So it is all the more important to maintain the **low-wage sector's absorbing capacity**, which has been key in increasing employment and decreasing unemployment in recent years. For example, the long-term unemployed often find jobs in sectors characterised by **high employment dynamics** and low wages. It may be prudent to pursue coaching concepts that offer support to workers coming out of long-term unemployment in order to stabilise these new employment relationships.
784. The possibility of preserving access to the labour market via employment in the low-wage sector is particularly relevant given the progress of **digitisation**. It is set to permanently change the world of work and shift economic structures (GCEE Annual Report 2015 items 545 ff.). These changes are not likely to cause major job losses or a substantial increase in structural unemployment (Wolter et al., 2015; Eichhorst, 2015), but in order not to be left by the wayside, it is paramount that older and less skilled workers in particular are equipped to work in the digitalised labour environment.
785. The low-wage sector will only be able to bring more people into work in the long term if, in addition to absorbing these people, it also offers them appropriate **advancement opportunities**. However, the opportunities to move out of the low-wage sector to better paying jobs have been **relatively scarce**. Labour market policy should therefore refrain from hindering the advancement of em-

ployees in the low-wage sector to more demanding and better paid jobs by more regulation.

786. In international terms, the German labour market is already **heavily regulated** (GCEE Annual Report 2013 items 452 f.). The regulation has increased further still with the introduction of the statutory minimum wage. The reforms on temporary work and jobs via contracts for work and services legislated this year continue in the same political direction. They generally benefit workers who are relatively successful anyway, but also have the effect of excluding the long-term unemployed even further. The draft law on wage equality contains obligations to give information on wages, which generates additional administration costs. Whether this contributes to the objective of equal wages between women and men is a moot question in view of the diversity of industrial relations.
787. From this perspective, the **minimum wage** represents a major hurdle to the labour market's ability to absorb, because it prevents jobs being created for the low-productive. The increase in the minimum wage from €8.50 to €8.84 as of 1 January 2017 may be moderate, but by including more recent and higher collective agreements, the Minimum Wage Commission deviated from the previously agreed wage index with its very first decision.

The **exemptions from the minimum wage** for the long-term unemployed in the first six months of a new job are a prudent insurance measure. They should therefore not only be maintained, but also extended to twelve months. The fact that little use has been made of the exemption rule as yet (Vom Berge et al., 2016b) must not be an argument against using it as lifeline for the long-term unemployed in periods of economic weakness.

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