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INTERNATIONAL SOCIAL SECURITY ASSOCIATION

Crisis country case study

Germany

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ISSA crisis case study: Germany

Summary

As the world's biggest exporter Germany was severely hit by the fall in global demand. To counter the crisis, the German government implemented two major stimulus packages. In addition to this, it passed a law in parliament to stabilize the financial and banking sector and introduced new legislation to stabilize pension income during the downturn. The stimulus packages were designed to counter the crisis by shoring up domestic demand in order to make up for the loss of external demand. Major measures taken to counter the crisis in the field of social security comprised partial unemployment benefits or reduced working hour compensation. The approach employed so far has been successful in avoiding "full" unemployment on a large scale.

Social security institutions covered

The statutory health insurance and statutory unemployment insurance, which is implemented by the Federal Employment Agency *(Bundesagentur für Arbeit).*

Overview of the social security system

Germany's social security system, established in 1884 by Chancellor Bismarck, today includes:

- Statutory pension insurance, based on defined contributions of at least five years by employees and employers (usually 9.5 per cent of monthly payroll). Between 2012 and 2029, the normal pensionable age will rise gradually from age 65 to age 67. Additional private and state-subsidized schemes are available (*Riesterrente*).

- Statutory health insurance (*gesetzliche Krankenversicherung*). Apart from a few special categories and conditions all employees are subject to compulsory insurance. Sickness insurance funds administer the collection of the overall social insurance contributions for all branches. Salaries continue to be paid by the employer for up to six weeks; thereafter, the sickness funds pay 70 per cent of gross earnings for up to 78 weeks.

- Statutory long-term care insurance (*gesetzliche Pflegeversicherung*). All persons who are members of a statutory sickness insurance fund are covered against the risk of need for long-term care. Persons with private sickness insurance coverage must correspondingly conclude a private long-term care insurance contract.

- Statutory accident insurance (*gesetzliche Unfallversicherung*). The relevant organizations of the statutory accident insurance are the accident insurance institutions of the private sector (*Berufsgenossenschaften*), of the agricultural sector (*landwirtschaftliche Berufsgenossenschaften*) and the accident insurance institutions of the public sector (e.g. state accident insurance funds), covering employees, certain self-employed persons, pupils and students, children in daycare, persons undergoing rehabilitation and others.

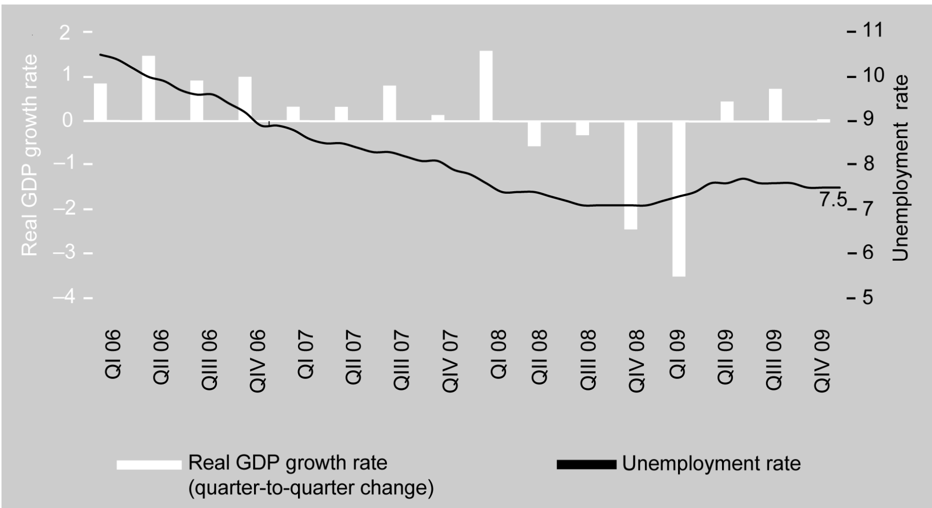
- Statutory unemployment insurance (*gesetzliche Arbeitslosenversicherung*) is implemented by the Federal Employment Agency (*Bundesagentur für Arbeit*). Unemployment benefits are paid to those insured who have at least 12 months of covered employment in the last two years, are registered at an employment office, are capable of, available for, and actively seeking employment.

Impact of the crisis

The global financial crisis transformed Germany's rather positive outlook of continuous solid economic growth fairly rapidly. With an expansion of Germany's Gross Domestic Product (GDP) of 3.2 per cent in 2006, 2.5 per cent in 2007 and 1.6 per cent in the first quarter of 2008, Germany had a good track before it was hit by the crisis, even though the demand for labour had already started to weaken in 2007. Like many countries, more recently during 2009 Germany has posted rather modest growth at less that 1 per cent.

While negative GDP growth in Germany began in the second quarter of 2008 and continued for four consecutive quarters, the effects were not immediately felt in the labour market. Employment growth only turned negative in the autumn of 2008, when the impact of the global economic crisis had begun to manifest itself through labour market statistics. The unemployment rate increased particularly sharply at the beginning of 2009 as shown in Figure 1.

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

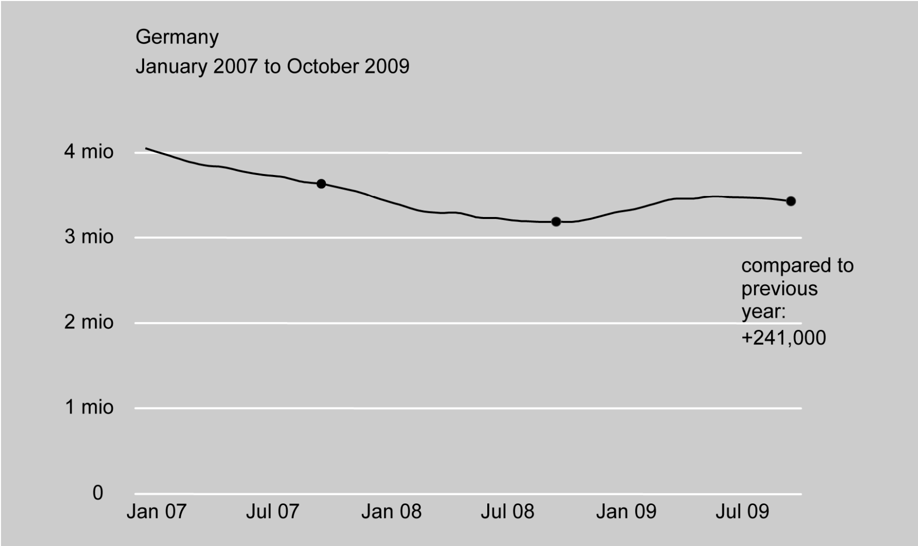


Source: Eurostat and official country information, seasonal adjusted data, prepared by the International Labour Office (ILO), Geneva.

The German labour market coped with the global economic crisis comparatively well compared with other countries. As a result of the crisis, unemployment increased. However, it has now returned to a similar level to that which existed prior to the crisis at nearly 7 per cent, which is equivalent to 2,945,000 unemployed people. This means that Germany is in considerably better shape than the European average seasonal unemployment rate of 10.1 per cent (see Figures 2 and 3). In addition to this, the latest figures of the Federal Employment

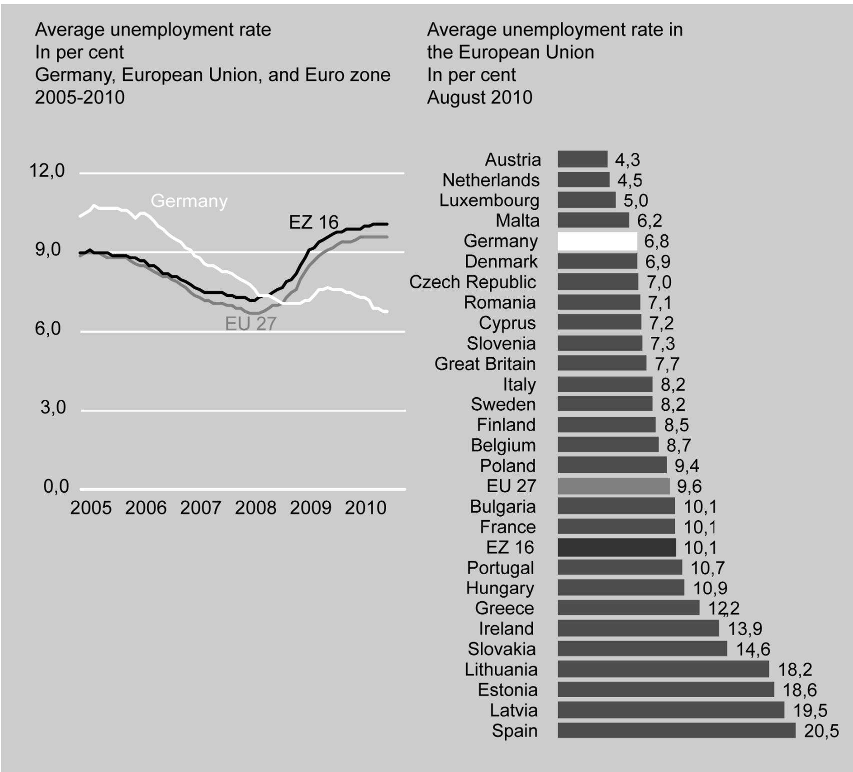
Agency indicate that GDP has increased again and now sits at 2.2 per cent (Federal Employment Agency, 2010c).

Figure 2. ***Unemployment seasonally adjusted figures before and during the financial crisis (January 2007 - October 2009)***



Source: Federal Employment Agency (2009).

Figure 3. ***The current unemployment rate of Germany and the European average***

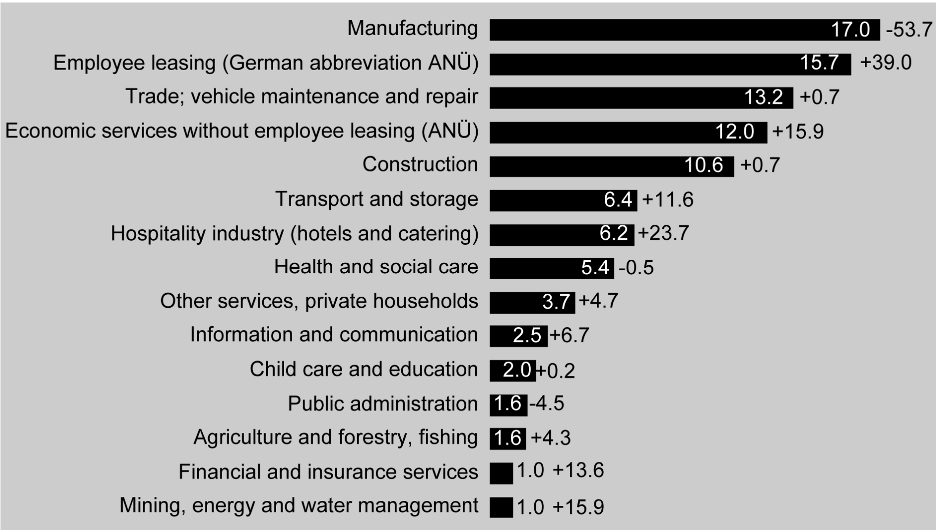


Source: Federal Employment Agency (2010c).

It is important to recognize that German unemployment statistics only count those who are fully out of work. People who have been temporarily suspended from work, but still hold a work contract, and at the same time receive a reduced salary and a government subsidy in addition to it, do not appear in these statistics. This kind of work arrangement is called *Kurzarbeit*, or short-time work. Under this scheme, employees are asked to accept reduced working hours and a reduced salary, but in return they can keep their jobs despite the lack of work and reduced hours. Government compensation schemes contribute to the monthly salary of the employees in order to cover their basic needs that the salary alone can no longer provide.

As can be seen in Figure 4, nearly one in five of the new cases of unemployment since autumn 2008 came from the manufacturing industries, followed by people in short time-work, who work under an employee leasing agreement (16 per cent), and those working in the trade and commerce sectors (13 per cent). The bulk of the rise in unemployment was therefore attributable to the manufacturing industries and time-work (+54 per cent and +39 per cent respectively compared to the same period in 2007). Export-driven industries and those regions supplying the manpower for them were particularly hard hit by the crisis. In addition, the crisis had an early and strong impact on the area of short-time work, which is also related to the German response to the financial crisis, as outlined below.

Figure 4. ***Impact of the crisis by branch of industry***



Source: Federal Employment Agency (2009). New job losses by branch as a percentage of total losses (and the percent change in new job losses compared with the previous year). Germany, October.

Responses to the crisis

Germany was hit hard by the crisis and has suffered its first economic contraction since 2002. However, it experienced low levels of employment loss compared to other countries. The high level of short-time work is one of the decisive factors that, hitherto, explains the relatively mild impact of the economic crisis on the labour market in Germany. This was especially the case in the western and southern areas of Germany. The metal and engineering sectors as well as automobile and electrical industries were especially affected.

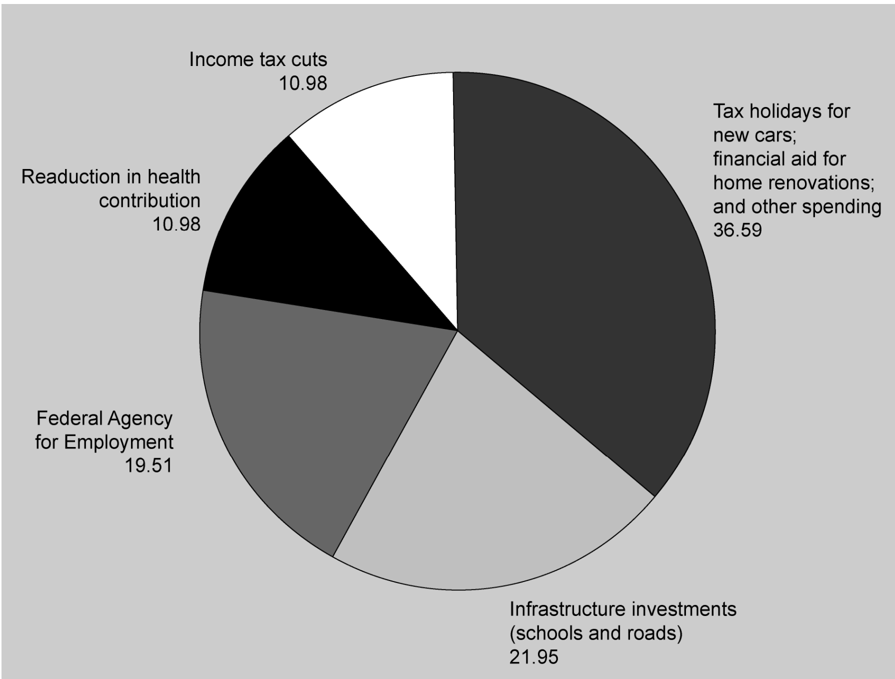
Economic stimulus packages

Germany launched several stimulus packages and new legislation in order to respond to the crisis, which were adopted between October 2008 and November 2009. These were the fiscal stimulus packages (the stimulus programmes I and II and the law on accelerating economic growth) as well as additional stimulus plans for the German social security system. Taken together, the stimulus measures totalled USD107 billion.

Both stimulus packages I and II contained measures to respond to the financial crisis, such as short-time work subsidies (stimulus programme I) or government incentives to buy new cars (stimulus programme II) as can be seen in Figure 5.

The share of spending assigned to social security measures represented approximately 30.5 per cent of the stimulus package and was often complemented by other aspects of the stimulus packages. For example, tax cuts to help increase the spending power of low- and middle-income households may have bolstered income from social cash transfers. Moreover, other measures helped keep the economy functioning by restoring public confidence and thereby helping to stimulate aggregate demand and therefore maintain liquidity in the economy. These measures also kept workers in employment, which has helped sustain contribution income to social security programmes.

Figure 5. ***Composition of Germany's fiscal stimulus packages (I and II)***



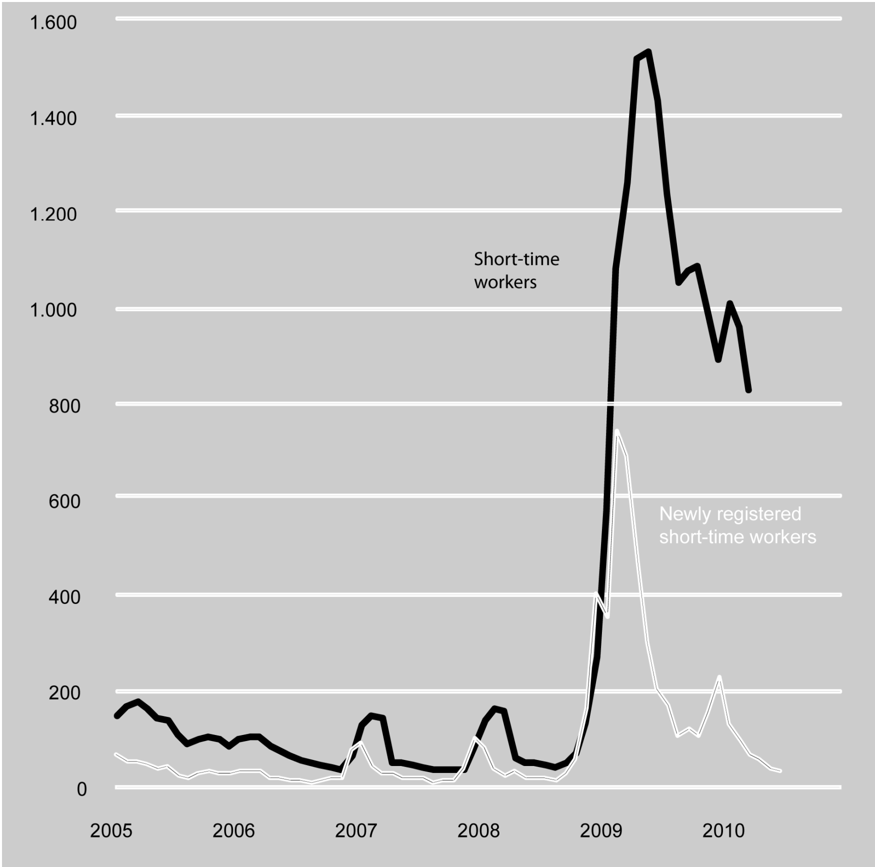
Source: Khatiwada (2009).

Stimulus plan for short-time work

In November 2008, under the German government's stimulus programme I, existing short-time work arrangements (*Kurzarbeit*) were extended in 2008 from 6 to 18 months. In May 2009, the maximum length was extended again to 24 months. Under this programme, employers could apply for temporary state assistance to top up the wages of employees who were working fewer hours. The Federal Employment Agency covered 67 per cent of the net wage losses suffered by the wage earner (60 per cent for childless workers), and employers were reimbursed 50 per cent of the social security contributions they had to make on behalf of workers. This could rise to 100 per cent if the "downtime" (i.e. reduced working hours) was used for training.

The assistance was available to enterprises facing a temporary unavoidable loss of employment due to economic factors. In situations where diminished activity would lead to a 10 per cent cutback in the gross wages of at least one-third of a company's workforce, that company was entitled to resort to this mechanism, if compliant with the industry's collective bargaining agreement. Enterprises made good use of this possibility in order to ensure their operations and to avoid losing their skilled workers (see Figure 6).

Figure 6. ***The financial crisis causes significant rise in short-time work***



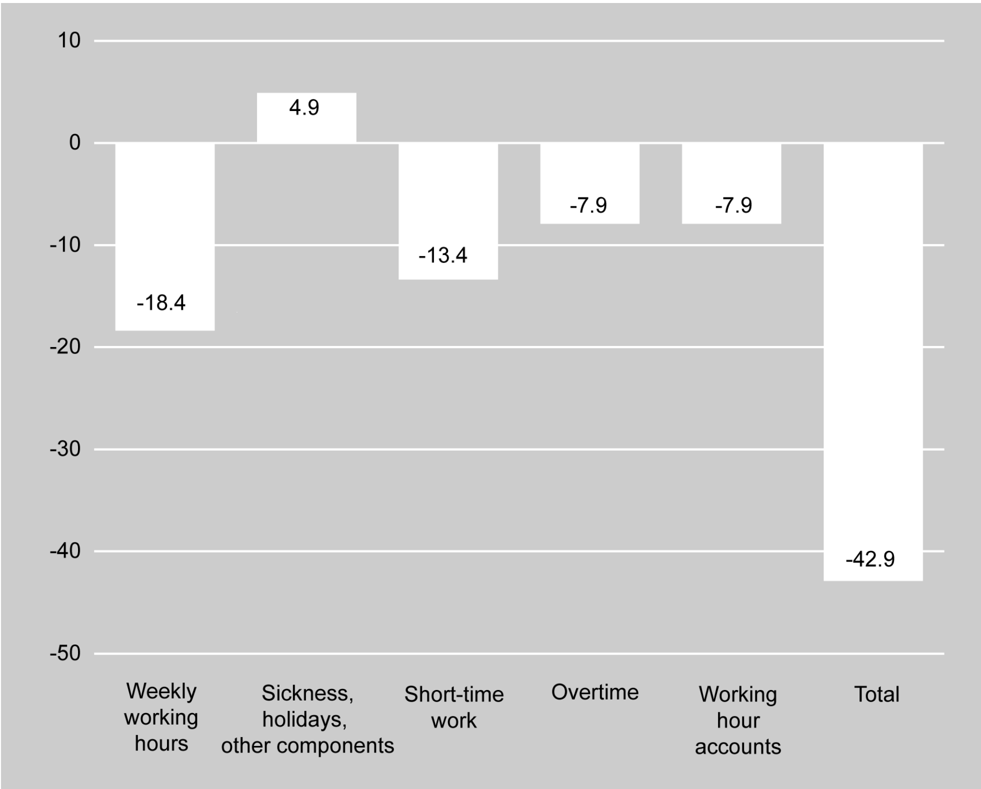
Source: Federal Employment Agency (2010b).

The number of beneficiaries covered by the short-time work scheme has risen dramatically since its introduction. Numbers increased from over 130,000 participants in November 2008 to more than 1.5 million workers in May 2009. However, the high number of short-time workers helped to keep the unemployment rates stable, reaching 8.5 per cent in February 2009 with over 3.5 million people unemployed. With the introduction of short-time work, the unemployment rate balanced itself out to 8.2 per cent in May 2009, and 7.5 per cent (i.e. equal to 3.15 million) in June 2010 (Online unemployment statistics for Germany, 2010).

Short-time work was effective in reducing the impact of the crisis on the labour market, although in mid-2010 it was used much less than at the peak time in summer 2009. The number of new entrants into short-time work significantly reduced to only 800,000 in January 2010 and again to 480,000 in May 2010 (Federal Employment Agency database).

As of 17 April 2010, the government extended the regulations regarding short-time work in Germany until the end of March 2012 as short-time work has turned out to be an effective protective shield for many employees. They were able to avoid losing their jobs during the economic crisis because of the government subsidies (*Die Welt*, 2010a). As can be seen in Figure 7, short-time work was necessary to keep people in jobs, as economic activity reduced drastically.

Figure 7. ***Changes in working hours 2009 (yearly averages by employee)***



Source: IAB (2010).

Stimulus plan for the social security system

In response to the economic downturn of 2009, the German government decided to provide additional financial aid amounting to approximately USD22.5 billion to support the German social security system. The new law for the stabilization of social insurances entered into force on 17 April 2010.

The law aimed at stabilizing the non-wage labour costs of employers thus also stabilized the overall social security contributions. This measure was intended to help avoid new lay-offs and protect employees from the effects of the economic crisis and provide an additional boost to the German economy (German Ministry of Finance, 2009).

Besides these measures, the German social security system has further challenges to meet. For example, the revenues of unemployment and health insurance through contributions of the insured have gradually been reduced as a consequence of temporally high unemployment rates induced by the crisis. Health insurances estimate their projected losses for 2010 to be around USD14.3 billion (*Focus, 2010a*). The German health reform, which will come into force on 1 January 2011 will usher in an increase of contribution rates from 14.9 to 15.5 per cent, which will be shared by insured workers and their employers as well as reduced remuneration for the health services provided (*Focus, 2010b*).

Lessons learned

The reduced working hours approach appears to have been successful in the short term, since the ultimate impact of the crisis was less severe than in other European countries. While the reduced working hours scheme effectively mitigated employment losses, this upside must be weighed against the possibility of losses in potential productivity gains. One criticism that has been made is that such an approach artificially props up firms and industries that are not competitive and therefore creates perverse commercial incentives. However, an alternative point of view reasons that Germany is now once again one of the world's biggest exporters precisely because of its abundance of short-term workers. Arguably when the recovery began and world export demand picked up Germany was able to mobilize these workers incredibly quickly, and much faster than those countries lacking access to a large pool of short-term workers who are sufficiently skilled and ready to work. This demonstrates the enormous flexibility of the German labour market, which managed to operate on a reduced level of working hours and then to ensure an incredible demand by working overtime (see Figure 7).

Conclusion

The impact of the economic crisis on the labour market was moderate and current developments clearly indicate that the situation has stabilized. According to the Federal Employment Agency, the German economy is on the road to recovery since June 2010 (Federal Employment Agency, 2010a). Indicators, such as the reduction in unemployment, the growth of GDP by 0.2 per cent, along with an increase in the volume of incoming orders, all point to a continued improvement in the labour market. However, short-time work is still providing relief to the labour market, although at the time of writing (October 2010) it is being used much less than at its height in May 2009.

The incentives for the purchase of new cars have also proven to be successful. In fact, so successful that German car manufacturers are again making good profits and politicians are now calling on the car industry to pay back the subsidies it received (BBC, 2010). This is especially pertinent given that Germany has recently posted impressive GDP growth, with its economy growing at 2.2 per cent in the three months to the end of June 2010 (its fastest quarterly growth in more than 20 years) (*Die Welt*, 2010b). This indicates strongly that a recovery is already well under way. All in all, the overall German response to the crisis has been effective.

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