

# NEW CHALLENGES FOR LABOUR MARKET AND SOCIAL POLICY

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This is a translated version of the original German-language chapter "Arbeitsmarkt- und Sozialpolitik vor neuen Herausforderungen", which is the sole authoritative text. Please cite the original German-language chapter if any reference is made to this text.

## THE KEY DETAILS IN BRIEF

The labour market situation in Germany is currently comforting. The sustained rise in employment since the mid-2000s continued in 2015, while the income distribution remained stable and regular employment contracts were picking up. The already familiar long-term challenges for the labour market and social policy remain: demographic change, advancing globalisation, increasing digitisation and an entrenched core of unemployed workers.

These challenges are currently taking a backseat to the large numbers of refugees arriving in the country. Granting asylum is first and foremost a humanitarian issue. However, the successful integration of recognised asylum seekers into society and the labour market is of paramount economic importance. It demands great effort and flexibility on the part of the refugees as well as society, the economy and policymakers. Integration will take many years and there is no guarantee as to its success.

As demonstrated in a scenario analysis by the German Council of Economic Experts, the effects on the labour market are extremely uncertain. Unemployment is expected to rise in the next few years. And the quicker recognised refugees have access to the job market, the higher unemployment is likely to be in the short term. Still, in addition to skill-acquisition, integration and language courses, an accelerated asylum process will be an important component of a successful refugee policy.

Fast labour market integration is impeded by regulatory hurdles. The minimum wage could prove to be a particular obstacle in this respect. Given the favourable economic environment, it is still far too early to conclude on the basis of the positive labour market situation since the minimum wage was introduced that its impact is harmless. It will not be possible to clearly assess the validity of these concerns until companies have been able to make all the relevant adjustments. Given the anticipated increase in the supply of labor in the low-skilled sector, the minimum wage should certainly not be raised. The rule exempting the long-term unemployed from the minimum wage could be extended from six to twelve months and expanded to include recognised asylum seekers, in order to improve their job prospects. Flexible employment opportunities, such as temporary positions and jobs via contracts for work and services, must remain in place.

Education policy is extremely important in enabling participation and for securing growth and prosperity in the long term. The age structure of the asylum seekers provides considerable potential for education and skill acquisition. In sum, focussing public spending more on the early stages of the education life-cycle increases equal opportunities. Moreover, training and further education become increasingly important with advances in the digitisation of the economy. Both employees and employers must commit more to lifelong learning to ensure the skills required in an ever-changing working environment are in place for the long term.

Continuous dialogue is necessary on growth, prosperity and quality of life. The Federal Government has taken a further step towards systematic welfare reporting in initiating the citizen dialogue on quality of life in Germany (Gut leben in Deutschland – was uns wichtig ist). The objective must be to develop a system of indicators which is widely accepted by society and used as a regular instrument for discussion. In addition to economic concerns, this should also address environmental and social issues, and be subject to systematic scientific evaluation.

## I. STARTING FROM A SOLID BASE

479. There has been significant improvement in the **overall economic conditions** since the middle of the last decade, facilitating a foresightful labour market and social policy. Structural change in businesses, moderate wage development and the economic policy decisions of the first half of the 2000s were contributing factors to the major employment upswing which weathered the financial and economic crisis in the euro area while distribution results remained stable. Germany's low unemployment stands out in an international comparison, but an entrenched core of unemployed workers remains.
480. However, the favourable situation on the labour market is at threat due to **multiple challenges**. First and foremost, Germany will have to cope with the sharp rise in migration. It will take considerable efforts to integrate recognised refugees; in addition to education and social policy, this will involve labour market policy above all. Moreover, demographic change and digitisation are likely to affect the working environment in a myriad of ways.

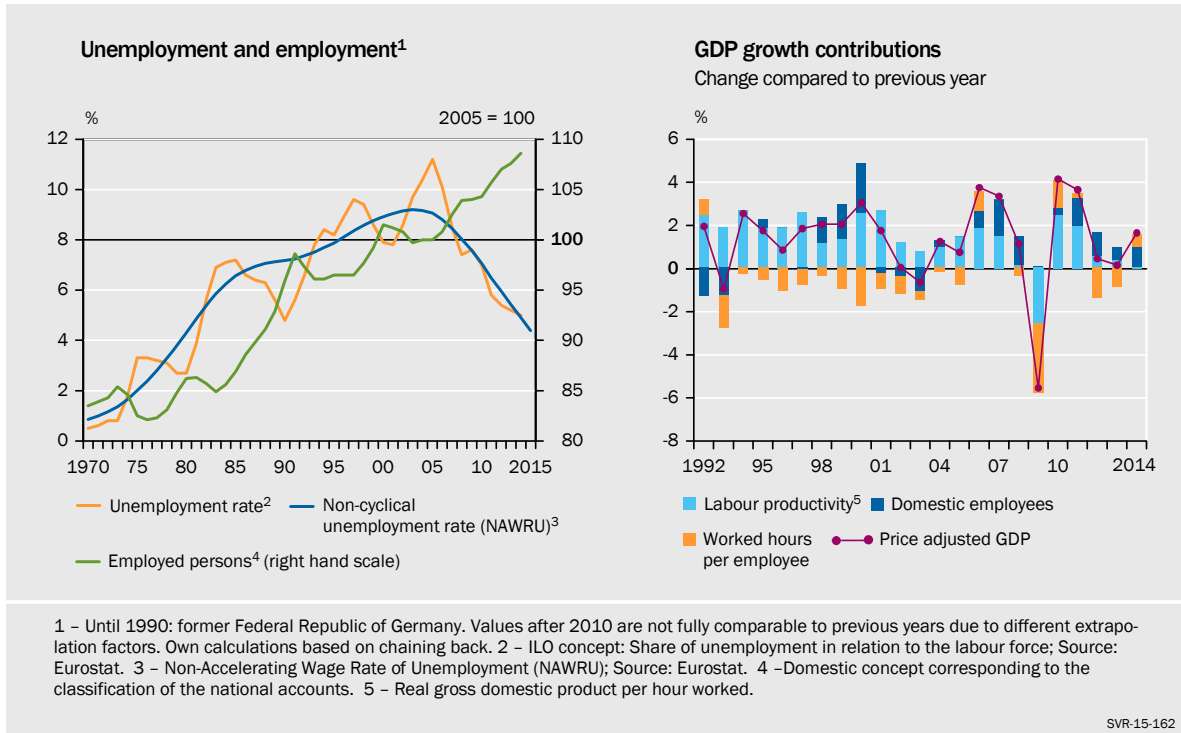
Although the German labour market can provide great opportunities for economic performance and individual inclusion even under these difficult conditions, higher **regulatory hurdles**, such as the nationwide minimum wage recently introduced, make this unnecessarily difficult. The labour market framework should instead be flexible enough for employees and businesses to rise to these challenges in their own way.

### 1. Stable employment, entrenched unemployment

481. Employment figures have been trending upward in Germany since the mid-2000s, and **structural unemployment** has been on the decline. [↘ CHART 72, LEFT](#) At the individual level, this helps to generate income and ensure social inclusion. In addition, labour volume combined with capital stock and productivity plays a key role in overall economic performance. [↘ ITEM 590](#) The development of employment and productivity is closely correlated. For example, the past three years saw both an increase in employment and moderate growth in labour productivity. [↘ CHART 72, RIGHT](#)
482. The current **healthy labour market situation** is unusual when compared internationally, and in particular in relation to other European countries. In fact, it has even been called the “German labour market miracle” due to the major economic challenges Germany faced in the early 2000s. Employment figures have risen sharply in the past few years, exceeding 43 million persons in work in 2015. The number of registered unemployed has been below 3 million since 2011, with the unemployment rate at 6.4% this year. [↘ ITEM 238](#) There are **many reasons** behind these developments, with key examples being the adjustment of value chains and cost structures, the favourable foreign trade environment for the German export industry, and the labour market, tax and social policy reforms of the first half of the 2000s.

↘ CHART 72

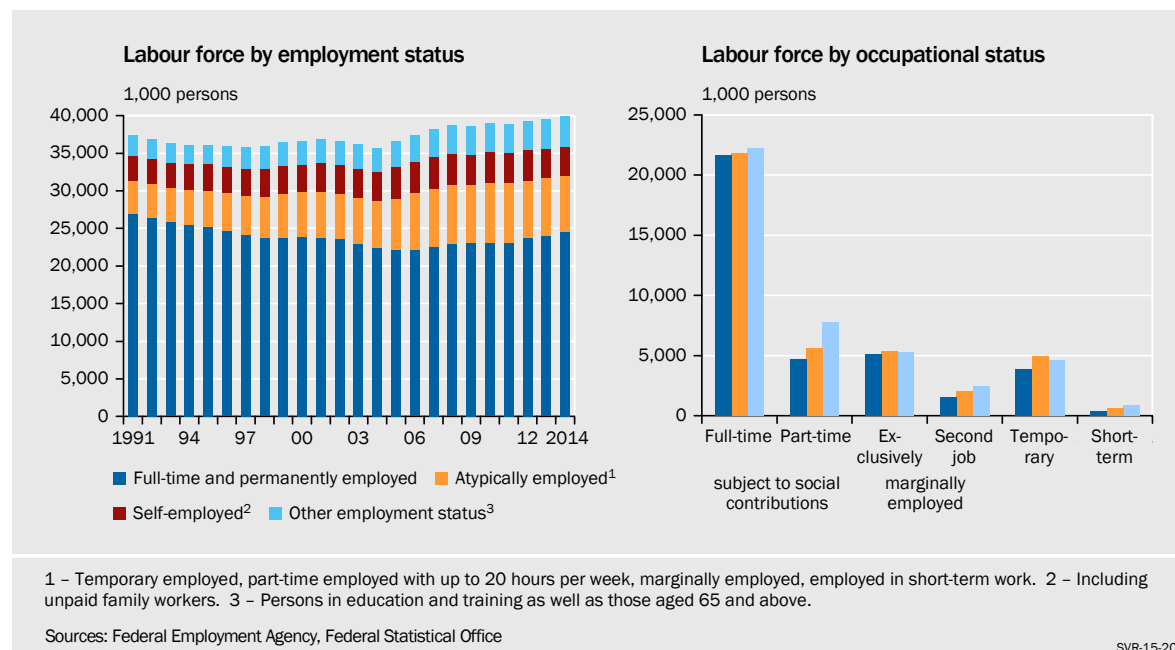
Development of the labour market and the gross domestic product in Germany



483. The **Agenda 2010 reforms** preserved the model of a social market economy with a central role for wage-negotiating parties in the labour market (Möller, 2015). Empirical evidence indicates that the Hartz reforms as a whole boosted the favourable labour market development (Jacobi and Kluve, 2007; Fahr and Sunde, 2009; Klinger and Rothe, 2012; Krause and Uhlig, 2012; Hertweck and Sigrist, 2013; Klinger et al., 2013; Krebs and Scheffel, 2013; Gadatsch et al., 2014). However, the significance for the overall economy – of Hartz IV in particular – is not without controversy (Launov and Wälde, 2013; Dustmann et al., 2014).
484. The increase in employment by around 3.5 million since 2005 was associated with an expansion in the **range of employment forms**, primarily of part-time and marginal employment. This did not cause a polarisation of the labour market in the sense of undermining the middle-skilled segment, but instead saw a stable rise in the number of middle-skilled and middle-wage jobs along with more dynamic development at the high and low ends of the wage and skill distribution (Eichhorst et al., 2015). ↘ ITEM 549
485. The stability of the middle of the labour market is also reflected in a **renaissance of regular employment contracts**; following a decline since the early 1990s, the number has risen again since 2005, also recently in relation to other forms of employment. ↘ CHART 73 The quality of employment in Germany with regard to pay structures, job security and the working environment is also good in comparison with other countries (OECD, 2014).
486. Overall, the more flexible forms of employment enable broader labour market participation. Apart from the rise in labour migration and the decline in unemployment, the largest factor in the **increased employment figures** has been

↘ CHART 73

Development of the labour force by employment status



the higher proportion of women and older people in work. Flexible working hours are of particular importance to these groups. For instance, the results of the 2014 EU labour force survey show that among part-time workers, 14% of women and 20% of men would like to work more hours. At the same time, around 90% of people are happy with their working hours, and would not want to work either more or less (German Federal Statistical Office, 2015).

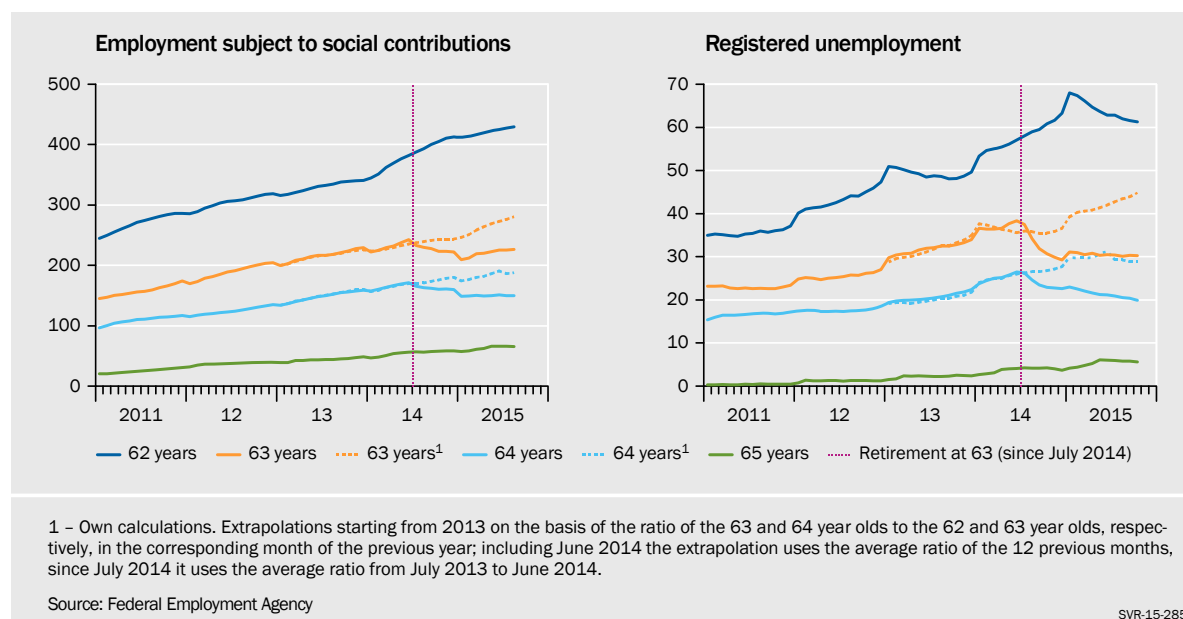
487. The introduction of the **retirement at age 63** for long-term contributors in July 2014 has been thwarting the uptrend in the proportion of older people working (GCEE Annual Economic Report 2014 items 565ff.; Feld et al., 2014). While the number of 62-year-old workers liable for social security contributions increased by 11.3% between June 2014 and June 2015, the number of 63 to 65-year-olds was down by 5.8%. In the latter group, the decline among 63 and 64-year-olds was offset by a slight increase in the number of 65-year-olds in employment (Hartmann and Reimer, 2015a). ↘ CHART 74 A rough calculation based on developments last year indicates that there were almost 80,000 fewer workers liable to pay social security contributions and around 20,000 fewer registered unemployed in June 2015 than would have been the case without the introduction of the retirement at age 63.

488. However, Germany still has deeply **entrenched structural unemployment**. According to data from the Federal Employment Agency (*Bundesagentur für Arbeit* - BA), an annual average of almost 1.1 million people or 37% of all registered unemployed were classified as long-term unemployed (more than 12 months without work) in 2014 (Hartmann et al., 2015). Taking into account interruptions in unemployment to participate in labour policy programmes, the average number of long-term unemployed was actually around 8% higher for the period from 2003 to 2013 (Rothe, 2015).



↘ CHART 74

**Employment and unemployment for persons aged 62 to 65 years**  
1,000 persons



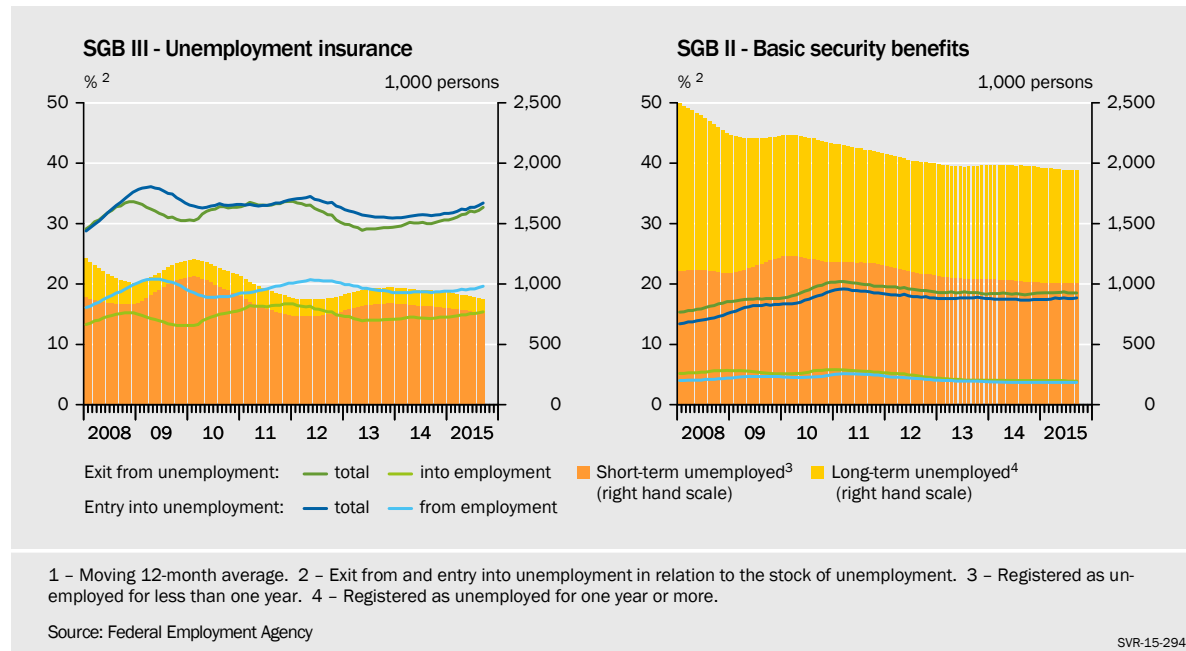
489. More than two-thirds of all registered unemployed have received the basic allowance for jobseekers in accordance with Volume II of the German Social Code (*Sozialgesetzbuch II – SGB II*) since 2007, with the exception of crisis-hit 2009. ↘ CHART 75 The **proportion of long-term unemployed** is substantially higher and the chance of finding employment considerably lower in this group than for those falling under the unemployment benefit provisions of SGB III. Low skills are likely to be one of the main obstacles to job opportunities for this group. A total of 45% of unemployed people had not completed any vocational training in 2014. The unemployment rate among unskilled workers was approximately 20% (Söhnlein et al., 2015).

## 2. Stable distribution results

490. The improved situation on the labour market since the mid-2000s – i.e. since the Agenda 2010 reforms – was accompanied by **stable distribution results**. For example, the development of the aggregate distributions of income and wealth in the past ten years in Germany is fairly unspectacular (GCEE Annual Economic Report 2014 items 509ff.). There was, however, a tangible increase in disparity in net equivalent household income prior to this, beginning in the mid-1990s (Grabka et al., 2015; Krause, 2015). Income inequality after taxes and transfers in Germany is below average in international terms (OECD, 2015a; GCEE Annual Economic Report 2014 items 705ff.).
491. A statistical survey of income and wealth inequality is subject to a number of problems, with the consequence that **different sources**, such as the Socio-Economic Panel (SOEP), the microcensus and income tax statistics, lead to **different results**. For example, a recent assessment by the German Taxpayer-Panel (TPP) for the period from 2001 to 2010 indicates a slight increase in inequality of market income, whereas a study using SOEP data for the same period

↘ CHART 75

Exit from and entry into unemployment by Social Code Book (SGB)<sup>1</sup>



shows a sharp increase followed by a slight decline from 2005 onwards (Schmid et al., 2015).

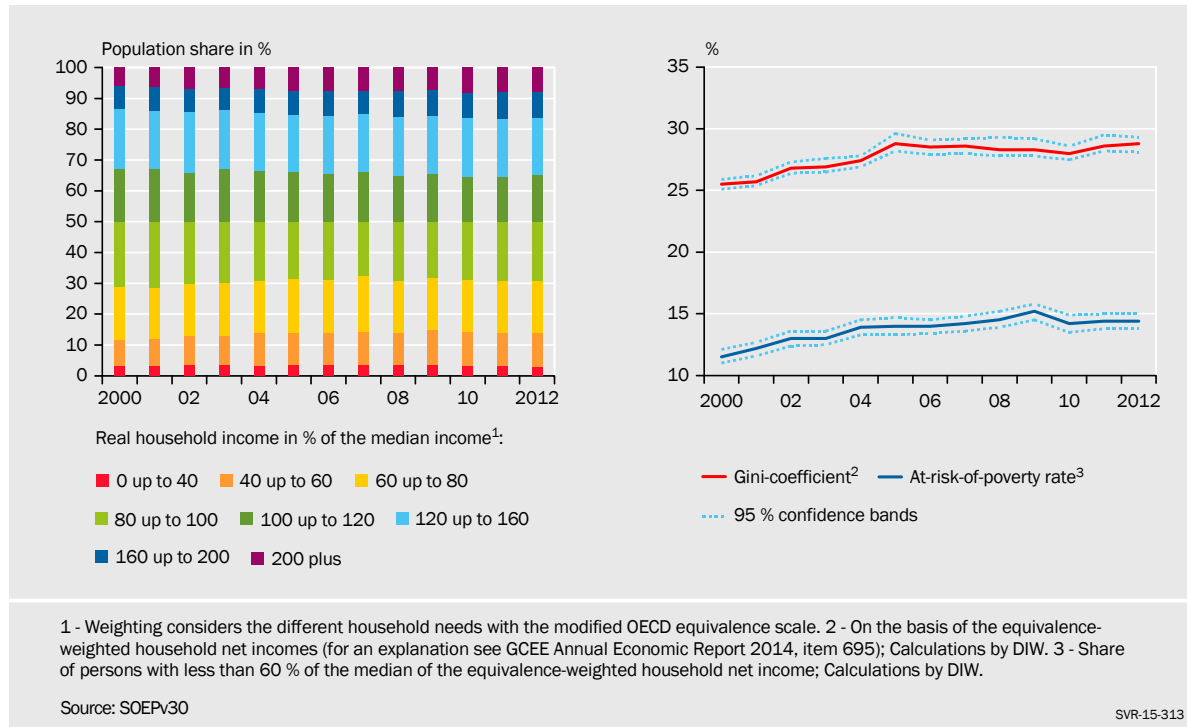
492. A large number of potential influencing factors must be taken into consideration when comparing such results. Although the **SOEP** presents a **representative data set** for the German population, it does not adequately account for high incomes, particularly investment income. Investment income is better recorded in income tax statistics, but this data set is not representative for the population as a whole, as only taxpayers who submit income tax returns (whether individuals or married couples filing together) are included. Moreover, the TPP 0.5% sample is a highly selected panel, as only people who had submitted an income tax return every year from 2001 to 2010 and had not changed between individual and joint filing were included.

Income tax statistics represent an important data source for the analysis of the upper income segment and cyclical fluctuations in market income. From the GCEE's viewpoint, however, the focus regarding welfare development should be on net household income, and structural shifts in the population and on the labour market should be given a closer look.

493. Even when similar statistics are used, the assessments as regards income distribution still often differ, for instance regarding middle-class development in Germany (ISG, 2011; Burkhardt et al., 2013; Niehues et al., 2013; Bosch and Kalina, 2015). In the GCEE's view, Germany remains a **stable middle-class society**; the majority of the population is clustered around the median needs-adjusted net household income, which was in the region of €20,000 in 2012. More than 75% of the population is in the 60% to 200% area of this median income, i.e. between the common empirical thresholds used to measure those at risk of poverty and the income-rich. ↘ CHART 76

↘ CHART 76

Development of the income distribution in Germany from 2000 to 2012



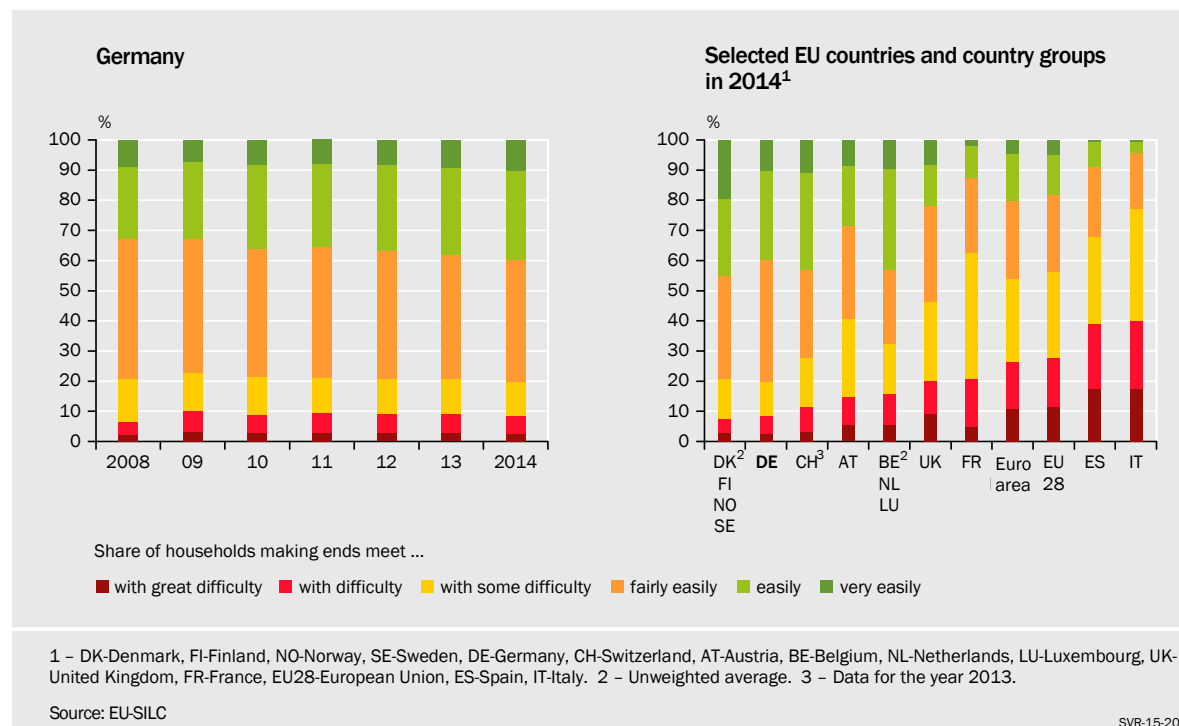
The development of the middle class share has been as unspectacular since the mid-2000s as that of the Gini coefficient for equivalence-weighted market and net household income (GCEE Annual Economic Report 2014 items 694ff.; Grabka et al., 2015). This applies all the more because shifts in the **household and population structures** were likely leading to changes in the aggregate distribution results (GCEE Annual Economic Report 2014 item 517; Peichl et al., 2011; Klemm et al., 2015).

494. The stability of the income distribution is also evident in an absolute observation; around 80% of German households classed their **personal financial situation** as at least **relatively good** in the European Union Statistics on Income and Living Conditions (EU-SILC), the standard data source for the measurement of poverty and living conditions in the EU member states. ↘ CHART 77 This assessment has been unchanged since 2008 and is high compared to other European countries. However, subjective assessment of personal situations need not match the perception of the state of society, as is clear from the views on income distribution (GCEE Annual Economic Report 2014 item 514; Niehues, 2014; Gimpelson and Treisman, 2015).
495. Developments in the **lower income area** are afforded particular attention from a social policy viewpoint. There was recently a slight rise in the at-risk-of-poverty rate, a measure of relative distribution. On the other hand, there was a small drop in the minimum benefit and the SGB II rate. There were **no major changes** in terms of material deprivation. ↘ CHART 78, LEFT This stability in the lower income bracket is due to the tax, minimum social security and general social security systems which help to equalise living conditions. Absolute poverty is practically ruled out due to the minimum social security systems and free access to healthcare and education.



↘ CHART 77

### Financial situation of European households



A target was set under the Europe 2020 strategy to reduce the number of people in the EU in or at risk of poverty and social exclusion by 20 million. The relevant statistical indicator is the proportion of households classified as either at risk of poverty, with low labour force participation or affected by severe material deprivation. Households are deemed materially deprived if, according to self-assessment questionnaires, they meet at least three of nine deprivation criteria in the EU-SILC statistics, and severely materially deprived if they meet four or more. These include financial burdens and the inability to afford selected durable goods. Germany was ranked around the middle of European countries, with a (severe) material deprivation rate of (5.0%) 11.3% in 2014. The indicators show the situation to be similar to that of France, and better than Italy and the UK. However, Germany ranked below the Nordic countries. A similar analysis based on SOEP data finds a share of 16.1% of materially deprived persons in Germany in 2013, compared with 19.8% in 2005 and 21% in 2007 (Grabka et al., 2015). These differing results highlight the difficulties of measuring material deprivation.

496. The **analysis of high income and wealth** has become more of an academic focal point recently, not least due to the works of Thomas Piketty. Wage and income tax statistics can be used to supplement surveys, which lack the willingness to provide information, particularly on income and wealth (Dell, 2007; Bach et al., 2013; Bartels and Jenderny, 2014; Drechsel-Grau et al., 2015).

However, following the introduction of the final withholding tax (*Abgeltungssteuer*), a portion of investment income is no longer included in wage and income tax statistics, which means that there are currently no comprehensive administrative statistics on investment income and wealth for Germany. Furthermore, the differences in entitlements to social security benefits and historical path dependencies must be taken into account in wealth analyses and interna-

tional comparisons. These include the low proportion of property owners in Germany and the low levels of personal wealth of many eastern-German households.

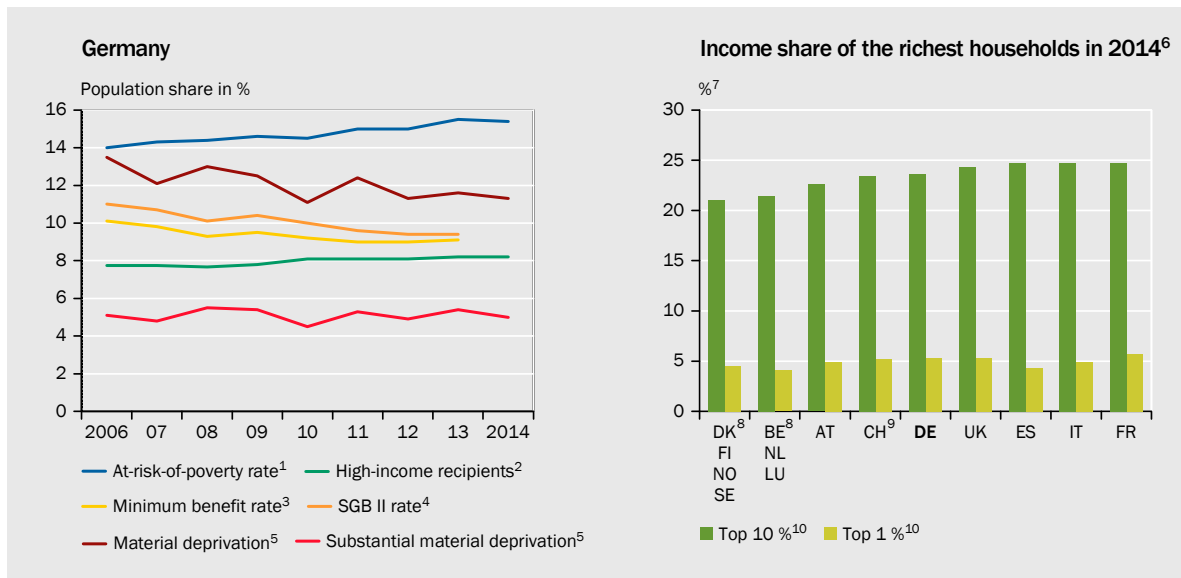
497. Income tax statistics indicate a **moderate increase** in the income share of the richest population groups; the top 10% generated almost 40% of taxable total income including investment income in 2010 (in 2001 this figure was just under 36%). The latest figures show that the richest 1% of the population accounts for 13% of taxable income, compared to around 11% in 2001. These income shares based on wage and income tax statistics are somewhat higher than those based on the SOEP (Bartels and Jenderny, 2014).

Net equivalent income figures also show that the **proportion of income-rich people**, who earn more than 200% of the median income, has grown slightly in the last ten years to the current 8%. The share of income of the richest 10% and 1% in Germany were **similar to other European countries** in 2014, at 23.6% and 5.3% respectively. [↘ CHART 78, RIGHT](#)

The development of income concentration at the **upper end of the distribution scale** is less dramatic in a longer-term comparison, particularly when compared with the US (Alvaredo et al., 2013). The fact that net equivalent income is much less concentrated than market income is not least due to the balancing effect of tax redistribution. Around 22% of income tax paid was therefore attributable to the top 1% of income distribution in 2014. [↘ ITEM 798](#)

[↘ CHART 78](#)

**Poverty and wealth indicators in Germany and in international comparison**



1 – Income threshold: 60 % of the median of the household net equivalent income after social benefits. Source: Microcensus. 2 – Threshold: 200 % of the median income without imputed payments of rent from owner-occupied housing. 3 – Share of recipients of minimum security benefits (including unemployment benefits after SGB II (Arbeitslosengeld II) and old-age basic income support) at the end of the year. 4 – Share of recipients of unemployment benefits after SGB II or income support (Sozialgeld) at the end of the year. 5 – Share of persons who by self-assessment cannot afford three or four of nine common used goods and activities, respectively. 6 – DK-Denmark, FI-Finland, NO-Norway, SE-Sweden, BE-Belgium, NL-Netherlands, LU-Luxembourg, AT-Austria, CH-Switzerland, DE-Germany, UK-United Kingdom, ES-Spain, IT-Italy, FR-France. 7 – Share of the national equivalent total net income. 8 – Unweighted average. 9 – Data for the year 2013. 10 – The highest 10 % or 1 %, respectively, of households with respect to income.

Sources: Eurostat, System of social reporting in official statistics

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## The growth effects of inequality

498. The connection between inequality and economic growth is currently the subject of intense discussion (OECD, 2015a; Samans et al., 2015). Recent empirical findings suggest that **reducing income inequality** may **foster growth** (Halter et al., 2013; Cingano, 2014; Ostry et al., 2014; Dabla-Norris et al., 2015).
499. However, theoretically, no clear cause-and-effect relationship between inequality and economic growth can be established. On the one hand, an ex-post unequal distribution of income and wealth reflects a functioning economy. The prospect of success is the greatest **incentive for individual effort**, and thus drives educational and investment decisions as well as economic growth.
500. On the other hand, there are **politico-economic arguments** for a growth-dampening effect of inequality (Aghion et al., 1999). **Income distribution conflicts** can contribute to social and political instability. As inequality in market income rises, there is likely to be more redistribution of income and wealth, which in turn reduces individual incentives to invest (Alesina and Rodrik, 1994; Persson and Tabellini, 1994; Alesina and Perotti, 1996; Keefer and Knack, 2002).

Inequality is particularly damaging to growth when sections of the population have few ex ante prospects of success, for instance because they have no **access to the education system**, or cannot make investments due to **financial restrictions** (Galor and Zeira, 1993; Bénabou, 1996; Perotti, 1996; Deininger and Squire, 1998). Consequently, stable institutions that secure personal rights, freedom and property rights are key to the social and economic development of a country (Acemoglu and Robinson, 2012).

501. There is thus no clear link between inequality and economic growth (Lundberg and Squire, 2003). An overview of the empirical studies therefore shows that there is **no consensus on this relationship**, in terms of either direction or strength (Cingano, 2014). It is important to note in this context that it is difficult to analyse any factors at play here empirically. The **inequality of individual circumstances** is linked to the distribution results in international comparisons (Brunori et al., 2013), however this inequality is difficult to measure precisely.
502. The empirical growth literature has a predominantly **macroeconomic** focus, which causes considerable methodological problems (Brock and Durlauf, 2001; Pritchett, 2001; Sala-i-Martin, 2001; Durlauf et al., 2005). For example, the empirically derived correlation between growth results and income inequality depends on a great variety of factors, such as the inequality indicators, countries and periods observed, and methods of estimation used (Panizza, 2002; Banerjee and Duflo, 2003). An assessment of estimation results with a view to such uncertainties suggests that findings of significant growth effects from income inequality are not robust. [↪ BOX 17](#)
503. Such results must therefore be interpreted **with extreme caution**. In particular, the conclusion that Germany would have generated a total of six percentage

points more economic growth between 1990 and 2010 if income inequality had remained at the level of 1985, is misleading (Cingano, 2014). This applies primarily in view of the economic conditions, such as reunification, globalisation and technological progress, which are not considered in the analysis or interpretation of the results.

504. Hence, an increase in income or wealth concentration does not automatically mean a need for political action (Mankiw, 2013). But when a need for action is identified, suitable measures must be found. Increased redistribution does not necessarily lead to either higher or lower growth (Ostry et al., 2014). Accordingly, **weighing incentive and distribution aspects** is always at the forefront in terms of tax policy. For instance, there is little evidence that a tax on wealth would be a wise solution to distribution problems (Auerbach and Hassett, 2015).

#### ↳ BOX 17

##### Assessment of the empirical relationship between income inequality and growth

The OECD report “In It Together: Why Less Inequality Benefits All” was published in May 2015 with a study on the relationship between income inequality and economic growth (Cingano, 2014; OECD, 2015a). It provides an extensive literary overview showing that there is no definitive academic evidence on this connection. However, the media focussed on the results of a dedicated empirical study, interpreted as “poverty slows economic growth” and “inequality hampers growth”. Similar results of other recent studies paint a much more nuanced picture (Halter et al., 2013; Ostry et al., 2014).

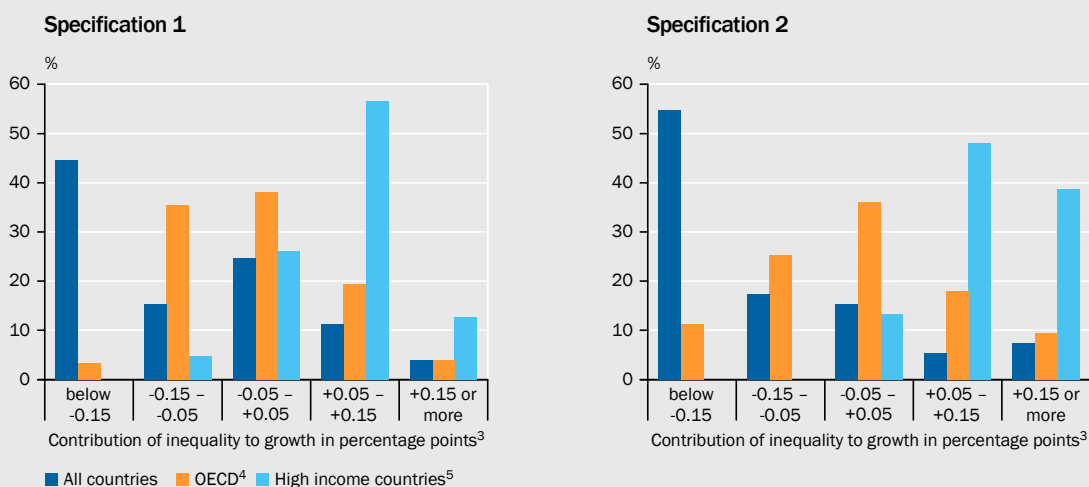
So the results of studies should be viewed with extreme caution, and their sensitivity to the assumptions made should be assessed, for example with a view to the countries and periods analysed, the quality of the data and the estimation methods used. In particular, questions must be asked regarding the GMM estimation used in inequality studies, as to its suitability for many macroeconomic analyses, due to lacking robustness (Roodman, 2009).

The GCEE performed its own analysis to highlight the great uncertainty, applying Cingano's approach (Cingano, 2014) to a comprehensive data set based on the Standardized World Income Inequality Database (SWIID, Solt, 2014) and the Penn World Table (PWT, Feenstra et al., 2015). Estimations were performed on three country groups and two variable specifications, as well as for all starting years between 1960 and 1989 and five growth horizons from three to seven years (900 estimations in all). The country groups were the 31 countries from the OECD study, 61 countries with high economic strength, and all countries from the data set (more than 150). The wide range of statistically largely insignificant results highlights the unsuitability of this method for assessing the matter in question. ↳ CHART 79

The big difference between the number of countries in the whole group and the countries with high economic strength suggests that the results are primarily based on the differences between the countries, and thus that the estimated effect from a single specification should not be interpreted as a clear causal relationship. Practically any result could be produced depending on the choice of parameters for countries, periods, variables and methods.

CHART 79

## Predicted correlation between income inequality and economic growth

Share of predictions<sup>1</sup>

1 – Share of 150 predictions (different starting years and growth horizons) for each specification and country group. 2 – Own calculations on the basis of the System GMM specifications (1) and (4), respectively, in Cingano (2014, Table 1). The dependent variable is the difference of the logarithmic per capita gross domestic product over the considered horizon, adjusted for price and purchase power parity. Specification 1 uses as explanatory variables the Gini coefficient of the household net equivalence income, the per capita gross domestic product adjusted for price and purchase power parity and year dummies; Specification 2 additionally includes the investment ratio and an indicator variable for human capital as explanatory variable. 3 – Contribution to the annual change in the per capita gross domestic product when the Gini coefficient of the household net equivalence income increases by one point. 4 – Country group as in Cingano (2014). 5 – Countries with a per capita gross domestic product, adjusted for price and purchase power parity, of 15,000 US\$ (in prices of 2005) or more and at least 10 observations.

Source of data: SWIID (Solt, 2014) and PWT (Feenstra et al., 2015)

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### 3. An encompassing perspective

505. The fierce debate on the effects of inequality on growth and the interpretation of the relevant regression results clearly shows that the statistical analysis of economic parameters primarily provides a **basis for discussion** and cannot serve as a guidance for economic policy without thoroughly putting things into perspective. As quantitative aggregations of reality, **indicators** can at best provide initial **signs** that economic and social policy action may be needed.

If indicators show differences between various observation units or change over time, this does not typically reflect the effects of specific political measures alone. Instead it reflects transformations of cyclical and structural nature that cannot easily be influenced through politics, if at all. **Causal statements** about the effect of policy measures are not always possible even in studies that allow a comparison of the difference in differences between the outcomes (i) of target and control observations and (ii) before and after (Bauer et al., 2009).

506. The origin of the discussions on statistical measurement of social development can be traced back to the 19th century (aus dem Moore and Schmidt, 2013a), but it is only in the more recent past that the international debate on the **measurement of social welfare and progress** has moved away from its focus on economic aspects and taken on an encompassing perspective. A consensus emerged under the theme of sustainability, that the analyses and reports must cover a **range of aspects**, and in addition to economic factors, also include social and environmental ones.

507. This discussion received a particular boost from the report by the Commission on the Measurement of Economic Performance and Social Progress (Stiglitz et al., 2009). The report argued for a regular **compact indicator dashboard**, as did the joint Expertise of the GCEE and the French Conseil d'analyse économique (Expertise 2010) and the “**Growth, wealth and quality of life**” report of the German Bundestag's enquete commission (Enquete Commission, 2013). This decision against condensing multi-dimensional reality into a single measure of wealth, i.e. against a single-figure welfare index, avoids the serious conceptual problem of the individual welfare dimensions having to be weighted against each other.
508. This “**dashboard**” approach is now the established standard both nationally and internationally, and has, for instance, been used in the European Commission's reporting on the sustainability strategy and the Europe 2020 strategy, and the Federal Government's indicator report on the sustainability strategy (Federal Statistical Office, 2014). The United Nations' recently adopted Sustainable Development Goals also take a broad approach (Beisheim et al., 2015). Depending on the focus there are differences in the selection of **welfare dimensions** and indicators from the areas of material welfare, quality of life, social inclusion and environment (Expertise 2010; aus dem Moore and Schmidt, 2013b; Enquete Commission, 2013; Diefenbacher and Zieschank, 2015).
509. The Federal Government advanced efforts to provide comprehensive welfare reporting from April to October 2015 with an extensive **citizen dialogue** via Internet and in many events around the country as part of the government strategy on well-being and quality of life (*Gut leben in Deutschland – was uns wichtig ist*). The aims of this initiative are:
- to find out and discuss the people's opinions on well-being and quality of life in Germany,
  - to categorise and classify these ideas and summarise them in a report on current quality of life in Germany,
  - and on this basis to develop an indicator system and government action plan.
510. Although the citizen dialogue will not produce representative results on growth, well-being and quality of life, the format allows for a more in-depth discussion than a survey, and systemically involves people who would generally be underweighted in representative surveys. The citizen dialogue is therefore able to provide valuable input for the further development of welfare reporting in Germany.

## 4. Interim conclusion

511. The currently favourable labour market situation and stable distribution results form a **solid foundation** for tackling the persisting challenges to labour market and social policy. These include in particular reducing the structurally entrenched unemployment and the impending decline in labour force potential due to demographics.



The heated public debate on the development and effects of inequality recently turned attention to the measurement of social well-being and led to a review of the associated reporting. However, a comprehensive academic assessment must be conducted to see the bigger picture before economic policy measures can be devised.

## II. NEW CHALLENGES

- 512.** A **functioning labour market** is the **cornerstone for private income, the government's capacity to act and social security** in a market economy. The best way to ensure economic and social inclusion of all sections of society is thus likely to be to secure and further develop the current successes in the labour market. The GCEE has been critical in previous Annual Economic Reports of the fact that – backed by successful past reforms and the healthy economic situation – questions regarding redistribution have taken more of a focus than ensuring a functioning labour market. Policy has intervened across the board in labour market pricing for the first time with the statutory minimum wage (GCEE Annual Economic Report 2013 items 515ff; GCEE Annual Economic Report 2014 items 540ff.).
- 513.** This criticism is rooted in the concern that the healthy cyclical phase is not being used to prepare the labour market for the impending **major challenges** posed by the demographic and technological change along with increasing globalisation. The drastic increase in the numbers of **refugees** means that the German labour market is now already facing another challenge in the short term. However, the hurdles to the labour market integration of refugees have not become smaller by the minimum wage.

### 1. The integration of refugees

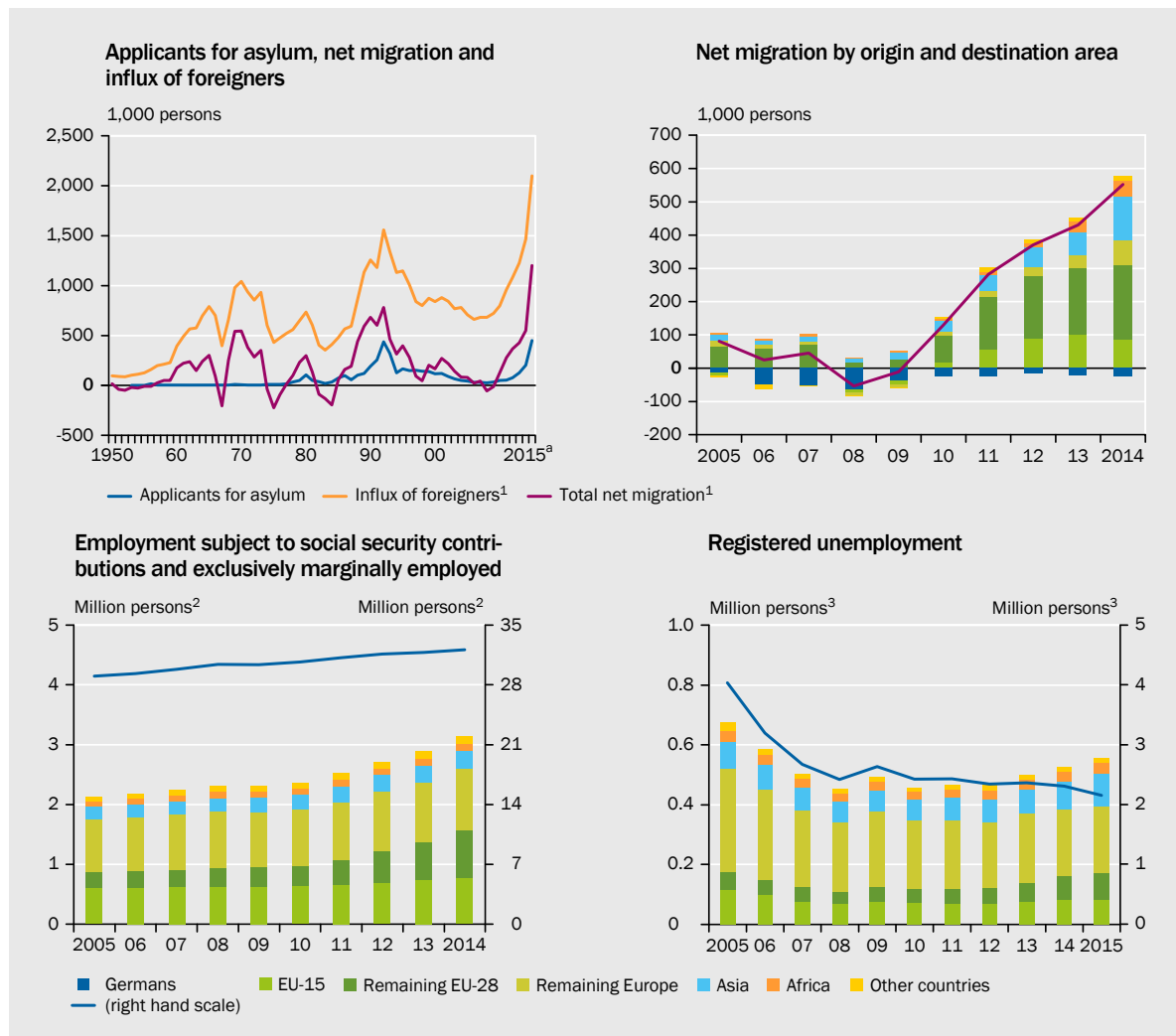
- 514.** Germany's population has risen significantly in recent years due to migration. Whereas in 2009 the numbers of immigrants and emigrants were almost the same, **net migration** has increased continually in the past few years to some 550,000 people in 2014. [↘ CHART 80, UPPER RIGHT](#) This figure will be far exceeded in 2015. While we can assume that migration will not remain at this level permanently, further considerable net migration is likely at least in the medium term. High migration represents both a great opportunity and a great challenge for the labour market.
- 515.** Germany is no stranger to large numbers of immigrants. [↘ CHART 80, UPPER LEFT](#) Guest workers were systematically recruited in the 1960s. The early 1990s saw a major influx of asylum seekers from the then Yugoslavia. And a large number of ethnic German repatriates came to Germany primarily in the same decade. Many of these immigrants have stayed in the country permanently. According to the microcensus, around 20% of the German population had a migration back-

ground in 2014, of whom two thirds had direct experience of migration. **Germany has become a country of immigration**, and should pursue appropriate migration and integration policy (Expert Council of German Foundations on Integration and Migration, 2014, 2015).

- 516. A large number of immigrants came to Germany from other EU member states since 2009. Crisis-related high unemployment in southern Europe and the lifting of restrictions on freedom of movement for eastern Europeans in May 2011 were contributing factors to this development. This wave of migration was accompanied by a **substantial increase in employment** of both the immigrants and German nationals. ↘ CHART 80, LOWER LEFT By contrast to Germans, the number of non-Germans, particularly Romanians and Bulgarians, who are unemployed and receiving SGB II benefits has risen recently (Brücker et al., 2015a; Hartmann and Reimer, 2015b). ↘ CHART 80, LOWER RIGHT The unemployment rate for German citizens fell from 7.4% in June 2009 to 5.4% in June 2015. The rate for

↘ CHART 80

Migration and labour market indicators by nationality



1 - The numbers for the years 2008 to 2011 are not fully comparable to those of the respective previous year due to adjustments in the register of residents. 2 - Reference date is June 30<sup>th</sup> in each year. 3 - June of each year. a - Forecast of the German Council of Economic Experts.

Sources: Federal Employment Agency, Federal Office for Migration and Refugees

non-nationals fell from 16.7% to 13.8% in June 2014, but then climbed back to 14.1% until June 2015.

517. There has recently been a significant increase in the influx from non-EU countries. This is largely due to the drastic rise in the numbers of refugees, which pose a particular challenge to society, politics and the economy. [▶ ITEM 18](#) The refugee influx is first and foremost a **humanitarian issue**. Education and skills, and therefore the individual employment prospects are irrelevant for the recognition of asylum seekers. However, these are key to social integration and economic implications. The schooling background and, in particular, the age structure of the asylum seekers provides **considerable potential for skill acquisition**; 70% were under the age of 30 in 2014, and almost a third under 18 (BAMF, 2015).

### Subdued labour market prospects for refugees

518. The high number of jobs currently available [▶ ITEM 534](#) indicates that existing job demand cannot be sufficiently met by jobseekers in Germany. However, it is not clear to what extent the **skills and qualifications** of recognised refugees fit this demand. There is currently no representative data available on the schooling and professional skills of the refugees. However, on the basis of various data collected, it must be assumed that they possess significantly fewer professional skills than the German population and other migrant groups.

For instance, 80% of the people eligible for asylum who were registered with the Federal Employment Agency (*Bundesagentur für Arbeit* - BA) as unemployed in June 2015 had not completed any vocational training; this figure was only 43% for German nationals (Brücker et al., 2015b). There is also the issue of the value of qualifications gained in the country of origin. For the majority of refugees, the likelihood of finding work quickly is minimal.

519. Linguistic and cultural barriers are additional aggravating factors, and are likely to be greater for the recent refugees than earlier migration groups due to the structures in their countries of origin. **Proficiency in German** is a key prerequisite for both social and economic integration. Language difficulties generally mean worse labour market results in the form of lower participation, higher unemployment and lower wages (Dustmann and van Soest, 2002; Aldashev et al., 2009; Isphording, 2014a, 2014b).
520. **Historical experience** is only of limited use for the labour market integration of new recognised refugees, as the types of people as well as economic and social circumstances are significantly different from earlier periods of high migration, such as that of guest workers in the 1960s (Expertise 2011 Box 4). It is not only of interest to see the extent to which migrant integration is successful, but also the extent to which the domestic population may be crowded out. Refugees are likely to compete primarily with German nationals and previous immigrants with similar training and skills. This is unlikely to affect the majority of the German population, however.

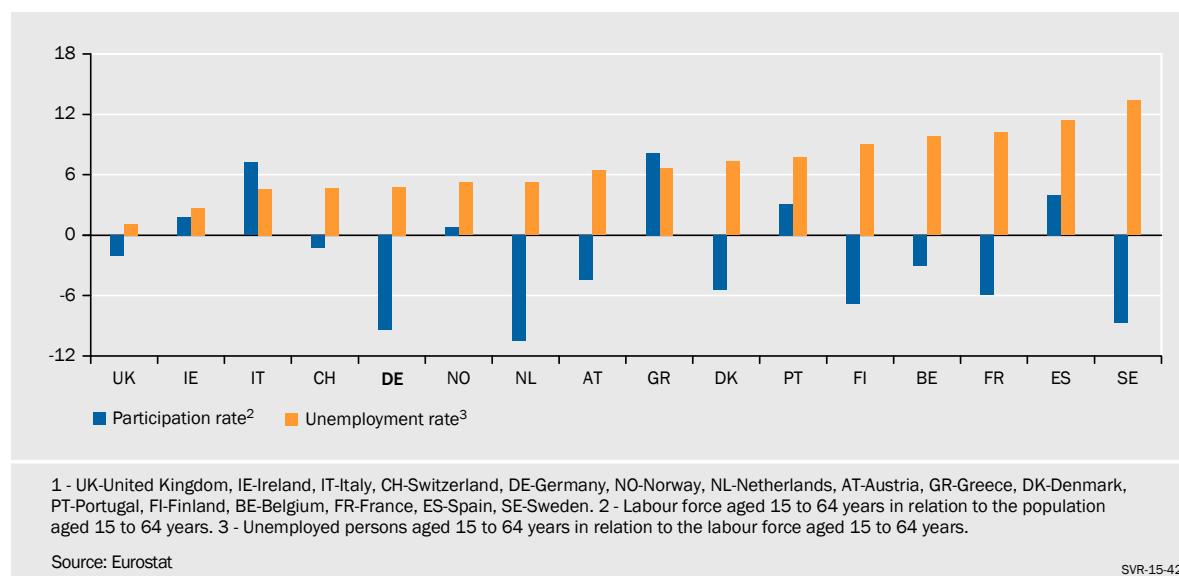
521. Empirical evidence **does not point to serious crowding-out effects** (GCEE Annual Economic Report 2010 Box 17; Friedberg and Hunt, 1995; Longhi et al., 2010; Constant, 2014). As regards Germany, empirical studies based on migration of ethnic German repatriates in the early 1990s show slightly negative employment effects in the short-term, in particular for the low-skilled (Glitz, 2012). Other studies, in contrast, do not find aggregate employment effects (D’Amuri et al., 2010; Brücker and Jahn, 2011). In terms of wage effects, there is evidence in the UK, for example, that immigration depresses the wages of natives in the lowest quintile, and contributes to slight wage growth at the upper end of the distribution scale (Dustmann et al., 2013).
522. Due to the lack of data, there has been very little empirical research done on the **labour market integration of refugees**. In the US, the difficult circumstances for refugees as opposed to other migrant groups are initially reflected in lower wages and shorter working hours (Cortes, 2004). However, there is more marked progress among refugees, resulting in higher wages and longer working hours for them after ten years than the other migrant groups of the same cohort. One reason for this is that refugees are less likely than other migrants to plan to return to their home country. Permanent immigration provides a greater **incentive to invest in human capital** than stays of a temporary nature (Dustmann and Görlach, 2015).
523. Employment of residents in Germany who were born abroad is compared to nationals lower than in other European countries, primarily due to a lower level of **participation**. The higher rate of **unemployment** among non-nationals as opposed to that for nationals is less marked in Germany than in other European countries. [↘ CHART 81](#)

Assessment of labour market participation in terms of migration background shows that participation is higher among those with no migration background than those with direct experience of migration. This is primarily due to lower labour market participation among female migrants. The unemployment rate for the section of the population without any migration background is considerably lower. Labour market results for people with a migration background but who were not migrants themselves (second and third-generations of migrant families) are worse due, among other factors, to the high proportion of under 25-year-olds. [↘ TABLE 23](#)

524. Labour market participation among ethnic German repatriates and naturalised citizens is closer to that of people with no migration background. The repatriates also have a comparatively low rate of unemployment. This suggests that, for one thing, integration is not equally successful for all migrant groups and, for another, that the **adjustment process takes time**. Results from the IAB-SOEP migration sample show a rising employment rate for migrants (refugees) over time, starting from a rate of only around 20% (below 10%) in the year of their arrival (Brücker et al., 2015b).
525. The participation rate of citizens from countries eligible for asylum in Germany was much lower in 2014 than for non-nationals living in Germany for longer. The unemployment rates for crisis countries in particular, such as Syria, Afghan-

↘ CHART 81

**Participation and unemployment of natives and foreigners in selected European countries in 2014<sup>1</sup>**  
Difference between foreign-born and native persons in percentage points



istan, Iran and Iraq was substantially higher (Brücker et al., 2015b). Recent developments among asylum seekers of non-European origin show that a sharp **rise in those claiming SGB II benefits** is to be expected followed by an increase in unemployment before employment rises at a later date. ↘ CHART 82 Current labour market indicators in this regard are largely based on people having entered Germany under other circumstances or who have lived in Germany for longer, and should therefore be considered too optimistic in the short term.

### Refugee labour market integration scenarios

526. The **impact** of the current refugee migration on the German labour market is still **extremely uncertain**, particularly in the medium term. This is largely due to the fact that many of the key parameters, e.g. the number of asylum seekers and recognised refugees, success of integration and political measures, develop endogenously over time. It can be assumed that successful integration into the labour market will encourage more migration, and a deterioration in employment prospects will discourage migration.
527. Various **scenarios** based on the information available can be used to illustrate the possible parameters and consequences thereof. ↘ ITEM 25 The number of asylum seekers entering Germany serves as the starting point. They go through the various stages of the asylum process and then enter the labour market. ↘ ITEM 23 It is assumed that the number of refugees will decline over time, but that Germany does not close its doors completely.

TABLE 23

Employment by migration background in 2014<sup>1</sup>

Person groups	Total				Men, 15-64 years		Women, 15-64 years	
	Population	at age 15-64 <sup>2</sup>	Participation rate <sup>3</sup>	Unemployment rate <sup>4</sup>	Participation rate <sup>3</sup>	Unemployment rate <sup>4</sup>	Participation rate <sup>3</sup>	Unemployment rate <sup>4</sup>
	In thousand	%						
Without migration background	64 511	64.7	79.4	4.3	83.2	4.6	75.6	4.1
With migration background	16 386	68.5	70.3	8.1	78.5	8.6	62.1	7.5
With own migration experience	10 877	81.9	73.9	7.9	83.4	8.3	64.7	7.4
Foreigners	5 866	83.2	69.3	9.5	81.2	9.7	57.5	9.5
Germans (late repatriate)	3 099	78.0	81.3	5.7	86.1	6.6	76.7	4.9
Germans (naturalised)	1 912	84.0	77.0	7.0	86.2	6.9	68.3	6.5 <sup>a</sup>
Without own migration experience	5 509	42.1	56.6	9.2	61.2	10.1	51.1	7.9
<b>Total</b>	<b>80 897</b>	<b>65.5</b>	<b>77.5</b>	<b>5.1</b>	<b>82.2</b>	<b>5.4</b>	<b>72.7</b>	<b>4.7</b>

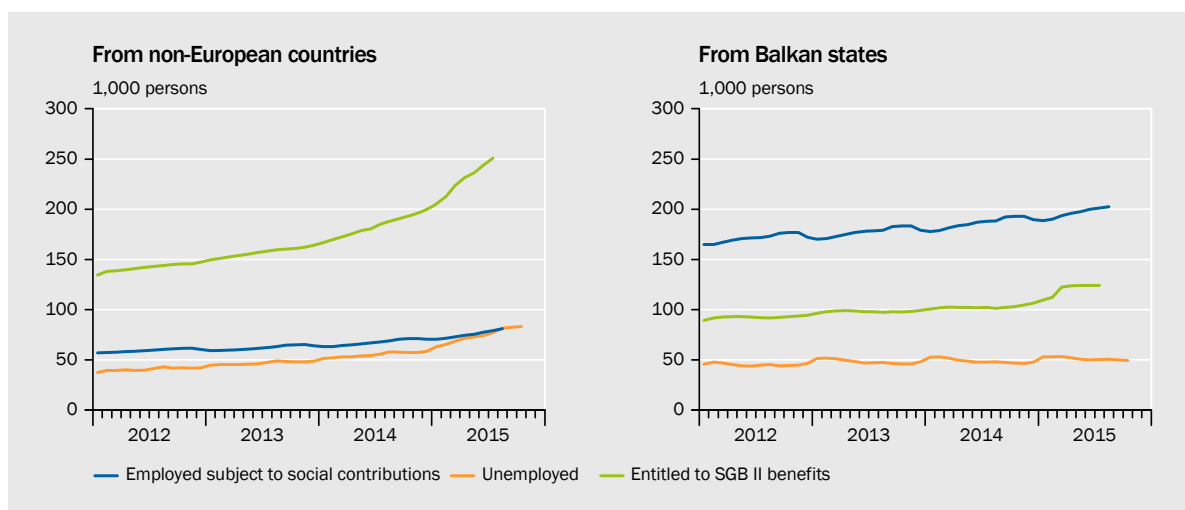
1 – Results from the Microcensus; Effective: August 2015. 2 – Share of the population aged 15 to 64 years in relation to the total population of the corresponding person group. 3 – Labour force aged 15 to 64 years in relation to the population aged 15 to 64 years. 4 – Unemployed persons aged 15 to 64 years in relation to the labour force aged 15 to 64 years. a – Persons aged 25 to 65 years.

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528. The assumptions on the development of labour market participation and employment are based on current labour market indicators for the different nationalities involved (Brücker et al., 2015b, 2015c). The participation rate is comparatively low and the unemployment rate comparatively high for countries affected by war and crisis. TABLE 24 The development of labour market participation and employment in the scenarios is modelled for each migration cohort over time. Both participation and employment are initially low but increase with

CHART 82

Development of the labour market for citizens coming from countries eligible for asylum



1 – Afghanistan, Eritrea, Iraq, Iran, Nigeria, Pakistan, Somalia and Syria. 2 – Albania, Bosnia and Herzegovina, Kosovo, Macedonia and Serbia.

Source: Federal Employment Agency

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time. [↘ TABLE 2](#) In the **base scenario**, labour market participation after five years is somewhat lower than is currently the case for the non-national population in Germany.

529. The GCEE considers the **base scenario** to illustrate a plausible situation for the possible development. The different scenarios reflect the effect of different **courses of action**. Key parameters are varied in combination for this purpose. In a favourable scenario, the asylum process is faster and so too integration into the labour market. In an unfavourable scenario, higher numbers of migrants mean the process takes longer and integration works less well. Another scenario assumes that comprehensive skill-acquisition programmes are provided at the outset. This results in higher costs and lower employment in the short term, but better integration potential in the longer term. [↘ ITEM 25](#)

[↘ TABLE 24](#)

**Selected key figures for the 15 most frequent nationalities of asylum seekers in Germany<sup>1</sup>**

Nationality	Population		asylum applicants	total protection rate (%)	participation rate (%) <sup>3</sup>	unemployment (%)	
	total	working age population (%) <sup>2</sup>				unemployment rate <sup>4</sup>	including: according to SGB II
Syria	118 196	69.5	65 915	93.6	40.1	48.6	96.7
Albania	23 938	76.5	44 140	0.5	x <sup>b</sup>	13.5	83.0
Kosovo	184 662	72.1	31 020	0.3	53.2	12.8	78.3
Afghanistan	75 385	68.9	14 405	69.7	56.0	31.4	94.8
Serbia	202 195	67.2	13 900	0.1	73.9	21.7	82.3
Iraq	88 731	68.2	13 580	98.8	63.0	38.5	93.4
Macedonia	83 854	71.0	7 110	0.3	61.7	16.7	82.7
Eritrea	25 776	82.0	6 615	90.2	31.4	28.6	94.0
Pakistan	46 569	83.8	4 980	19.8	47.4	29.0	94.2
Nigeria	29 071	77.4	4 190	30.8	59.0	22.0	82.5
Bosnia and Herzegovina	163 519	75.3	3 720	0.2	70.2	9.7	72.3
Russia	221 413	78.3	3 605	16.3	59.6	17.3	83.3
Somalia	16 489	74.4	3 585	44.0	27.3	40.5	93.9
Ukraine	127 942	72.8	3 550	85.7	61.3	20.8	87.1
Montenegro	18 977	70.2	2 905	0.0	83.0	18.1	81.2
memorandum:							
Foreign population	8 152 968	78.6	255 095	43.4	63.7	13.2	80.0
Germany	81 197 537	62.9	x	x	80.1	6.9	69.3

1 – The calculated key figures partly deviate from common definitions due to data restrictions. 2 – Persons aged 18 to 65 years in relation to the total population of the respective person group. 3 – Employment subject to social contributions, marginal employment, and registered unemployment (June 2014) in relation to the working age population (average of the numbers at the end of the year for the years 2013 and 2014). 4 – Registered unemployment in relation to the sum of employment subject to social contributions, marginal employment, and registered unemployment. a – For the months January to September. b – Implausible participation rate.

Sources: Federal Employment Agency, Eurostat, Federal Statistical Office

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530. All of the scenarios make it clear that **unemployment** will initially **rise** before there is significant growth in employment from 2017 onwards. [↘ CHART 83](#) This is

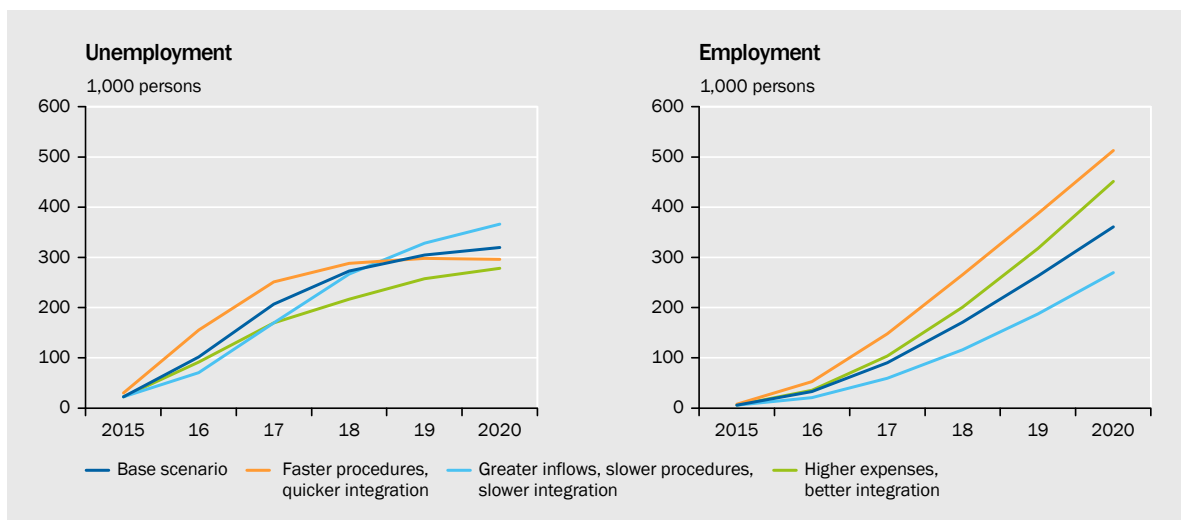
due above all to the likely **difficulties in entering the labour market**. We can also assume that many recognised refugees will first have to complete integration, language and skill-acquisition courses. The scenario analysis does not include separate modelling of the number of people involved in labour market or integration policy programmes, so the effects of these on registered unemployment cannot be precisely quantified. The scenario with greater efforts in skill acquisition initially implies a much lower contribution to unemployment. The extent to which these efforts will lead to better labour market results in the long term is not yet assessable.

531. An acceleration of the asylum process is likely to be accompanied by a sharper climb in unemployment in the short term, even if labour market integration is improved. However, this would also mean a faster increase in employment. In this case, rising unemployment would not necessarily reflect a deterioration of the labour market situation, but simply provide **transparency** as regards the integration challenges to be met. If the process were to take longer, the opposite would happen. It is likely that longer delays would lead to much higher macroeconomic costs in the medium term, which, however, cannot be quantified at present. An **acceleration of the asylum process** is therefore very important.
532. The integration of refugees is an **investment** in the future which is not guaranteed to pay off. It largely depends on the efforts made in terms of integration, education and skills acquisition. A short-term increase in statistically reported underemployment in this context should be accepted given the need and potential for skills acquisition.

Integrating recognised refugees into the labour market will result in an **increase in atypical employment relationships**, including marginal employment and temporary work, as well as more internships. These types of employment offer employers more flexibility given the great uncertainty regarding

#### ▸ CHART 83

#### Scenarios to the impact of the refugee influx on the labour market<sup>1</sup>



1 - The assumptions of the scenario analysis are listed in the appendix of chapter 1, table 2.

Source: own calculations

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the productivity of the job seekers. The number of top-up benefit recipients – workers who receive government transfer payments in addition to their employment income – is also likely to rise.

## 2nd Initial experience with the minimum wage

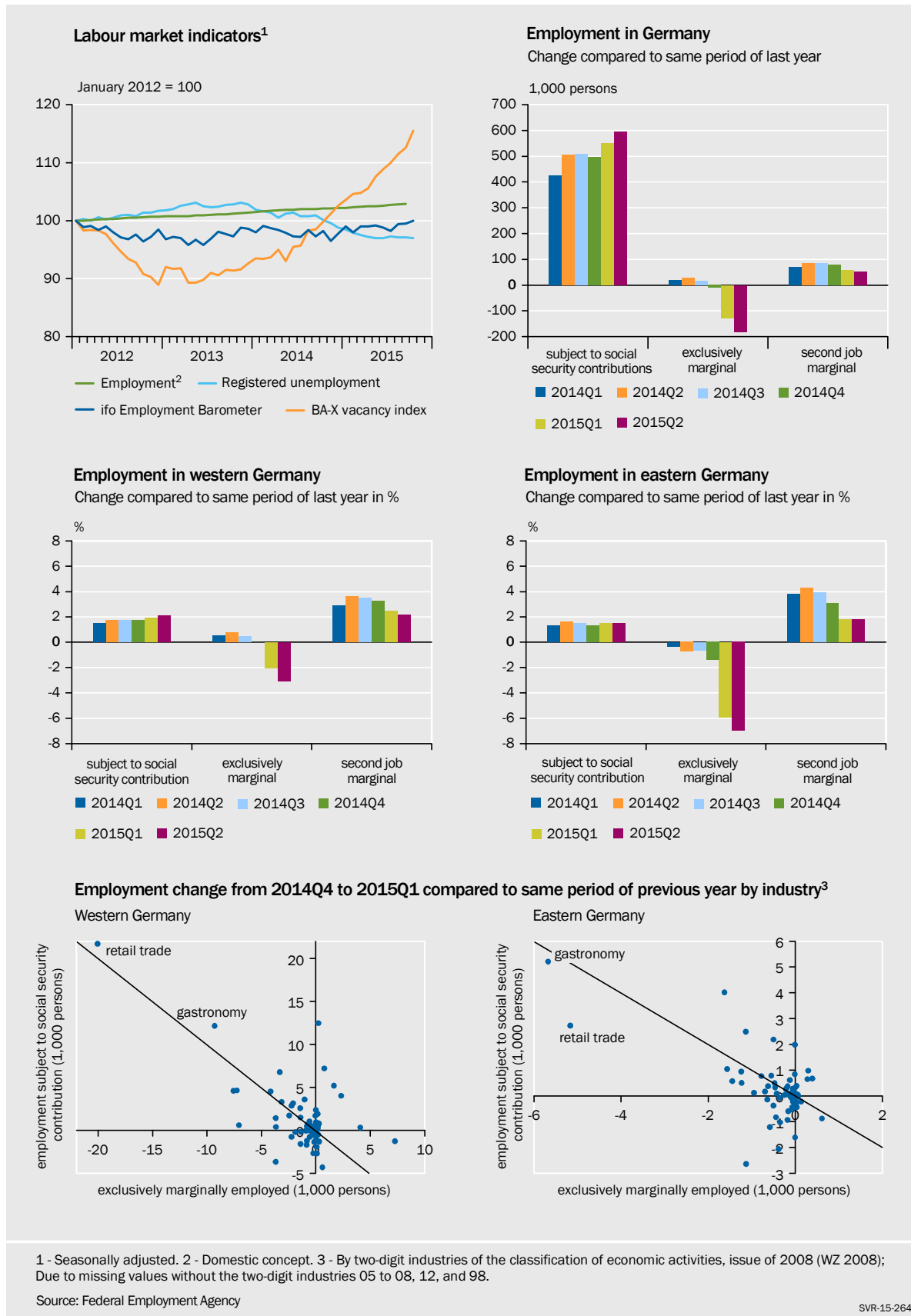
533. The introduction of a national minimum wage of €8.50 per hour effective 1 January 2015 is the **biggest labour market policy reform since the Hartz IV reforms**. Such fundamental labour market intervention requires accurate and constant observation of further developments. This is particularly important for future adjustments to the minimum wage, potential exemptions and administrative requirements. However, **a reliable assessment of the impact** of the minimum wage is **not yet possible** for a variety of reasons.
534. **No serious overall economic consequences** of introducing the national minimum wage have been observed to date. The current favourable economic environment should be noted nonetheless. The minimum wage was introduced **in a healthy labour market** situation. Labour market demand is high as the upward trend in job vacancies since the first half of 2013 makes clear. ↘ [CHART 84, UPPER LEFT](#) In its Annual Economic Report 2014, the GCEE assumed in its outlook on the employment trend that the minimum wage would dampen the development in hiring otherwise setting in, to the tune of 140,000 jobs (GCEE Annual Economic Report 2014 item 192).
535. The rising trend in employment weakened after the second quarter of 2014, but regained momentum in the second and third quarters of 2015. ↘ [ITEMS 238FF](#). The number of newly created jobs subject to social security contributions increased year-on-year in the first two quarters of 2015. However, exclusively **marginal employment decreased** at the same time by more than 150,000 persons. ↘ [CHART 84, UPPER RIGHT](#)

This decline was particularly **pronounced in eastern Germany**, where the impact of the minimum wage on businesses and workers is considerably higher than in western Germany (Bellmann et al., 2015a). In eastern and western Germany, there were 7.0% and 3.1% fewer workers respectively in exclusively marginal employment in the second quarter of 2015 compared to the same period of 2014. ↘ [CHART 84, CENTRE](#)

536. The decline in exclusively marginal employment occurred in parallel with a year-on-year **rise in those in marginal employment as a second job**, although this was weaker than that of the prior-year quarters. The minimum wage has apparently not resulted in workers giving up second jobs and simply pursuing a single occupation instead. The minimum wage could even make working in a second job more attractive than taking on more hours in primary employment.

CHART 84

Labour market indicators and development of employment in Germany



537. Quantification of the number of “**mini jobs**” converted into employment subject to social security contributions and those lost has not been possible to date. Initial aggregated figures at sector level indicate that such conversions may have occurred. The number of employees subject to social security contributions rose in some sectors that recorded a decline in marginally employed people between the fourth quarter of 2014 and the first quarter of 2015 compared to the corresponding prior-year change. This development was particularly marked in the retail trade and the gastronomy industries, both heavily impacted by the minimum wage due to their wage structure. ↘ [CHART 84, BOTTOM](#) Such conversions can ultimately only be clearly identified on the basis of individual data.

Particularly in some sectors in eastern Germany, the beginning of 2015 saw the elimination of more marginal employment than creation of employment subject to social security contributions. For **most economic sectors**, particularly in western Germany, the introduction of the minimum wage likely had **no direct consequences** for aggregate employment.

538. The minimum wage results in wages rising in the short term. Primarily low-skilled employees and employees in low-wage sectors in eastern Germany saw **above-average wage increases** in the first two quarters of 2015 in a year-on-year comparison (Deutsche Bundesbank, 2015; Joint Economic Forecast project group, 2015). In the first quarter of 2015, gross hourly wages of unskilled and trained workers increased by twice/three times as much (9.3% and 6.6% respectively) as those of highly skilled professionals and executives.
539. Wage increases lead to other adjustments besides potential employment adjustments. In eastern Germany, for example, it has already been observed that companies are **reducing working hours**, primarily of part-time employees (Brautzsch et al., 2015). In the service sub-sectors most heavily impacted by the minimum wage, **higher consumer prices** than in previous years have also been observed (RWI, 2015).

On the other hand, the introduction of the minimum wage at the beginning of 2015 had no significant impact on the number of workers receiving top-up benefits under basic social security (*Aufstocker*). Only the number of low-qualified among the top-up benefit recipients was around 50,000 people lower in the first quarter of 2015 than in the previous quarter. To what extent a change in the number of **top-up benefit recipients** is due to workers earning higher wages and thus requiring lower benefits, or having fewer employment opportunities and thus receiving full benefits can only be examined on the basis of microdata. However, it should not be assumed that the minimum wage significantly alters the net income of top-up benefit recipients (Bruckmeier et al., 2015).

### Approaches to and limitations of evaluation

540. An assessment of the minimum wage on the basis of the statistical data analysed is of limited use, as the overall result is determined by many different factors. How companies react to the minimum wage and how the minimum wage affects the employment situation of individuals can only be more closely examined us-

ing **disaggregated data** which is as yet unavailable. The first scientifically sound preliminary evaluation results cannot be expected for at least one or two more years. The constant development of new approaches which could provide valuable evidence for assessing the causal effects of the minimum wage and future adjustments should help in this regard. [↘ BOX 18](#)

[↘ BOX 18](#)

### Minimum wage evaluation

The impacts of the minimum wage, particularly on employment and income, are of major importance to workers, businesses and the government. Minimum wage effects were exclusively calculated at the aggregate level until the beginning of the 1990s. Commencing with the study by Card (1992), there has been increasing use of disaggregated data at regional, company and individual level, which allows a substantiated evaluation of minimum wage effects and enables evidence-based political recommendations (GCEE Annual Economic Report 2013 Box 16).

### The difference-in-differences approach

The most common method of estimating causal effects of a minimum wage is the difference-in-differences approach (DiD). It performs a “before and after” comparison on a group affected by the introduction of, or increase in a minimum wage (the treatment group) and on a control group for which this is not the case. The difference between the group-specific developments over time is the minimum wage effect. The following two assumptions must hold for interpreting this difference in differences as a causal effect:

- The outcomes for both groups would have followed a parallel trend without a minimum wage.
- The control group must not be indirectly affected by the introduction of or increase in the minimum wage, i.e. there must not be any spillover effect.

The evaluation studies conducted in Germany in recent years on sector-specific minimum wages relied almost exclusively on the DiD approach. Control groups were formed both within and outside the minimum wage sectors analysed. It is difficult to fully ascertain the validity of the stated assumptions when using this approach (Möller, 2012; Paloyo et al., 2013; Doerr and Fitzenberger, 2015). Consequently, alternative techniques to DiD are increasingly under discussion for evaluating minimum wages (Aretz et al., 2014). [↘ TABLE 25](#) Such alternatives are necessary, not least since sectoral comparison is no longer as easy with DiD since the introduction of the minimum wage across all sectors, because there is no longer a control group to which the minimum wage does not apply.

### Structural and non-structural methods as alternatives to the DiD approach

Alternative approaches can be divided into structural and non-structural methods, which can be considered as complementary. Non-structural methods such as the DiD approach are exclusively used to analyse the ex post effects of the minimum wage after its introduction. Structural methods, on the other hand, can also be used to estimate the ex ante effects of the minimum wage by means of model simulations before the minimum wage is introduced or increased.

The advantages of structural approaches are that, firstly, the overall effect of the introduction of the minimum wage can be quantified and secondly, the impact of future minimum wage increases on different outcome variables can be estimated. Compared to non-structural methods, the model simulations require strict assumptions about market structures and market participants' behaviour; their conformity with reality decisively determines their explanatory power. Moreover, implementing model simulations requires a great deal of computation and time.



TABLE 25

## Alternative evaluation methods of the minimum wage to the difference-in-difference approach

Method	Procedure	Advantage (+) / disadvantage (-) compared to DiD approach	Usage <sup>1</sup> / Potential <sup>2</sup>
<b>Non-structural methods for ex-post evaluation</b>			
DiD approach with matching (Heckman et al., 1997; Dehejia and Wahba, 1999; Nguyen, 2013)	Observation pairs of most similar individuals are built in the control and treatment group	+ Better comparability of the control group - Policy endogeneity; problem to find statistical twins	Yes / not substantial
Incremental DiD approach (Dolton et al., 2012)	Exploit regional variation of the bite of the minimum wage	+ Annual rise of the minimum wage is explicitly estimated - Policy endogeneity; spatial spillover effects of the control group; exogeneity assumption of the bite indicators	Yes / limited
Regression discontinuity analysis (Hahn et al., 2001; Dickens et al., 2014)	Assignment to control and treatment group by threshold, e.g. age	+ Only few assumptions necessary for identification of a causal effect - Threshold required; determination of the functional form difficult	Yes / not substantial
Synthetic control method (Abadie and Gardeazabal, 2003; Abadie et al., 2010; Sabia et al., 2012)	Synthetic control group is built on aggregate level from weighted control units, e.g. different industries and regions	+ Maximal group comparability before the minimum wage introduction is achieved by weighting procedure - Problem to find suitable synthetic control groups	Yes / existing
Changes-in-changes approach (Athey and Imbens, 2006; Lechner, 2011)	Generalization of the DiD approach: differences of the distributions of the outcome variables are built	+ Approach applicable to transformations of the outcome variable, e.g. logarithmic values; minimum wage can influence the treatment group with different intensity - Computationally intensive; large number of observations required	No / existing
<b>Structural methods for ex-ante simulation</b>			
Search models (Burdett and Mortensen, 1998; van den Berg and Ridder, 1998; Gorry, 2013)	Search behaviour of employees and employers as well as their matching are modeled	+ Mechanism by which the minimum wage exerts its effects, e.g. the market power of firms, can be modeled - Employment effects are partially a foregone conclusion; no consideration of goods markets	Yes / existing
General equilibrium models (not yet specifically designed for minimum wage evaluation)	Investigation of equilibrium states	+ Interactions between markets are taken into account; systematic comparison of alternative action strategies is possible; policy analysis in controlled environment - Data availability only given with extensive effort; suitable model so far nonexistent	No / in principle existing
Labour supply models (Knabe et al., 2014; Arni et al., 2014)	Labour supply decision is modeled	+ Fiscal effect of the minimum wage can be modeled - Minimum wage does not alter labor demand; wage increase implies negative employment effect; no positive minimum wage effects by	Yes / in principle existing <sup>3</sup>

1 – Has the method been applied in minimum wage research? 2 – Improvement potential compared to the DiD approach according to Aretz et al. (2014). 3 – Own assessment.

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## Conclusion

The expanding tool box reflects the complexity of identifying minimum wage effects. Provided the relevant data is available, the further development of microeconomic approaches enables minimum wage evaluations to be conducted for different outcome variables. Above all, as regards minimum wage adjustments, the identification of causal relationships and the difficulties in establishing them is highly relevant.

541. It is still too early to evaluate the effects of the minimum wage however, not only due to the current lack of available data. The **adjustment reactions** generated by the introduction of the minimum wage will manifest themselves **over time**. Business surveys indicate that primarily price increases, staff cuts and reductions of special payments are considered as reactions to the introduction of the minimum wage (Erthle et al., 2014; Wojciechowski and Wollmershäuser, 2015). Immediate minimum wage-related structural changes, such as in price and competitive environments, should not be expected. Rather, adjustments are likely to set in gradually in a stable economic environment. A significant change in employment would only be the clearest evidence of a reaction to the minimum wage.
542. Some companies are likely to have **already adjusted their behaviour before the introduction of the minimum wage**. Anticipatory wage adjustments were likely made as early as 2014, particularly in companies with collective wage agreements (Bellmann et al., 2015b). The wage distribution for new hires in 2014 exhibited a significant jump discontinuity at €8.50 per hour (Kubis et al., 2015). It should be borne in mind when evaluating the effects of the minimum wage that it had generated reactions before actually entering into effect.
543. An additional problem in evaluating minimum wage effects is the uncertainty as to whether the statutory amount of the minimum wage is **actually paid**. Non-compliance strategies of the minimum wage include resorting to unpaid overtime, undeclared jobs, commissioning more freelancers and reducing additional wage components. It is not possible to foresee at this time the degree to which such loopholes will be utilised.



The responsible customs administration agency will create 1,600 new jobs over the next few years to supervise compliance with the minimum wage requirements. To ensure companies comply with the minimum wage, employers must record the beginning, end and length of each working day for marginally employed workers outside of private households and for workers in sectors that fall under the Act to Combat Illegal Employment (*Schwarzarbeitsbekämpfungsgesetz*). Review mechanisms are important to ensuring minimum wage compliance (Aretz et al., 2011). However it is advisable to weigh up the costs of review against the benefits. A case in point reflecting the problem in weighing pros and cons is the lowering of the regular gross monthly remuneration threshold for the documentation obligation from the initial €2,958 to €2,000 for those employed for more than 12 months, in August 2015.

544. It would currently be wrong to assume that adjustments to the minimum wage are already **fully complete**. The variety of effects that can be observed is evident in the long-term shifts in the roofing industry following the introduction of a sector-specific minimum wage in 1997. ↘ [BOX 19](#) Developments on the labour market should therefore be continually monitored and evaluated in order to avoid drawing any premature conclusions.

↳ BOX 19

### Adjustment reactions after the introduction of a minimum wage in the roofing sector

Following the introduction of a minimum wage in the roofing sector in 1997 (west: €8.18, east: €7.74), no initial major effects on employment, salaries or competition were noted. In western Germany, 4% of employees (eastern Germany 16%) were initially affected by the minimum wage. The same minimum wage has applied to both parts of the country since 2003 and has been progressively raised every year to today's relatively high rate of €11.85.

This development primarily affected the wage structure in eastern Germany. Due to the significantly lower wage level in the eastern German states, more than half of the workers in the roofing sector are paid the minimum wage which equates to an extremely hard bite of the minimum wage in international comparison (Gregory, 2014). This means that many skilled workers are affected by the minimum wage in the eastern German roofing sector, while in western Germany it primarily affects less-skilled workers.

An initial study showed that the minimum wage has not significantly changed total employment in the roofing sector. Employment opportunities for certain subgroups, such as unskilled workers, have, however, deteriorated (Aretz et al., 2011). A detailed follow-up study found a decline in employment even for workers compensated above the minimum wage due to the hard bite in eastern Germany (Aretz et al., 2013). Moreover, the minimum wage contributed, above all in smaller businesses, to falling real wages among better paid roofers in the eastern German states (Gregory, 2014). This indicates that the minimum wage can also impact employment relationships that are not directly affected by the minimum wage.

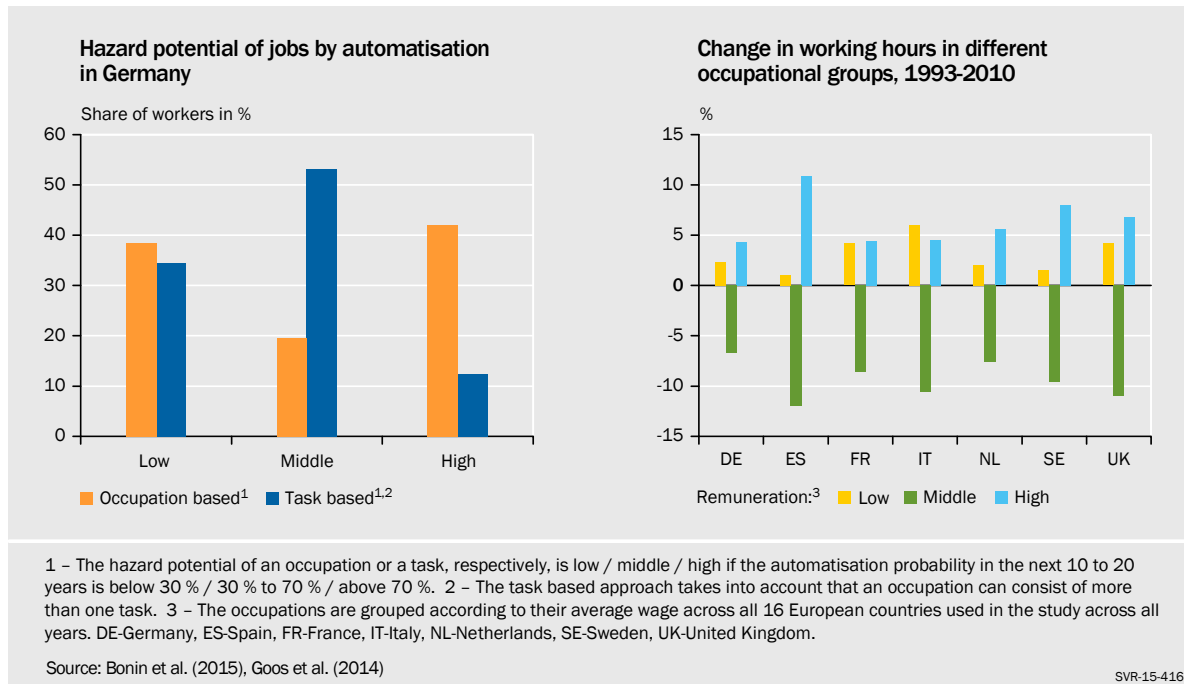
The compressed wage distribution has reduced the motivation to obtain higher-level skills as the pay differential for skilled versus unskilled workers has decreased. The reduced returns to education manifest themselves in a greater decline in the numbers of trainees and master craftsman qualifications in comparison to other construction-related industrial sectors (Gregory, 2015). The market structure of the companies is also likely to have been adjusted for minimum wage reasons. As a consequence of the deterioration in working conditions, many skilled roofers started working as sole traders. The declining number of market entries of small businesses in eastern Germany also indicates that the minimum wage has contributed to reducing competition among the companies already established on the market (Kraft et al., 2012).

## 3. Innovative working environments

545. Increasing **digitisation** harbours considerable potential for the German economy and is currently receiving a great deal of attention with the catchphrase “Industry 4.0”. ↳ ITEMS 647FF. Technological change and the related **shifts in the economic structure** have already left noticeable traces on the labour market. Numerous new job profiles emerge while others disappear. Particularly high increases in employment in the IT, corporate governance and management consulting sectors as well as in the creative professions were noted in Germany between 1993 and 2011, while the demand of jobs in the ceramic and glass industry and textile and clothing sector has since considerably declined (Eichhorst and Buhlmann, 2015).
546. Technological advance has stoked **exaggerated fear of humans being replaced by machines** for decades (Autor, 2015). Nowadays there are fears that digitisation could result in a dramatic reduction of existing occupations (Frey

↘ CHART 85

Potential consequences of the technological change on the employment structure



and Osborne, 2013; Brynjolfsson and McAfee, 2011, 2014). Horror scenarios in which entire occupations disappear without replacement are, however, unfounded. Taking into account that job profiles comprise a variety of activities and that digitisation permits primarily individual activities to be automated, the **potential threat is much lower** (Bonin et al., 2015). In Germany, 12% of all jobs are estimated to have a high probability to be replaced by automation over the next 10 to 20 years. ↘ CHART 85, LEFT However, this depicts only a gross effect, which should be viewed alongside the new jobs that digitisation creates.

547. The results of an initial model-based estimation of the effect of Industry 4.0 on the labour market indicate that **worker flows between sectors and occupations** are likely to be far greater than the changes in the number of workers (Wolter et al., 2015). While 420,000 jobs are estimated to be lost by 2030, primarily in the manufacturing sector, 360,000 new jobs will be created. The forecast loss of employment of 60,000 jobs as a result of Industry 4.0 should, however, be cautiously interpreted due to the high uncertainties of model assumptions. Digitisation is not expected to result in any substantially higher structural unemployment (Eichhorst, 2015).
548. It could also contribute to further shifts in labour market conditions for different skill and thus also wage groups. An increase has been observed in employment in occupations with remuneration at the lower and higher ends of the scale in recent decades, compared to the mid-range. ↘ CHART 85, RIGHT This can be viewed as **labour market polarisation**. One potential reason noted for the US and 16 European countries is that work has shifted from routine activities that can be classified as medium-skilled, such as machine operation and repetitive monitoring functions, to more abstract activities such as management and planning tasks. (Autor and Dorn, 2013; Goos et al., 2014).

549. Germany has experienced stronger growth in employment of high-skilled and low-skilled workers since the 1990s, however **employment of medium-skilled workers has remained stable** (Eichhorst et al., 2015). In interpreting these developments, account must also be taken of the fact that the structure of the workforce is quite different now to that of the mid-1990s. The economic environment was also fundamentally different 20 years ago.
550. Increasing digitisation has generated **many new forms of employment** that did not yet exist in the year 2000 (Eurofound, 2015). For instance, companies outsource work via online crowdsourcing platforms. Other examples include job sharing between two or more workers for the same employer, and staff sharing of a single employee between two or more employers. Such options could offer more flexibility, particularly for small and medium-sized enterprises outside metropolitan areas, in meeting skilled worker needs and being attractive employers (Hertwig and Kreisch, 2012). However, not every change becomes a trend. For example, the percentage of companies that offer job sharing rose from 9% in 2003 to 20% in 2009 but has been on the decline again recently (BMFSFJ, 2013).
551. **Organisation of work** overall will **continue to become more flexible**. Information and communication technologies facilitate mobile activities in which workers can work in different places and at different times. This increases employees' time autonomy, facilitates their work-life balance and expands the possibilities for organising their personal lives. However, increasing work flexibility is accompanied by the risk of increased workloads, higher stress, longer working hours and blurred boundaries between professional and personal life. Responsibility for shaping the working environment and social security could in the future shift further from employers to more autonomous employees than has traditionally been the case in Germany.

#### 4. Interim conclusion

552. The drastic rise in the number of refugees combined with technological change presents considerable challenges to the labour market and social policy. Integration of refugees is an investment in the future which is not guaranteed to pay off. The GCEE's scenario analysis shows that the number of employed recognised refugees will steadily increase. However, unemployment can be expected to rise as well in the next few years. An **acceleration of the asylum process** is very important even if it causes a rise in short-term unemployment. **Integration and skill acquisition programmes** can contribute to faster labour market integration of recognised refugees and thus to improving the labour market situation in the medium term.
553. The **labour market integration** of the low-skilled, long-term unemployed and youth is impeded by **regulatory hurdles**. The minimum wage could prove to be a particular obstacle in this respect. No serious overall economic consequences have been noted to date, although adjustment reactions have been observed since 2014. It is too early to conclude that the minimum wage has had no

impact on Germany's employment situation. Instead, effects must be observed and analysed on an ongoing basis. The first academic evaluations cannot be expected for at least one or two years.

### III. ECONOMIC POLICY OPTIONS

554. In view of the major challenges and in line with the social market economy, less attention should currently be drawn to the distribution results. Rather, economic and social policy measures should place a greater focus on **opportunities** and **incentives** for **individual success**. The economic framework is currently much more favourable for achieving this rebalancing than it was ten years ago when the Agenda 2010 reforms were implemented.
555. Coping with the inevitable **adjustments** and recurring **shocks** requires **flexibility** on the part of all market participants. This situation creates a conflict between extending individual labour market participation and strengthening economic growth. The implications are twofold. Firstly, education policy is tasked with improving the skill set of market participants to be better able to meet the challenges independently. Secondly, a flexible institutional framework needs to be created that does not prevent adjustments, but rather supports them.

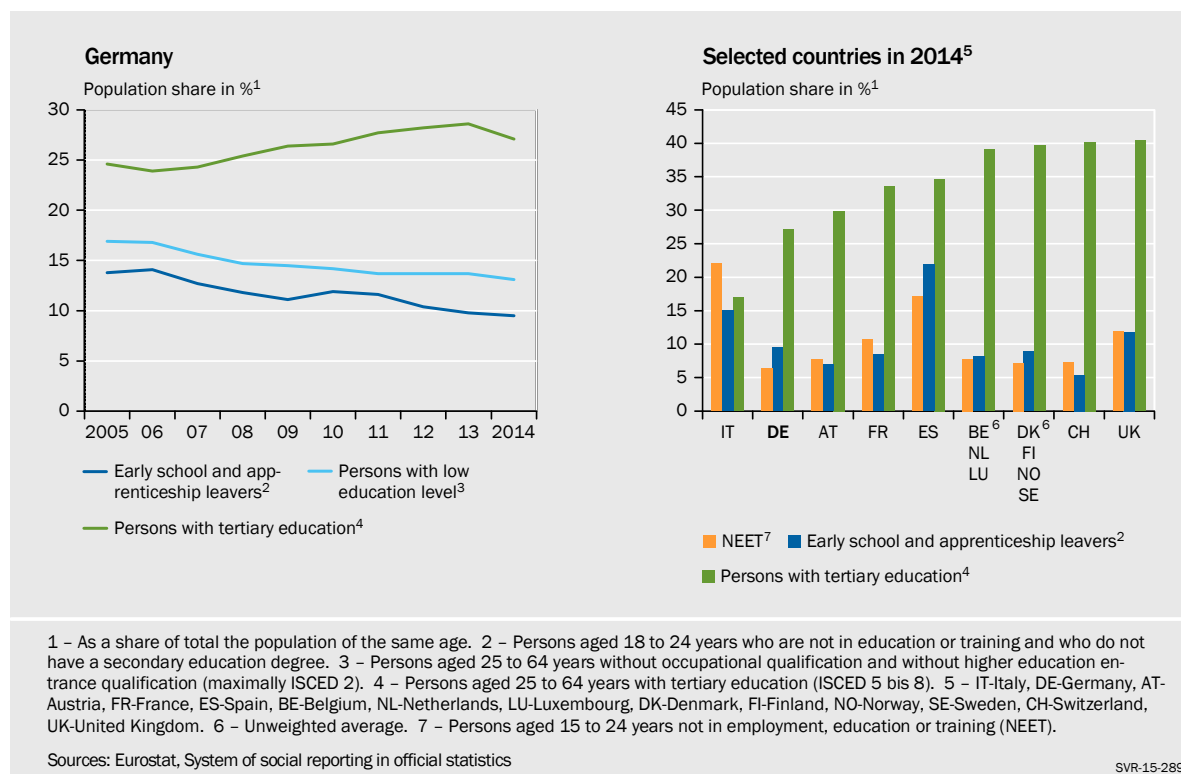
#### 1st Moving equal opportunities into the spotlight

556. Education investments make economic sense as they can both bolster **growth potential** and improve **equal opportunities** (GCEE Annual Economic Report 2009 items 441ff.). It is particularly critical for both economic and social development if one generation's unequal distribution results cause unequal opportunities for following generations (Blanden, 2013; Corak, 2013; OECD, 2015a). The levels of education and income in Germany are strongly influenced by that of the parents. There is thus a need for action to improve income and education mobility in Germany, particularly across generations (GCEE Annual Economic Report 2013 items 686ff.; GCEE Annual Economic Report 2014 items 702ff.). The education system in particular can play an important role in equalising individual opportunities and by the same token improve upward mobility (Checchi et al., 2010; Brunori et al., 2013).
557. The last ten years have seen considerable advances in the field of education policy, such as the expansion of child daycare and promotion of doctoral studies as part of the Excellence Initiative aimed at promoting top-level research and improving the quality of German universities and research institutions. The reduced and internationally low rate of young people who are not in education, employment or training (NEET rate) is an indicator of **advances made** in average level of skills acquisition. However, there remains **considerable room for improvement**. For example, nearly 10% of young adults still have at most



## ↘ CHART 86

## Population by educational attainment



a secondary school-leaving qualification (*Haupt- oder Realschulabschluss*) and no professional training. ↘ CHART 86

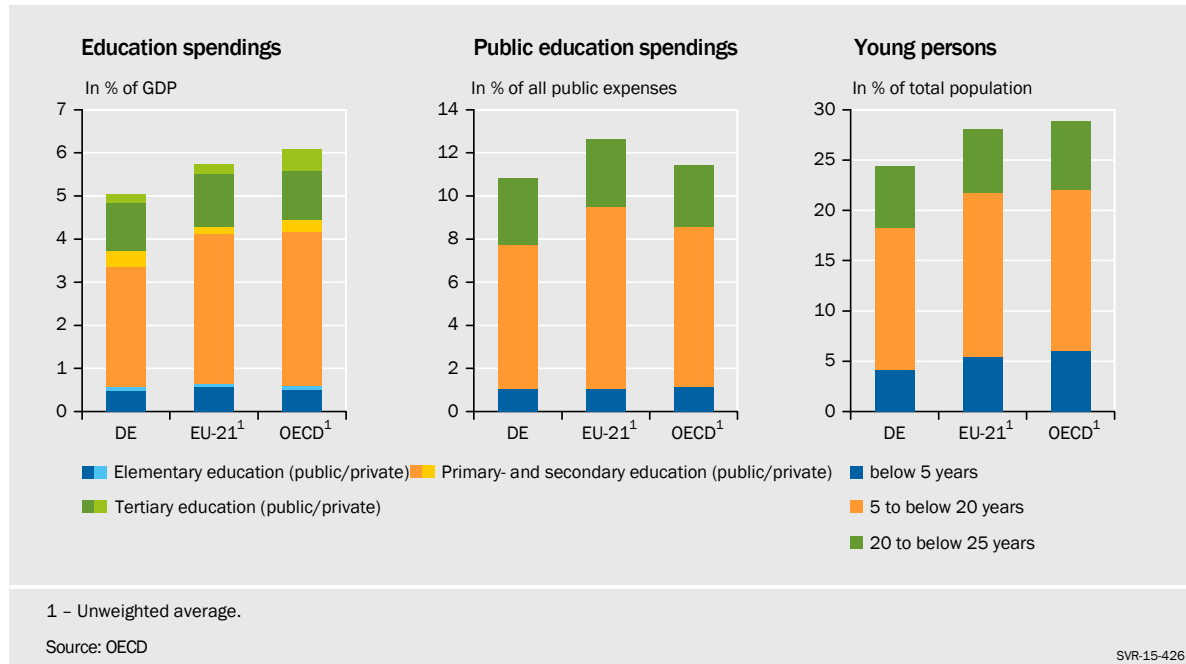
558. Germany's ratios of education expense to GDP and to overall public expense are both relatively low in international comparison. ↘ CHART 87 Efficiency considerations should, however, play a central role in public education investment. One issue here is the priority given to **education investment** in relation to other areas of public spending. In view of the demographic change and the decreasing number of school pupils, an absolute increase in overall education expense is not required.

Another issue is the allocation of resources throughout the education cycle from early childhood care to further career training. The primary aim of government action should be to give everyone a fair chance of attaining basic skills. This is the biggest factor in ensuring that the need for subsequent support measures is as low as possible, particularly due to unemployment (Nores and Barnett, 2010; Hines et al., 2011; Mervis, 2011; Heckman, 2013; Heckman et al., 2013).

559. There are a many areas of education in need of reform. Moreover, it appears that the population at large is willing to reform (Wößmann et al., 2015). From the GCEE's point of view, there ought to be a stronger focus of public funds on the **beginning of the education life cycle** and a stronger involvement of private funds for the financing. Such funds should not, however, serve as a substitute, but be mobilised to complement public expense, particularly in higher education. There is a good argument for **tuition fees**, which can be designed to accommodate students from lower-income families (Richter and Wigger, 2010;

CHART 87

## Education spending by comparison for the year 2011



Council of Experts to the German Federal Ministry of Finance, 2010; Bruckmeier and Wigger, 2014; Fels et al., 2015).

560. The increase in early childcare supply in recent years is certainly a major advance in education policy, which, moreover, is fully in line with family policy objectives (Bonin et al., 2013). This improves the balance between family life and work and promotes child development. But there are still major regional differences in the **quantity and quality of childcare** (Bock-Famulla et al., 2015). Moreover, the availability of all-day schools and afternoon childcare is still inadequate. Statistical reporting should be further developed in order to better evaluate advances in this important area of education.
561. Investment in childcare and training supply is in the best interests of both employees and employers. With a view to the changing working environment, it should therefore go without saying that employers offer continuing education and that employees take advantage of such offers. **Life-long learning** is necessary to develop the skills needed in a changing world of work.
562. The heavy influx of **refugees** is a major challenge for the education sector. For example, an additional 325,000 children are assumed to have entered the education system as refugees this year and last year (KMK, 2015). The high proportion of children and youth means **considerable educational potential**; however this is offset initially by cultural and, above all, language barriers. Thus, integration problems and resultant costs should not be underestimated. However, political efforts should focus primarily on the medium and long-term opportunities of successful integration and migration policy.

This applies equally to working-age refugees, with early skills assessment playing a major role. On the one hand, **integration into the labour market** as quickly as possible is desirable, although regulatory requirements could be an

obstacle in the short term. On the other hand, further medium-term to long-term skills acquisition could prove more useful. In both cases, it is important for job seekers and employers to take a **long-term view**. This applies in particular to training contracts, which will probably be concluded less frequently if there is the possibility that the potential trainee could be repatriated.

## 2. Labour market adjustments

563. In an increasingly global and digital economy, the framework for a “**Working 4.0**” must be based on future requirements. The specific changes are virtually unforeseeable, which means they cannot be accounted for in planning. Successful shaping of structural change will consequently depend largely on employee and employer ability and willingness to adapt. Labour market policy can facilitate the inevitable adjustment processes by creating an institutional framework which allows for flexibility in order to achieve customised solutions at the individual level. This strengthens, for one thing, labour volume and **participation prospects** through an increase in employment opportunities. For another, a faster reallocation of labour can contribute to **productivity gains**.
564. Recently, however, steps were taken in the opposite direction towards more stringent regulation, for example, with the **law on collective bargaining agreement unity** (*Gesetz zur Tarifeinheit*) that entered into effect in July 2015. In the GCEE's opinion, the law is an intervention in competition between employee representation groups, which is difficult to justify (GCEE Annual Economic Report 2014 item 550). Collective bargaining autonomy is an important contributing factor to employers and employees finding solutions adapted to the relevant economic conditions.
565. In its 2014 pension package, the statutory pension scheme took a turn away from longer working lives for demographic reasons – which is also questionable in terms of distribution policy – lowering the retirement age to 63 for those who have paid contributions for 45 years (Börsch-Supan et al., 2014; Kallweit and Kohlmeier, 2014). However, **more flexible solutions regarding retirement** could increase the acceptance of necessary increases in the retirement age. Policy must ensure that employment beyond the statutory retirement age is attractive for employees and employers. Moreover, retirement before a worker has reached statutory retirement age should not result in additional burdens on the social security system (GCEE Annual Economic Report 2014 item 589). Company pension schemes offered on a voluntary basis can make sense and serve, for example, to increase employee loyalty. Nevertheless, promoting pension schemes would be better aimed directly at the individual, among other reasons, in order to keep any hurdles to job changes low.
566. The German labour market is still highly regulated (GCEE Annual Economic Report 2013 items 452f.). This applies in particular to the rules on protection from unfair dismissal. A uniform legal framework with a clear schedule of severance payments, for example, could contribute to more flexibility. Otherwise, other **means of flexibility** will be needed. For this reason, restrictions on

**temporary work and contracts for work and services** should be avoided and flexibility maintained for employment adjustments to economic conditions. A minimum of flexibility supports companies' investment activity and helps to create and maintain jobs.

567. The **hurdles to labour market entry** should be kept to a minimum, above all with regard to the persistently high long-term unemployment and the high influx of refugees from countries affected by war and crisis. In view of the foreseeable rise in low-wage jobs, **the minimum wage should certainly not be increased** to avoid negative consequences for employment opportunities. Experience from France and the UK shows that lowering the nominal minimum wage will likely meet with political resistance even in times of greater economic strain (GCEE Annual Economic Report 2014 item 546). However, in the event that unemployment worsens, the options of reducing the minimum wage or creating further exemptions from it should not be ruled out.
568. The Minimum Wage Commission could initially focus its work on minimum wage exemptions and administrative requirements instead of the amount. The **minimum wage** could, for example, be **scaled by age**, similarly to the UK model, lowering the entry hurdles for young adults (Low Pay Commission, 1998). The minimum wage ultimately jeopardises their opportunities to gain work experience (Abowd et al., 2000; Gorry, 2013). This would simultaneously reduce the incentive to refrain from investing in education, due to the relatively good opportunities for earning money in the short term, and take up unskilled employment in the low-wage sector instead.

The exemption from the minimum wage for the long-term unemployed in the first six months of a new job should be extended to twelve months. As the chances of finding employment for jobseekers receiving SGB II benefits are very low, extending the exemption to this group is also advisable. All internships should be exempted from the minimum wage, for at least up to twelve months, due to the important function they provide in entering the labour market and gaining experience.

569. Moreover, an extremely critical view should be taken of employer **subsidisation of the minimum wage**. The example from France demonstrates how expensive wage subsidisation can be: the French government currently spends almost 2% of GDP per year, among other things, on subsidising social security contributions of employees who receive the minimum wage or just above (GCEE Annual Economic Report 2014 item 548). Germany has specific instruments in place to support household income and ensure higher income if employment is taken up, with its income top-up based on household need under the unemployment benefit II scheme, its housing subsidy and supplementary child allowances.
570. The key question remains as to how the recently stalled reduction in unemployment, especially long-term, can be reinforced. **Strengthening active labour market policy**, such as the government's plan for reducing long-term unemployment, could make a contribution. The effectiveness of active labour market policy is, however, limited and should aim above all at longer-term human capi-

tal creation (GCEE Annual Economic Report 2013 items 487ff.; Card et al. 2015). Education and labour market policy should always focus on preventing long-term unemployment.

571. This responsibility is likely to gain increasing importance in view of the dramatic rise in the number of refugees. The **integration of recognised refugees** into the labour market presents a particular challenge for the next few years. The hurdles to the labour market entry should therefore be kept to a minimum. At the same time it is advisable to obtain the support of the German people in the integration efforts. Refugee-specific exemptions should be avoided where possible in favour of general measures to facilitate entry and support programmes.
572. In addition to accelerating the asylum process, **early skills assessment** is key in order to quickly place refugees in jobs and find appropriate education options or language and integration courses. In the GCEE's view, **recognised refugees** should be deemed **long-term unemployed** as regards the minimum wage rule, as in the past the majority of them were unable to work in paid positions for an extended period of time.
573. Since many asylum seekers are likely to be granted asylum and have good prospects for obtaining residency permits, lowering the general asylum-seeker ban on working to three months has been appropriate. Labour market access was recently facilitated for asylum seekers and tolerated refugees, in that internships could be commenced without permission from the Federal Employment Agency. Although this makes sense, granting asylum must be viewed first and foremost as a **humanitarian issue**. There should therefore be two separate regimes for asylum applicants on the one hand and immigrants on the other. In particular, the asylum process and labour migration should not be mixed, for example, by options to switch track. The resulting incentives could increase immigration of individuals who attempt to use the asylum process to access the German labour market.

In order to disburden the asylum process, hurdles to labour migration should not be set too high. However, Germany already has relatively liberal laws on labour migration. For example, the minimum stay for Blue Card holders to receive permanent residence has been significantly reduced and access to the labour market for non-academic skilled workers improved (Expert Council of German Foundations on Integration and Migration, 2015). The GCEE therefore sees **no acute need for new immigration law action**.

### 3. Measuring wealth and progress

574. Public discussion has recently been heavily dominated by the distribution of income and wealth. Particular emphasis has been put on **measuring welfare and progress** with an encompassing perspective comprising environmental aspects as well as economic and social ones. Various institutions have developed relevant dashboards over the past few years, which are cited in political and so-

cial discussion (Expertise 2010; Enquete Commission, 2013; Federal Statistical Office, 2014; UN, 2014; OECD, 2015b).

575. The studies available on comprehensive welfare reporting – along with the insights gained from the citizen dialogue recently conducted by the Federal Government – suggest that the resulting indicator system for Germany will be employed as a **regular instrument for discussion** and that it **meets with broad public acceptance**. It should, in fact, be subject to a systematic process of evaluation. The Federal Government could then commission an **independent body of experts** to evaluate this comprehensive dashboard from an academic point of view once each legislative period.

The mandatory counterpart to this independent evaluation would then be the relevant **government response**. Such process would follow the German Council of Economic Experts' Annual Economic Report commented on in the government's Annual Economic Report. This would, in all probability, generate an intensive public dialogue on the status quo and prospects of well-being and quality of life in Germany. The evaluation would thus constantly spur on the social dialogue and contribute to relating this debate to research-based evidence.

576. As indicator dashboards are by nature descriptive instruments, **setting political targets** in the sense of specific values that an indicator is to achieve by a specific date or within a specified period of time, should be avoided. Setting targets as benchmarks for gauging the necessity and – ex post – the effectiveness of political action only makes sense if the chain of cause and effect is fairly well known, there is not much structural or cyclical overlay and thus **political efficacy** is substantial.

This is likely very seldom the case for questions of sustainable economic activity. Thus, the German Council of Economic Experts welcomes the Federal Government's decision in the summer of 2015 after joint assessment with the GCEE, not to overload the Stability and Growth Act by expanding it to reflect a holistic view. [▷ BOX 20](#)

#### [▷ BOX 20](#)

##### **Stability and Growth Act: a toolkit for exceptional economic circumstances**

In its **coalition agreement** of autumn 2013, the German government set out to develop a new strategy for economic policy and growth. This was intended, not least, to engage with the discussion about a more comprehensive approach to measuring welfare and the justified calls for a more sustainable economic policy. The citizen dialogue on quality of life in Germany (*Gut leben in Deutschland – was uns wichtig ist*) is a step towards formulating such a strategy. In addition, the coalition agreement promised a review of the **Stability and Growth Act** (*Stabilitäts- und Wachstumsgesetz – StabG*) by the Federal Government together with the German Council of Economic Experts (CDU/CSU and SPD, 2013). The findings of this review in June 2015 were clear: it does not make sense to overburden the StabG by adding environmental and social sustainability objectives and expanding the economic policy toolkit accordingly.

The StabG, which dates from 1967, is expressly designed to enable rapid application of economic policy instruments in order to maintain **macroeconomic balance** as far as possible within the market



regime. The range of macroeconomic objectives includes stable prices, high employment and balanced trade with a steady, appropriate rate of growth (the “magic square”). Seen from today's perspective, these objectives include key aspects of economic sustainability. The StabG is based on the idea that the state's primary role is to provide **competitive markets** and that the government should only intervene in economic activity where the macroeconomic balance is at risk.

It provides a **policy toolkit** to enable rapid implementation of the economic and financial policy measures considered necessary in such cases. The fiscal instruments provided, which can be implemented **without significant delay** in the legislation process, include payments to and withdrawals from a reserve fund designed to stabilise the economy, as well as cuts or increases to government spending on the expenditure side of public finances, and changes to tax rates and measures to limit borrowing on the revenue side. The StabG was primarily intended to allow the government to implement counter-cyclical fiscal policy more quickly than the normal legislative process (**statutes requiring assent**) would allow, and thereby to prevent delays.

The Act must be understood in the context of economic thinking at the time, which interpreted changes in economic performance largely as **cyclical fluctuations** around a stable growth path. Problems of awareness about the cyclical state of the economy were largely ignored. The evidence now available, however, on the accuracy of output gap estimates, shows that major and persistent under or overestimates of potential output remain commonplace. Economists in the past thus **overestimated the effectiveness of cyclical policy** in returning the economy to this growth path. They therefore saw delays in applying economic policy measures as the most pressing problem.

The experience of recent decades has shown, however, that it is extremely difficult to determine the cyclical state of the economy and that economic output cannot be precisely controlled by fiscal measures. In fact, much evidence points to **structural rather than cyclical factors** being at the heart of weak growth. These must be dealt with by structural reforms rather than policies aimed at the business cycle. Given the problems of awareness described above, cyclical fluctuations are best reduced using **automatic stabilisers**.

Nevertheless, the joint review by the Federal Government and German Council of Economic Experts concluded, in its first finding in June 2015, that the StabG should not be abolished, as it may be useful in enabling a rapid response to **economic emergencies** such as the recession triggered by the financial and economic crisis and resulting recession in 2009. In such situations, awareness problems take a back seat. The fact that the StabG was not applied in 2009 was likely primarily due to the unusual political constellation at the time.

The joint review also examined the possible extension of the StabG to encompass additional objectives such as **environmental and social sustainability** with the ambitious aim of enabling economic policy to take a holistic view of growth and prosperity. In its second finding, however, the review concluded that extending the StabG in this way **would not be expedient**.

- Firstly, in the event of trade-offs, it would require consensus on the **objectives and their prioritisation**, i.e. on issues that will be the topic of future public debate and cannot serve as a starting point for political action in the present.
- Secondly, it would have to provide a suitable **toolkit** to achieve these objectives. There is even less clarity about the appropriate tools and their effectiveness regarding sustainability issues than in the case of macroeconomic policy.
- Thirdly, the StabG is, first and foremost, a piece of legislation intended to **accelerate** economic policy interventions. The speed of intervention, however, is hardly the most pressing problem when it comes to issues of sustainability.

## A different opinion

577. One member of the German Council of Economic Experts, Peter Bofinger, holds a different opinion on the economic policy proposals made in this chapter.
578. The majority of the council members assert that it is not yet possible to seriously evaluate the impact of the minimum wage. Developments on the labour market, they argue, should be continually monitored and evaluated in order to **avoid drawing any premature conclusions**.
579. The majority nevertheless present a series of **specific** proposals regarding the minimum wage:
- The minimum wage should on no account be increased.
  - Moreover, in the event that unemployment worsens, the option of reducing the minimum wage or creating further exemptions from it should not be ruled out.
  - The exemption for the long-term unemployed should be extended from six to twelve months.
  - All internships should be excluded from the minimum wage, at least for up to twelve months.
  - They also see potential for different minimum wages to apply to different age groups.

All these proposals involve limiting the scope of the minimum wage.

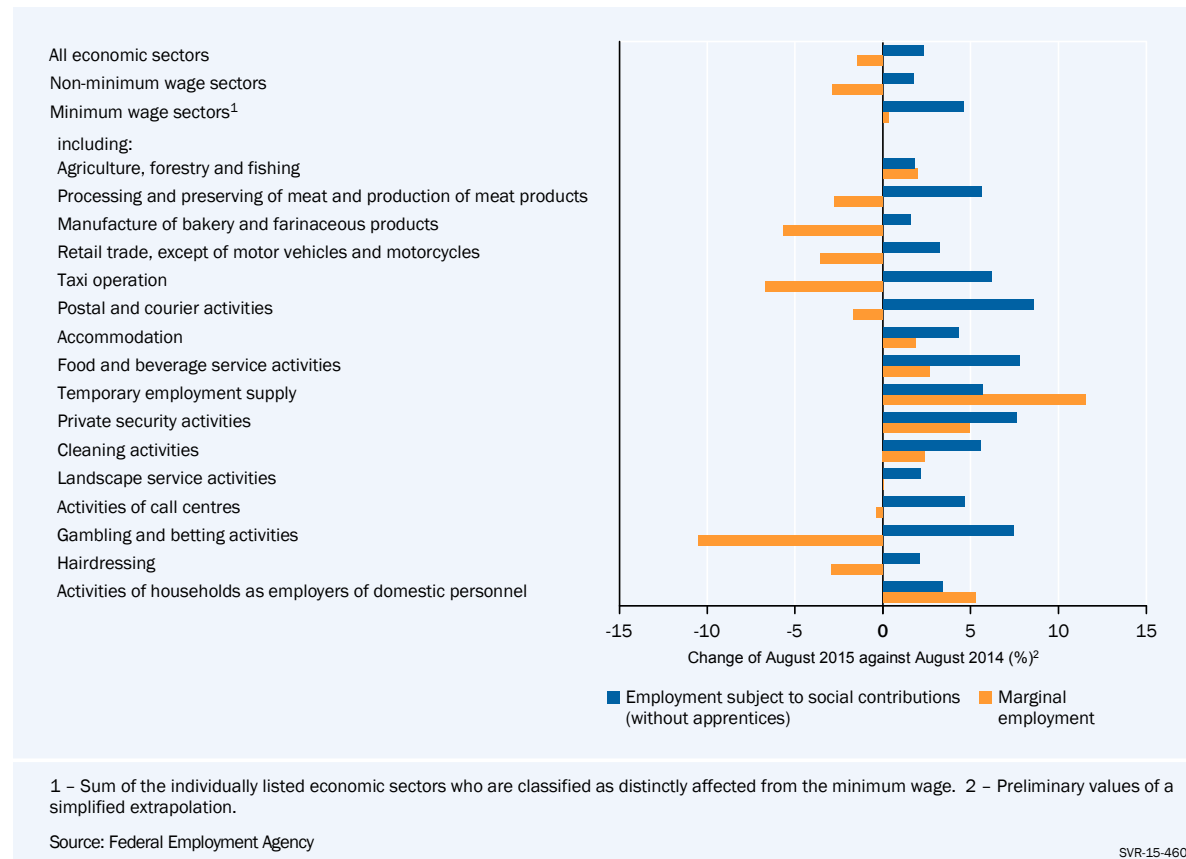
580. Emphasising the uncertainty surrounding the effects of the minimum wage like the GCEE majority means at least waiting to see how these unfold before calling for restrictions to be imposed on the legislation.

The **employment data available to date** paints an interesting picture: between August 2014 and August 2015, employment in jobs subject to social security contributions (not including apprentices) saw a greater increase in those industries that may be particularly affected by the minimum wage (4.6%) than in other sectors (1.8%). ↘ CHART 88 On average, even marginal employment not subject to social security contributions performed better in the industries judged to be most affected by the minimum wage (up 0.3%) than in other sectors (down 2.9%).

581. The **influx of refugees** should not be used as argument to restrict the scope of the minimum wage. For all the uncertainty surrounding the development of migration, the number of officially recognised refugees entering the German labour market will remain limited for the time being. Even with an accelerated asylum process and rapid integration into the labour market, no more than around 200,000 additional workers can be expected in 2015 and 2016 combined. A further 200,000 may join the labour force in 2017. This compares to a total employment in Germany of 43 million. An increase of 300,000 workers is expected for 2016 alone.

↘ CHART 88

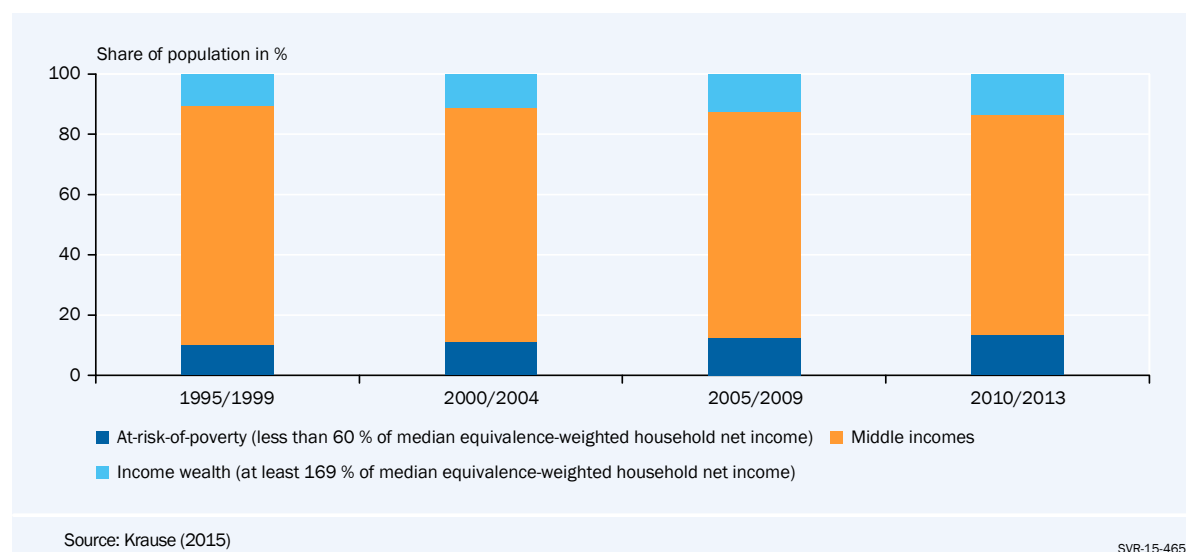
**Employment development after the introduction of the minimum wage**



582. With regard to the finding that Germany is a “**stable middle-class society**” ↘ ITEM 493, it should be noted that the share of medium incomes (between 60% and 169% of equivalence-weighted net household income, in the same relative intervals), fell from 79% in the second half of the 1990s to 73% in the period from 2010 to 2013 (Krause, 2015). ↘ CHART 89

↘ CHART 89

**Development of the income distribution according to equal relative income differences**



**References in the different opinion**

Krause, P. (2015) Einkommensungleichheit in Deutschland, *Wirtschaftsdienst* 95, 572-574.

# APPENDIX TO THE CHAPTER

## 1. Increasing efficiency in the hospital sector

583. The future development of healthcare spending will be one of the factors deciding how robust the public finances remain in the face of demographic change over the coming decades (Expertise 2011). This will not only depend on the age profile of healthcare spending and the increased costs caused by medical and technological progress, but also, to a great extent, on the economic efficiency of healthcare. The hospital sector is a key area in which existing potential for greater efficiency needs to be leveraged. The **efficiency** of the facilities must be **weighed up** against the reasonable **accessibility** of healthcare.
584. The Federal Government presented the draft of the **Hospital Structures Act (Krankenhausstrukturgesetz – KHSG)** in 2015 in order to support the structural adjustment processes needed for accessible, high-quality healthcare. The KHSG aims to make levels of quality more transparent and create extensive opportunities for hospital planning and remuneration in order to react appropriately to quality deficiencies. ↘ **BOX 21** Overall, the focus of the KHSG on quality creates incentives for healthcare providers to use **quality to compete for patients** and thus to reduce inefficiency, inadequate standards, oversupply and facilities that fail to meet patients' needs (Beivers and Penter, 2015). It is therefore a step in the right direction.
585. The draft legislation, however, leaves many **details of practical implementation** unspecified, by moving responsibility for these to the Federal Joint Committee (*Gemeinsamen Bundesausschuss – GBA*) and self-governing bodies. Implementation of the quality-based restructuring process will, in future, primarily be the responsibility of the newly founded Institute for Quality Assurance and Transparency in Healthcare (*Institut für Qualitätssicherung und Transparenz im Gesundheitswesen – IQTIG*), commissioned by the GBA.

A particular challenge will be to assess quantitatively the quality of hospital provision with the aid of **indicators** that take into account the different types of patients as part of the risk adjustment and that avoid incentives for patient selection (Marshall et al., 2000; Lindenauer et al., 2007; Eijkenaar et al., 2013).

From 2017, volume-based cost advantages for additional services are to be considered in the negotiations at hospital level. The planned price discount will be higher than the volume discount used in the past. This is intended, not least, to reduce the present high **incentives to increase service volumes**. It will be important to distinguish the desired increase in service volumes at high-quality hospitals from volume increases that are driven by purely economic factors.

586. A stronger focus on competition in hospital care may lead to individual departments or whole hospitals having to exit the market for economic reasons. The KHSG is intended to prevent broad healthcare access from being affected by this. For example, surcharges for emergency care and a consistent accessibility

indicator are intended to guarantee **appropriate emergency care** in rural areas. However, specific accessibility criteria have yet to be defined and the service areas for which they apply must still be identified.

587. Moreover, the draft of the KHSG largely ignores the problem of the enduring **lack of investment funding by the German federal states** (GCEE Annual Economic Report 2012 items 634ff.). Even in the event of noticeable capacity pooling through the structural fund, the federal states' currently available programme funds would not be sufficient to maintain the consolidated hospital structure and restructure the hospitals to make them more profitable (Augurzky et al., 2015a). Due to its exclusive focus on hospital provision, the KHSG does not address cross-sectoral quality assurance and transparency.
588. A **nursing jobs funding programme** is also to be implemented to strengthen direct nursing care. It is, however, unclear whether a higher level of direct nursing care always improves treatment quality. There is no clear empirical evidence to support this (Griffiths et al., 2014). The treatment quality level should thus be raised preferably by promoting quality transparency and competition, as already provided for in the KHSG draft. Hospitals must then decide themselves what combination of services results in higher quality.
589. At any rate, a nursing jobs funding programme will be unable to quickly offer the desired number of additional nursing staff, since there is already a lack of trained nurses, which can only be filled through training or immigration in the long term (Augurzky et al., 2015b).

#### ↳ BOX 21

##### The Hospital Structures Act

The draft Hospital Structures Act (*Krankenhausstrukturgesetz*, KHSG) presented by the Federal Government, with its supplementary amendments dated 2 October 2015 provides for changes, in some cases significant, in hospital provision structures in Germany (Federal Government, 2015):

- The draft act consistently focuses on quality. Quality is to be introduced as a criterion in hospital planning. Future plans for hospital remuneration include quality surcharges and discounts on services. Hospitals' quality reports are to have a more patient-friendly design and provide patients with more user-friendly information on the quality of hospital care. Quality transparency in general is to be increased – supported by the Institute for Quality Assurance and Transparency in Healthcare (*Institut für Qualitätssicherung und Transparenz im Gesundheitswesen* – IQTIG), newly created in January 2015. The minimum volume regulation intended to underpin the quality of interventional procedures performed in hospitals via the frequent execution of interventions is to be designed legally certain according to the requirements laid down by the Federal Social Court.
- Adjustments are also to be made to volume control, which serves to provide incentives against excessive volume expansion. Starting in 2016, regulations are to be introduced under the Statutory Health Insurance Care Improvement Act (*GKV-Versorgungsstärkungsgesetz* – GKV-VSG) as regards obtaining second opinions on non-emergency interventional procedures that are subject to minimum volumes. Volume management is scheduled to be moved from federal state to hospital level from 2017. Volume-related price discounts should then primarily occur at individual hospital level and no longer at federal state level.

- Hospital funding should be further developed in order to secure care. For example, surcharges and discounts are to be introduced for (non-)participation in the provision of emergency care. Moreover, conditions for service guarantee fees need to be defined more closely. They are intended to furnish hospitals providing an essential service with financial support if they are unable to cover their costs with per case base rates due to low utilisation. A uniform accessibility indicator is to be defined in order to objectively evaluate the assurance of care. Surcharges are to be further developed for special services provided by centres and specialised hospitals. The range of federal-state per case base rates is to be further reduced from 2016 by moving even closer to a uniform base rate corridor.
- A nursing jobs funding programme is planned to improve direct nursing care in hospitals, with total funding of up to €660 million to be provided between 2016 and 2018, and up to €330 million per year from 2019 onwards. The supplementary key issues paper prepared by the federal/state working group amending the KHSG draft (Preusker, 2015) announced additional measures to improve direct nursing care in hospitals. For example, a care surcharge is to be introduced from 2017. The funding volume for this surcharge is €500 million per year. The funds are to be distributed in line with nursing staff costs in general hospitals, to give hospitals an incentive to maintain a suitable number of staff (Preusker, 2015). A partial refinancing of wage increases is also planned.
- A structural fund will be implemented to directly finance measures to improve care structures. For this purpose, €500 million is to be provided one time only from the liquidity reserve of the healthcare fund. This money is intended to support the plans of the federal states to improve care structures (rebalancing capacities and site closures) if the states make a matching contribution. This would mean a maximum funding volume of €1 billion would be available in addition to existing investment support. Moreover, health insurers are to participate in the costs of closing hospitals in future.
- Hospital planning is to remain a responsibility of the federal states, including providing sufficient funding for necessary investments in hospitals.

According to the Federal Ministry of Health, additional funds to the tune of €6.2 billion will be available to the hospital sector by 2020 through the various instruments (quality surcharges, emergency care surcharges, etc) (Federal Government, 2015). The supplementary key issues paper of the federal/state working group amending the KHSG draft (Preusker, 2015) announced additional financial amendments for the hospital sector, in the amount of around €800 million per year from 2017.

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