

Liberalizing a coordinated market economy: The transformation of the German welfare and employment regime

Is the Nordic Model relevant?

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This paper is a very preliminary draft on the reform process of the German political economy in the light of the Nordic experiences. It argues that the German welfare and employment regime has undergone a substantial transformation over the last two decades. The changes can be described as a process of a partial liberalization of the labour market within the boundaries of a co-ordinated industrial relations system and a conservative welfare state. The paper starts off by locating the German welfare and employment regime in the context of other OECD countries, particularly regarding liberal and Nordic countries. Secondly, it depicts the transformation as a trend towards a more liberal welfare and employment regime by focusing on the shifting boundaries between status and income maintenance and poor relief systems. The paper then discusses the relevance of the Nordic countries concerning these changes.

Introduction

It is now common knowledge that particularly the continental European countries face strong challenges when facing deindustrialization and structural changes on the labour market. Both liberal and Scandinavian countries have been more successful at reaching and maintaining high employment levels, especially for women and elderly workers. Continental European countries have, in contrast, tended to create more incentives for inactivity in the labour market. Low employment levels were increasingly accompanied by comparatively low productivity levels, low growth rates and high unemployment. As such, continental European countries found it harder to adjust to the challenges of globalization, deindustrialization and the rise of female employment over the last four decades.

This is an unsatisfactory situation for the continental European countries. When searching for alternative models, the Nordic variations are more attractive for continental Europe than the liberal Anglo-Saxon models, for obvious reasons. The high levels of inequality and flexibility of liberal countries appear to offer a bad deal when compared to those countries which seemingly are able to combine social protection with a successful adaptation to change. This is especially the case when regarded in the context of the European social model, which prides itself on values of solidarity and egalitarianism,

Two crucial questions are relevant to the discussion: a) how can we characterize the path of adjustment the German political economy has followed in the past decade and b) what is the relevance of the Nordic model for this process.

The paper aims to give a tentative answer to both questions. It firstly lays out a conceptual understanding of where the continental European countries are situated vis-à-vis the Nordic countries. This is an essential precondition for any judgement about the divergence or convergence of national models. Secondly, the paper traces the German political economy's path of adjustment by tracing changes in the area of industrial relations and selected social policy reforms. Thirdly, it discusses the relevance of the Nordic model for those changes.

The paper does not cover all features attributed to the Nordic model. Not all policy fields can be discussed; rather the focus is on the interaction of employment and welfare. Pensions, family policy, taxes and social services will not be covered, even though they are important components of what is usually described as the Nordic model. Particularly the ability to tax and sustain a large public sector boosting female employment rates and providing comprehensive public services such as childcare could be seen as a crucial

component for achieving high employment levels and high degrees of equality (Iversen and Wren 1997), which the continental countries will find hard to pursue.

How to benchmark models of employment and welfare regimes and changes thereof

As advanced market economies vary in dimension and category, assessments of reforms and policy change will crucially depend on the categories used for comparison. One way of benchmarking recent reforms in Germany is a comparison of outcomes. The Nordic model is often described by a summary of its various features, such as high employment rates, high employment in the public sector, the universal and generous nature of welfare entitlements and the strong focus on public services (Kuhnle 2008).

In other approaches, Germany is depicted as pursuing the middle way (Schmidt 1987). Situated between the liberal countries on the one hand and the Nordic countries on the other, Germany shares features with both groups. It has equally low employment levels in the public sector and correspondingly low tax burdens, as do the liberal states. Social benefits and social spending is, however, more comparable to the Nordic countries. Spending on active labour market policy is closer to Nordic levels and, like the small, open states it has always positively embraced the challenges of globalization. Esping-Andersen also places the continental European countries in a middle group, when looking at the degree of de-commodification. Ultimately, however, the famous three worlds of welfare capitalism depict different types of welfare regimes whose relevance does not lie in the ranking but in the contrast of different structures of welfare provision. (Esping-Andersen 1990). Esping-Andersen commented by saying that the biggest difference between the social democratic and the conservative welfare state “*lies not so much in their de-commodifying income-maintenance guarantees as in their approach to services and sponsoring women’s careers*”(Esping-Andersen 1999: 88).

When comparing trends with respect to convergence and divergence, the more promising benchmark stems from a fundamental understanding of the characteristics of key institutions of the employment and welfare regimes. The assumption is that key institutions determine the nature and character of welfare regimes; policy change will only have a lasting impact if it affects the workings of these key institutions. Moreover, the workings of these institutions might change without policy change if economic actors – firms, employees and their organisations – change their behaviour within the context of given institutions.

This requires the selection of key institutions and categories. Literature provides two useful starting points: the Varieties of Capitalism concept of distinguishing between

coordinated and liberal market economies. The second starting point is the Esping-Andersen measure of decommodification. In the following I will propose a combination of both schools of thought by suggesting a number of dimensions that can be used to look at the pathways of reform in continental European countries.

The first dimension is based on the concept “welfare production regime” (WPR) as introduced by Estevez-Abe et al. (2001), because it aims to capture the ways in which social protection regimes, skills regimes, and production regimes are interconnected. As Estevez-Abe et al. put it, “welfare production regimes are the set of product market strategies, employee skill trajectories, and social, economic, and political institutions that support them.” (146).

The VoC literature contrasts the working of liberal market economies based on market mechanisms for the coordination of economic actors with coordinated market economies. These are based on non-market mechanisms, such as organizational interaction and long-term relationships. The Nordic and continental European countries are both classified as CMEs. In coordinated market economies (CMEs), firms’ product market strategies are based on the availability of specific skills. In order to protect their investment in specific skills, workers demand social insurance policies that protect these skill investments, such as employment protection, job specific unemployment insurance and earnings-related pensions. Firms then pursue product market strategies based on incremental innovation or “diversified quality production” (Streeck 1991) because of the abundance of specific skills. According to this logic, skilled workers will join with manufacturing employers in supporting social protection and training policies that support this high skill equilibrium.

Key institutions in this perspective are those institutions which protect the acquisition of specific skills, either through high degrees of employment protection (dismissal protection) or specific welfare provisions for groups of skilled employees. Highly specific skills are correlated with more welfare provisions aimed at protecting these skills and with less flexible labour markets. Demands by specifically skilled workers in manufacturing industries have led to specifically designed welfare programmes, as well as to relatively strong employment protection legislation. The strong focus on protecting specific skills has led to the adoption of systems, which – in contrast to the Nordic countries – did not ask skilled workers to change their skill sets, but rather promised life-long earning-related benefits in case of unemployment with no obligation or expectation to acquire new skills or move to new occupations.

In countries with more general skill sets, the demand for skill-specific social protection is lower and programmes are more employment friendly in nature. In both, liberal

and Nordic countries the emphasis of benefits focus much more on moving unemployed workers into new employment rather than protecting their acquired skills. As Karen Anderson and I have argued in another paper, this is closely related to the training system of some of the continental countries, in which companies invest highly in initial skill sets (Anderson and Hassel 2008).

The distinction between ‘social democratic’ and ‘conservative’ welfare states, which appears in the expansive literature on welfare regimes originating from Esping-Andersen’s work (Esping-Andersen 1990), can to some extent be incorporated into this dimension. The labels ‘social democratic’ versus ‘conservative’ describe the distinction between the universal characters of the Nordic welfare state versus the ‘status-oriented’ nature of benefit provisions in the conservative ones. The distinction between social democratic and conservative does not, however, introduce a new dimension into the discussion of welfare production regimes but rather helps to understand welfare production regimes by pointing to the administrative logic of welfare provisions in countries with specific skills. A status oriented welfare state provides special benefits to particular groups of employees, particularly employees in the manufacturing sector with very specific sets of skills. The insurance based nature of the benefit system ensures via its ‘equivalence-principle’ that benefits are tightly coupled to contributions and therefore counteracts any tendencies towards a more ‘employment oriented’ benefit system.

Graph 1

In this perspective, countries are situated on a continuum of flexibility of labour markets and the employment friendly character of the benefit system under the assumption that these two categories correspond.¹ In liberal countries with general education systems, the regulation of labour markets is loose and benefits are aimed towards high employment levels. No assumption is made about the generosity of the benefits. The group of coordinated market economies is broken up into three different groups: the Nordic countries are closest to the liberal model with regard to the measure of the benefit system’s universality and the degree of flexibility in the labour market. The other two groups, the continental European and southern European have, in comparison, more strongly regulated labour markets and an increasingly inactivity prone benefit system.²

¹ This conceptualization therefore moves away from the standard assumption of the VoC literature, which is organized around two poles.

² Anderson and Hassel (2008) propose a similar typology based on training regimes.

An important implication of this approach is that it removes the traditional stark contrast between liberal and Nordic models and puts both groups of countries on the same level. Both models are similar not only regarding employment levels and the role of women in the labour market. Also in terms of education levels and the importance of general skills, the Nordic countries are closer to the Anglo-Saxon world than to their Continental European counterparts.

Critics might take issue with the notion of the Nordic countries as being more flexible in terms of labour market regulations. Standard measures of employment protection for regular employment (EPL) by the OECD give most of the Nordic countries (with the exception of Denmark) a similar score compared to standard continental European countries (see table 1). Scholars of the region frequently disagree with the notion of labour market flexibility as a Nordic trait.

However, when putting the issue of flexibility and employment protection in a greater context of the role of active labour market policy and high employment rates in the Nordic model as a precondition for high taxation, it becomes evident that the practice in the Nordic countries prefers activation over preservation. Though all CMEs are characterized by high social spending, countries with strong Social Democratic incumbency differentiate themselves with regards to the employment-regarding nature of their social policies (Huo, Nelson and Stephens 2008). As case in point, Social Democratic welfare state regimes are characterized by high spending on active labor market policies and generous short term unemployment replacement rates, which relate to higher employment levels (Bradley and Stephens 2007); Christian Democratic states, in contrast, demonstrate strong employment protection, high social security taxes, and generous long-term unemployment replacement rates, which relate to lower employment levels (Bradley and Stephens 2007). In Sweden, the Rehn-Meidner model recognised in the 1950s that workers benefit from mobility between jobs rather than fighting for the stability of existing workplaces. There, active labour market policies were combined with early investment in education, good child care facilities, centralised wage bargaining and large public sector. Today, Denmark excels at achieving high growth rates, high employment levels, high levels of labour turn-over and high degrees of worker mobility.

This also becomes apparent when looking at job tenure rates. Tenure rates in the Nordic countries are considerably shorter than in continental European countries and fall exactly between the high turn-over rates of liberal market economies and the substantially lower rates of continental Europe (table 1).

To depict the Nordic countries as in between those of continental Europe and those of more liberal economies has important implications in judging reform movements. A movement towards the Nordic model by the continental European countries is, at the same time, a move towards liberalization. In other words: approaching the Nordic model from a continental European viewpoint would entail a dose of liberalization, even if policy-makers have a 'social-democratic' model in mind.

The second dimension of welfare and employment regimes refers to a measure of social protection, which Esping-Andersen labelled 'de-commodification'. This indicator looks at the degree to which social transfers protect the individual from the hardship of the market with regard to unemployment and old age. The measure sets liberal and Nordic countries far apart, since Sweden occupies the end of the spectrum while Australia is at the other end (Esping-Andersen 1990, 52; Scruggs and Allan 2006). Benefit entitlements as well as the overall degree of social spending structure the employment system in several ways. They give incentives and disincentives for low paid employment and thereby add to inactivity. They also protect acquired skills by taking pressure off the unemployed to immediately take on a new job. Moreover, they are an important factor in redistribution and the degree of equality in societies.

Adding the second dimension of decommodification to the understanding of national models, we can construct a two by two table in which the Nordic and liberal countries score high on the degree of labour market flexibility / employment friendliness compared to continental and southern Europe. On the other hand, Nordic and continental European countries score considerable higher with regard to the degree of social protection / decommodification compared to both liberal and southern European welfare states. Both country groups are similar with regard to income maintenance.

Mapping the advanced industrialized countries like this provides us with a set of important dimensions which are useful in assessing policy reforms and the trajectory of change. It also fits neatly in with the policy debate on 'flexicurity', as of now the most sophisticated policy approach that aims to combine change, flexibility and the protection of workers. Flexicurity has been discussed within the European Union for the last decade or so and has recently moved high onto the agenda of the European Commission.³ Denmark, in particular, has been used as a case for flexicurity, but in this analysis the Nordic countries combine a comparatively high degree of flexibility in the labour market with a certain high degree of social protection.

³ The concept was endorsed by the European Council of Ministers in December 2007 and has informed the discussion on revitalizing the Lisbon Agenda.

Graph 2

With regard to Germany, the mapping assumes that continental Europe is less liberal and less employment friendly than both the liberal and the Nordic countries. Therefore, Germany is not perceived as pursuing a middle way but is rather situated at the other end of the scale of labour market flexibility and employment friendliness. Secondly, it assumes that Germany provides higher degrees of social protection than the liberal and southern European countries, but less than the Nordic countries. In the following, recent policy reforms and institutional changes will be discussed in this light. If Germany was to move closer to the Nordic model, it would have to liberalize its employment regime and add more employment friendly components to its welfare systems while maintaining or even increasing its degree of social protection. As the analysis will show, this runs into some contradictions with the underlying logic of the German model.

Germany's path of adjustment

For at least a decade it was popular to criticise Germany for its failure to adjust to economic, social and demographic challenges. The urgent need for “reform” appeared frequently in newspaper headlines, in reports by expert commissions and high-flying economists, and even in newspaper adverts placed by German “citizens’ campaigns”. The basis for the call for action was Germany’s low – and partially negative – growth rates, its high levels of unemployment and steadily rising public deficits.

The Agenda 2010 in March 2003 and the subsequent adoption of the proposals have exemplified the awareness of governments to react against this. Whether these reforms present a break with the German model and whether they have gone far enough is still subject of intensive debate. The view taken here is that a major adjustment process started in Germany in the early 1990s, which was prompted by the multi-layered challenges of reunification, the changing role of Germany in EMU and the recession immediately after reunification, which affected the competitiveness of the German export industry significantly. In this adjustment process many facets of the traditional German institutions have remained remarkably stable and probably will remain in place for a long time to come. However, if one scratches the surface it becomes clear that Germany has been, and is, changing more rapidly and radically than is often perceived. Two areas of change – the regulation of the labour market and the unemployment benefit system – are used to illustrate this.

This reform process has two defining characteristics. First, traditional German institutions remain in place but are nevertheless undergoing processes of change. This combination of continuity and change is key: It is as if the institutions are being gutted while their ‘walls’ and ‘ceilings’ remain in place. Second, changes in underlying expectations, attitudes and values in business, policy-making and in the wider society are fundamental forces driving Germany away from its traditional model towards one that remains essentially German but draws on a much wider range of social, economic and cultural influences than, say 30 years ago.

In the reform debates, which have been raging ever since the mid-1990s, actors have discussed many reform proposals but only few resulted in concrete action. But changing attitudes and expectations have already had a severe impact on these institutions. Globalisation, in particular the internationalisation of companies and of business standards, has forced German managers to adopt more open, international approaches. They have adapted the workings of the traditional corporate governance institutions to their own needs – including the role of employees in codetermination procedures. Similarly, changing attitudes towards work and towards the often conservative role played by centralised unions and employers’ bodies have fuelled an approach among the wider population towards trade unions in particular that is largely instrumental and stripped of traditional political motivations.

Such changes add up to a gradual transformation of the old German model established during the post-war period, to something that is indeed more liberal and more employment friendly than before. But the move toward more flexibility and more employment friendly policies takes place in the old structures and institutions and therefore leads to different forms of flexibility than in both the Nordic and the liberal countries.

Achieving flexibility in a system of tight employment protection

In many accounts by the IMF and the OECD, the regulation of the labour market is seen as a stumbling block limiting the growth potential of the German economy. According to the OECD, Germany is near the top in a ranking of employment protection measures, in 4th place behind Italy, France and Sweden. Recipes for overcoming economic stagnation usually start with proposals to deregulate the labour market, including Germany’s labour relations model. The most recent Germany survey by the OECD states: “The government should thus consider easing employment protection legislation for regular job contracts, which is strict by

international standards, in order to use the current upswing to create as many regular job contracts as possible.”⁴

Indeed, despite the continuous recommendations by the OECD since the Jobs Study in 1994, Germany has done very little to change its system of labour market regulations including employment protection and the collective bargaining framework. Political proposals to reduce employment protection and to decentralize collective bargaining were often on the political agenda. In Gerhard Schröder’s Agenda 2010 speech, both items were mentioned as potential reforms if the social partners were unable to find their own ways of making the labour market more flexible. The social partners did find their own ways and as a result the core elements of this model are still in place – centralised, industry-wide collective bargaining, co-determination, and sectorally-based union and employers’ bodies operate in a tight legal framework, in which dismissals are highly regulated.

At the same time, the image of tight regulation enforced by strong trade unions holding a firm grip on companies is a distorted view. In fact, the employment landscape in Germany has changed much more significantly than is commonly perceived. Companies today are generally much more able to determine wages and working conditions for their employees than they were a decade ago.

During the recession of 1992/93 half a million jobs in the manufacturing sector were shed. Redundancies were negotiated with the help of unions and plant-level representatives. ‘Concession bargaining’ at the plant level now takes place in the majority of big companies in industry: Longer working time, pay cuts and flexible work organization has spread throughout the economy. Today in a third of companies in the private sector plant-level agreements exist that provide for terms and conditions that diverge from the industry-wide collective agreement. Another 15% of companies simply violate the agreements, according to a survey by the union-based research institute WSI.

The price companies pay for plant-level agreements is, however, a move towards tighter dismissal protection for the existing workforce rather than a more flexible regime of hirings and firings. Firms pledge in plant level agreements to refrain from any collective dismissal for a period of several years. In a recent bargaining agreement, Deutsche Bahn, the German railway firm whose goal is to be listed on the stock exchange, has committed itself to forego any redundancies until the year 2023 (!).

The flexibility firms gained from concession bargaining is internal cooperation rather than external adjustments. Unions and employers adjusted collective agreements to allow for

⁴ OECD 2008: Policy Brief. <http://www.oecd.org/dataoecd/24/9/40367952.pdf>

plant-level deals. They have introduced 'opening clauses' that allow for local bargaining, if the business situation is bad. In the chemical sector, pay grades were widened by introducing a 'pay corridor' reaching down to ten percent below agreed rates, following pressure from tyre manufacturer Continental. Pay grades have thereby become more differentiated and lower pay grades have been introduced. Even the trademark of German trade unionism, the 35-hour week, has been effectively shattered. Studies show that the majority of white-collar employees in the car industry does not work the 35-hour week but has returned to a 40-hour week. In a face-saving exercise, the IG Metall engineering union now negotiates over annual working time accounts, in which an average of 35 hours for blue-collar workers must be reached over a period of two years. In reality, the issue for the IG Metall is not the length of the working week but overtime bonuses. The fight for a shorter working week has long been lost. According to data from the federal statistical office, the share of German employees who work 40 hours or more has steadily increased since 1993. At the same time, the share of those that work between 35 and 40 hours is decreasing.

Many companies design new work arrangements with their works councils at the plant level without even informing the associations. Monitoring and policing violations of collective agreements at the plant level are virtually impossible for the unions. Hardly any employee is prepared to sue a company for breaking an agreement, and unions do not have the staffing capacity to enforce or negotiate agreements in small and medium sized companies.

Why did German business opt for sticking with the institutions rather than pushing for more fundamental moves towards labour market deregulation? This is due in part to a collective action problem. Those firms unhappy with the general state of labour market regulation left the system – they chose exit rather than voice. Firms are generally less willing to participate in the industry-wide collective bargaining system. The share of firms that belong to employers' associations and are thereby obliged to apply industry-wide collective agreements has diminished to 45 percent in western Germany. In eastern Germany, only 23 per cent of companies are members of associations. The share of employees in the private sector who work in companies that are part of a collective agreement has declined to roughly 60 percent.

The remaining firms chose to reform the system from within. Changes in legislation would often not have increased flexibility, since collective agreements propped up labour law. For instance, the framework collective agreements in the metal sector have clauses which

forbid dismissals for elderly workers above the age of 53.⁵ Looser employment protection legislation would not have changed this.

Rather, firms hoped that competitive pressure, stubborn high unemployment, and weaker trade unions would allow them to change the conduct of these agreements and give them internal flexibility to reduce labour costs as was needed.

With regard to union cooperation, this strategy worked. While unions rarely block workplace deals aimed at providing job security and competitiveness, they usually do not talk about these deals in order to avoid other firms following suit. This led to a further worsening of the unions' public image and tended to undermine their own authority. The IG Metall's failed strike for the 35 hour week in the Eastern metal industry in mid-2003 showed how much the union misjudged the effects of these deals.

The labour market that has emerged is less regulated than is commonly assumed. One should recall that big manufacturing companies in the US and UK also have strong union representation. The regulatory power of the unions in these countries does not, however, extend beyond these plants. It has been a feature of the German model of labour market regulation that agreements were forged that set universal rules for the vast majority of employees. This system is being eroded by company opt-outs and concession bargaining.

Tight labour laws that regulate dismissals and workers' participation still exist. However, they increasingly divide the labour market into those who enjoy them and those who do not. Employment expansion has taken place among workers on temporary contracts, those in temping agencies and in precarious jobs. More than a fifth of young workers under the age of 30 (and not on vocational training contracts) are employed on temporary contracts which forestall employment security and dismissal protection. In September 2003 there were 6.7m workers employed in so-called mini-jobs – low wage jobs that are largely exempted from social security charges. Temping agencies are now widespread even in the manufacturing sector. Deregulation is spreading at the fringes of the labour market, and unions have little power to do anything about it.

Protection for the core of the workforce and instability for fringe workers (the insider-outsider problem) are complementary to each other. Firms argued that the only way to protect core workers was to look for other options to lower labour costs – at the expense of other parts of the workforce. Flexibility was thereby achieved in an uneven – segmented - pattern. The German case therefore shows that flexibility has increased, however in a patchy and not in a universal way.

⁵ Framework agreement for the metal sector in Baden-Württemberg.

Activation: Addressing the public funding crisis by increasing work incentives

The move towards employment friendly policies took place at the interface between social assistance as a poor relief instrument and the insurance based unemployment benefit system.

The German welfare state has always been a mixture of an Anglo-American lean benefit system for the needy poor, and a contribution-based insurance system covering periods of unemployment and old age that links benefits to previous pay. In the past, however, the focus was firmly on the latter component, centred on the idea of ‘Lebensstandardsicherung’, or the ‘securing of living standards’ both now and in the future. Once a certain living standard was reached, say that of a skilled worker, the system guaranteed that that standard was maintained, also during periods of unemployment and in retirement.

Until 2005, there was a third category between the means-tested poor relief benefit and the regular unemployment benefit, which was specifically designed for the long-term unemployed. Those still unemployed after UB entitlement had expired received ‘unemployment assistance’. Unemployment assistance was lower than unemployment benefits but still related to previous earnings. It was tax-financed.

The three different benefit systems for the unemployed produced complex administrative processes. Partly in order to streamline these processes, the Hartz reforms proposed to merge unemployment assistance and parts of the coverage of social assistance into one benefit, called Arbeitslosengeld II (ALG II), essentially for the long-term unemployed. (Social assistance remains for those unable to work). The philosophy that underlies the reform had previously been used by the Blair government for activating the unemployed. The state provides opportunities but also asks for commitments and personal effort. It aims to toughen the rules for entitlements of social assistance and to increase the incentives to look for work for those on unemployment assistance. These include tougher sanctions for the unemployed. Jobless people face cuts in benefits if they refuse job offers, and increased pressure to be more geographically mobile in order to find a job.

Labour economists and sociologists frequently make the point that after a year of unemployment the value of previous qualifications is significantly reduced, and the long-term unemployed will only find new work in areas that are markedly worse paid than their previous job. Therefore, linking unemployment benefits to previous earnings in the past was seen as creating a disincentive for people to accept a new job. In contrast to the Nordic countries, where long duration periods of unemployment benefits are also common, the German system

had additional features that prevented the unemployed from looking for work. In particular, the protection of skills was a major hallmark of the system. Unemployed with a specialist trade could not be asked by the Job Centers to move into a different profession. Up until the 1990s, job agencies could only offer vacancies that matched the skills of the unemployed.

The high degree of skill protection was gradually eroded during the adjustments in the 1990s. But still, when it came to implementation, many professionally trained unemployed insisted on pursuing their trade or remaining unemployed, even when the chances of being reemployed were slim.

The reform in 2004 of the unemployment system therefore targeted the incentive structure of benefits and the level of skill protection. In order to reduce these incentives to remain unemployed rather than taking low paid employment, the maximum duration of unemployment benefit has also been cut. Unemployment benefit is still available, but is limited to the first year of unemployment (18 months for those over 55).

A new benefit (ALG II) was introduced for long-term unemployed (exceeding 12 months of unemployment). This is a means-tested flat rate payment set at what is universally seen as a low level, that of social assistance (it can be topped up temporarily if a claimant previously received considerably higher unemployment benefit). Those receiving ALG II must usually prove that partners and close family members living in the same household are unable to support them, and that most of the recipient's savings are used up. Moreover, ALG II recipients will be required to take any job that is offered to them to prove their willingness to work.

The reform has shifted the balance between means-tested flat rate benefits which are available universally and not tied to entitlements and contribution based status oriented UB benefits clearly towards the former. As the data in table 2 shows, before the reform the ratio of recipients of earnings-related benefits to flat rate recipients was well in favour of earnings-related benefits, while after the reform the flat rate recipients clearly outnumbered the others.

At the same time, the reform of the benefit system has not altered some of the most important obstacle towards a more employment friendly system – the high tax-wedge that burdens low skilled and low paid work unproportionally. Germany remains the country within the OECD with the highest marginal tax rate for low paid employment. While a number of social security exemptions were introduced for part-time low paid employment (the so-called Mini-Jobs), full-time employment for low paid workers is taxed at a rate of 36%. Combined with strong pressure on the unemployed to take up low paid employment and a new system of topping up income with partial benefits, the recent reforms have created strong incentives for

low skilled workers to take up part-time employment for very low wages and simultaneously draw social security benefits. As a consequence, Germany has now moved to the top of the list within the EU as the country with the highest share of working poor.

Unlike the labour market regulation example above, this benefit system reform has been largely driven by politicians, but with economic and financial factors – in particular high structural unemployment, the state's severe budgetary problems and the financial crisis of local authorities – playing a vital role in forcing political decision-makers to act. The motivation for a comprehensive restructuring of the benefit system was a mixture of providing more financial incentives for work as compared to non-work and a deep financial crisis of local authorities, which were increasingly forced to take care of the long-term unemployed.

As a result, the distinction between skill-specific and unspecific benefits has become sharper. Insiders – those with permanent employment – tend to worry even more about employment security. Firms are therefore even more under pressure to avoid major lay-offs.

The process of adjustment

As the two examples make clear, Germany is moving towards more flexibility and more employment friendly policies, but it is doing so gradually and more or less within the framework of the established institutions of a conservative welfare state and a coordinated market economy.

Increased flexibility on the labour market is achieved by a two tier system in which the insiders are forced to make concessions regarding pay and working time in order to achieve job security, while the outsiders remain on relatively unstable employment conditions. The move towards a more employment friendly benefit system accordingly provides temporary skill-specific benefits for the insiders, which increases the pressure on firms to provide job security or facilitate the transition to new employment if the firm has to lay-off workers. For instance, in the recent Nokia relocation from Bochum to Romania the management was pressured not only to pay exceedingly high severance payments to those who lost their jobs, but also made strong commitments to find new investors for the location. Insiders have a stronger expectation vis-à-vis their employers to protect them from the threat of unemployment.

Segmentation is therefore still a defining characteristic of the transformed German model with the inner core being smaller than before and the outer fringe being under stronger pressure to adapt to a flexible labour market. As a result, liberalization takes place in the context of a German regulatory framework and German institutions.

Relevance of the Nordic model: taking diversity seriously

The Nordic model has been instrumental for the German adjustment path in the sense of providing a positive role model for some part of the political landscape, in particular among the Social democrats and the Green party. It has been of little relevance for policy design or policy orientation. While benchmarking has become an important tool in the context of the Open Method of Coordination (OMC) and governments are today frequently more informed about policies and performances in other EU countries, one should not over-estimate the effects. This can be shown by looking in more detail at the discourse on activation and labour market participation.⁶

The activation discourse

Until well into the first term of the Schröder government, activation was not a theme on the reform agenda. For instance, the labour minister at the time, Walter Riester, took a position of defending early retirement as a useful policy instrument for creating employment for the young while taking care of the older workers. At the same time and within the same ministry, expert rounds had long realized not only the detrimental effects of early retirement and generous benefits for the long-term unemployed on the social budget at the local and federal level. Comparative studies on participation rates of elderly workers and the share of long-term unemployed and elderly workers among the unemployed were used to raise and increase the awareness among policy-makers to change the course of events.⁷

Only during the second term of the Schröder government, when the Agenda 2010 proposals were already underway, did policy makers and experts start to more actively look at neighbouring countries. For instance, when discussing activating labour market policies, experts turned particularly to the UK and the Netherlands, but less to the Nordic countries. The UK was heralded as a model for restructuring job centres; the Netherlands were seen as leading the way in terms of temping agencies, which the experts thought a necessary tool for increasing the degree of flexibility of the German labour market. Delegations were sent to both the UK and to the Netherlands to examine new practices of job placements in real life. The inspiration that came out of these study trips was, however, less of a policy-design nature (given the marked difference between the countries) but much more the strengthened political will to enhance the importance of activation for German labour market policy.

⁶ There has been more reference to the Nordic model in the new family policy where an earnings related benefit during the first year of child-caring was introduced. And to some extent the Pisa Study has highlighted the Finnish education system as a role model for policy makers.

⁷ One influential report was the report on Benchmarking Germany with detailed policy recommendations.

The Nordic countries did not feature in the context of the reform proposals by the government because the Nordic countries did not fit into the discourse on incentives and the lowering of benefits for the long-term unemployed, which was part of the overall reform strategy (which was closer oriented to the liberal models). After the adoption of the reform, the positive connotation of activation in the Nordic countries was emphasized alongside with the practices in the Netherlands and the UK. A higher profile of the Nordic countries only emerged with the increased discussion of flexicurity, which is categorized as a Danish concept, and has been propagated by the EU commission to some extent.

In the discourse, the government aimed to draw legitimacy for its reforms from the Nordic countries by highlighting that even the stronger social democratic states were able to have high employment rates and stronger pressure on the unemployed to find new work.

The limits of role models and national diversity

The reluctance of the German government to take in the Nordic model as a reference point even when there was a red-green government can be explained by the fact that the government under the second term aimed at liberalizing the labour market. While the Nordic model has – at least in my understanding – a more flexible labour market it was at the same time the model with high degrees of social spending and high levels of decommodification. The German government, however, was determined to cut social spending and lower benefits in order to increase incentives for the long-term unemployed to look for work. Being too close to the Nordic model was therefore not on the agenda –neither in public or in terms of policies.

While this observation says more about the tactical manoeuvring of the government, it can be used to make a general point about the role of national diversity and policy learning. National employment and welfare regimes are made up of a complex web of institutions, structures and policies. Developing these models into any further direction requires certain policy instruments, which can be observed in other settings and countries. However, it is clear to all policy-makers that these policy instruments will have a rather different effect when put into another context. There are therefore good reasons for policy-makers to be reluctant vis-à-vis policy advice based on benchmarking.

For instance, the OECD published its influential Job Study on the labour market in 1994 and advised a general decentralization and deregulation approach, regardless of the institutional, economic or political context of the countries concerned.⁸ Today, in the face of the continuing and re-emerging success of small and open European countries, which is based

⁸ OECD (1994). The Jobs Study. Paris

on regulated labour markets and centralized wage setting institutions, the OECD had to accept that there is more than one model which can produce high employment levels and good economic performance (OECD 2006). If anything, the Scandinavian countries are the current role model for how to cope with adverse effects of globalization in the early 2000s.

But even here, it is still not clear how much of the institutional architecture is really understood and how much of current assessment is just ex-post rationalization. Denmark, as well as the Netherlands in the 1980s, was in deep trouble due to several failed attempts to adjust to external shocks and closer monetary integration in the European Union. Similarly, Sweden in the 1990s was no showcase for dealing with globalization. Today, their institutions of training, wage setting and social and family policy are seen as leading the way to adjustment.

Moreover, even if countries tried to follow the Scandinavian path of combining high welfare with high flexibility on the labour market, it is far from clear what the effects would be. If continental European governments were enthusiastically adopting ‘flexicurity’ policies, would they all end up looking like Denmark? How would they move towards a high taxation regime in a global context, in which tax competition takes place? Or would there be the danger that their welfare states lose the benefits of the protection of their traditional institutions without gaining the flexibility and the welfare provisions of a Scandinavian welfare state? Rigidities in labour market can stem from many more sources than just regulations of employment protection legislation. They can be rooted in training certifications, social transfers, business regulation and a lack of interregional mobility of workers.

In many countries, employment protection is interlinked with social protection in a rather complex way and in many – in particular Southern European – countries employment protection has substituted for welfare provision. A call for a general decrease in employment protection in order to facilitate workers’ mobility is therefore not a solution.⁹ A lot depends on the labour market institutions and policy supporting labour turnover and workers’ expectation on the consequences of job losses.

Conclusion

Germany certainly is moving. It is moving towards more flexibility and more employment oriented policies; however in the framework of traditional corporatist,

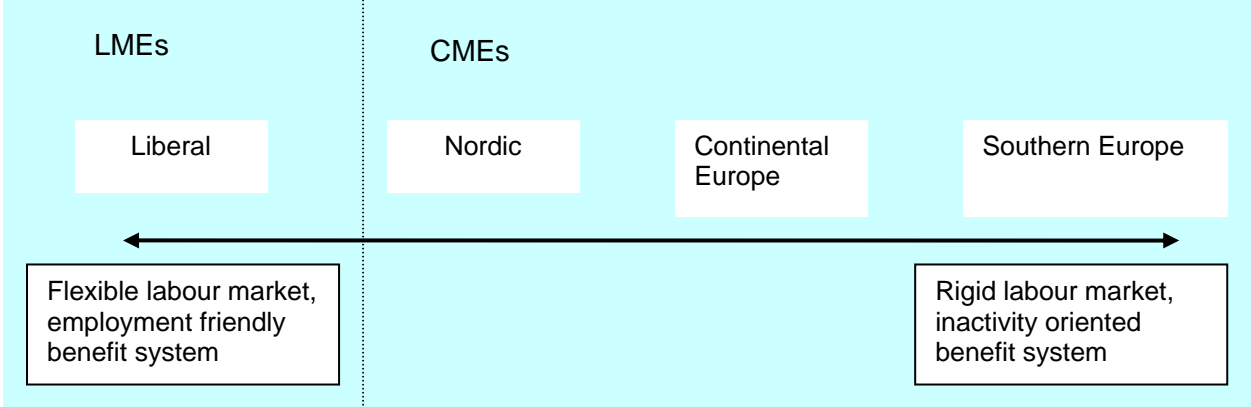
⁹ The irony is that struggles over plant closures traditionally were much fiercer in countries with rather liberal and flexible labour markets than in countries with higher degrees of employment protection. Low levels of employment protection in themselves do not make workers more mobile, just as higher levels of employment protection do not make labour markets more sclerotic

conservative and coordinated institutions. The changes therefore do not necessarily produce similar outcomes as in more liberal and flexible countries. Rather, policy actors and economic actors in Germany deal with their local problems by adjusting local institutions in their own way and according to their own interests.

More successful countries such as the Nordic countries can provide a toolbox of policy instruments which might serve as a blue print for individual reforms. Again, this does not mean that the whole model will converge towards the role model. Rather, individual reforms in a different context might lead to a different dynamic of institutional change.

Applied to the German case, the paper argues that the recent patterns of transformation have been real and have moved the country from where it was two decades ago. But the transformation has not changed the 'Germanness' of the national institutions. The Nordic model was instrumental occasionally when policy makers searched for legitimate arguments for change by drawing to more successful countries. It has not served as a blue print for policy design with the exception of some selected policy instruments.

Graph 1: Liberal and co-ordinated welfare production regimes



Graph 2: Degree of social protection by type of welfare production regime

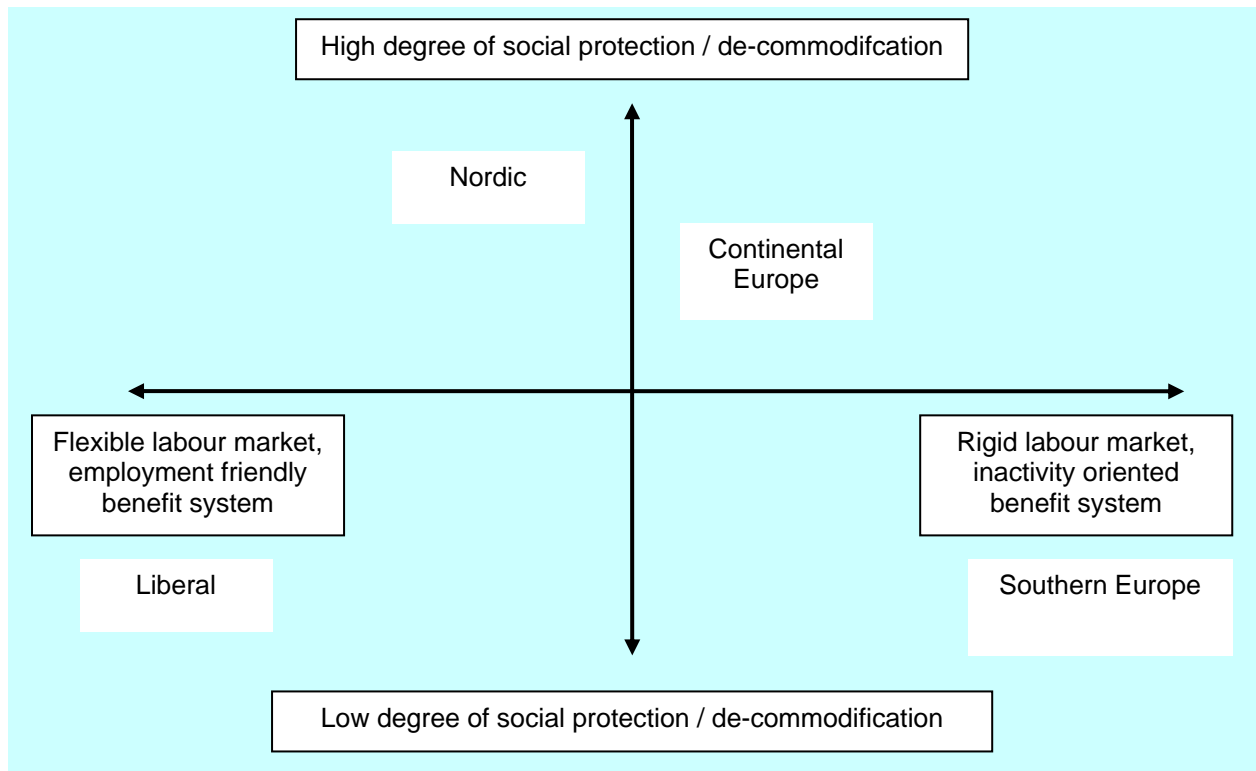


Table 1: Decommodification and employment protection legislation, 2003

	Decommodification index	Job Tenure	EPL overall	EPL regular work	EPL temporary work
Germany	30,2	10.7	2,4	2,7	2,0
Continental Europe	28,3	7.5	2,2	2,2	2,2
Scandinavia	33,7	6.6	2,1	2,2	1,9
Anglo-Saxon Countries	22,5	4.8	0,9	1,2	0,7

Sources: Lyle Scruggs database and OECD.

Table 2: Recipients of benefits due to unemployment (in millions)

	Earnings related benefits		Universal benefit, no eligibility test
	Unemployment benefit	Unemployment Assistance	Social Assistance
2004	1.84	2.19	2.91

	Earnings related benefit	Universal benefit, no eligibility test, means tested	
	Unemployment Benefit	Unemployment Benefit II	Social Assistance
2005	1.72	4.98	0.27

Source: Bundesagentur für Arbeit (2007). Arbeitsmarkt in Deutschland. Zeitreihen bis 2006. Nürnberg, Bundesagentur für Arbeit. Statistisches Bundesamt 2004. Sozialeistungen. Statistik der Sozialhilfe. Fachserie 13/ Reihe 2.1. Statistisches Bundesamt, Wiesbaden.