Labour-Market Reforms in Denmark and Germany

*Jacob Isaksen, Uffe Mikkelsen and Peter Beck Nellemann, Economics*

**INTRODUCTION AND SUMMARY**

The German labour market has seen extraordinary development over the course of the past years. Unemployment has dropped significantly since 2005 and is currently below the pre-financial crisis level. Germany is Denmark's largest trading partner, and Danish exports and the Danish labour market are strongly affected by trends in the German economy, including the labour market.

Since 2005, the German labour market has developed in a way similar to that of the Danish labour market in the mid-1990s. In both Denmark and Germany, unemployment had hit record highs and a number of labour-market reforms helped turn the trend.

On the demand side, however, the reforms were introduced at different times in the two countries. In Denmark, the reforms were introduced at a time of rising labour demand. Basically, competitiveness was good, and demand was stimulated by fiscal relaxation, declining interest rates and an international upswing. In Germany, on the other hand, reforms were introduced at a time of more subdued demand. This resulted in a prolonged period of low wage increases that put a damper on domestic demand, but boosted competitiveness. Thus, demand for labour did not increase until after the reforms had been implemented, and was driven by rising exports.

The Danish and German labour market reforms have several characteristics in common, such as a more active labour-market policy and reduced unemployment benefit periods. The effects of the reforms are a significantly reduced level of unemployment, including long-term and youth unemployment, and a rise in the senior employment rate.

Despite reform similarities, the labour-market structure in the two countries remains different. Consequently, the labour markets have reacted differently to the recent economic backlash. In Germany, businesses to a wide extent chose shorter working hours over layoffs, as permanent employees enjoy a fairly high level of job security. The limited number of layoffs, however, must be seen in light of the fact that be-
cause of the high level of job security, German businesses had been reluctant to hire during the economic upswing preceding the crisis. Temporarily shorter working hours as a response to the crisis proved appropriate in Germany, as the sectors hardest hit by the crisis experienced only a temporary setback. In Denmark, where the laying off of employees is less complicated, businesses had been less reluctant to hire before the crisis and reacted to the crisis by dismissing employees. Certain Danish industries, the construction industry in particular, overheated prior to the crisis, and the setback experienced during the crisis, therefore, proved more permanent. Consequently, labour-market flexibility was both necessary and appropriate in order to allow labour to be redistributed between industries.

THE YEARS LEADING UP TO THE REFORMS

The pre-reform labour markets
During the period preceding the Danish labour-market reforms, unemployment had reached almost 13 per cent of the labour force, cf. Chart 1. In Germany, unemployment increased from approximately 7 per cent at the time of the reunification in 1990 to approximately 12 per cent in 2005. The concepts of unemployment are described in Box 1.
In Germany as well as in Denmark, the pre-reform labour markets were characterised by a limited incentive to work. Unemployment benefit rules were favourable, and the labour-market policy was characterised

---

1 See Beier and Sand (2005) for a detailed description of the pre-reform German labour market.
by lenient availability requirements and limited sanctions against jobless who did not observe the availability requirements. As a consequence, the employment rate was fairly low, cf. Chart 2, and long-term unemployment high.

**Demand during the reform years**

In Denmark, demand for labour was low for a number of years leading up to the labour-market reforms due to the aftermath of the overheating of the economy in the mid-1980s, including the required tightening of the fiscal policy, the tax reform and the October 1986 economic package as well as interest rate increases in the wake of the German reunification. As a result, the level of unemployment was significantly above its potential level in the years leading up to the reforms. In 1993-94, however, a prolonged upswing began in Denmark. Declining interest rates and the liberalisation of mortgage-credit legislation, which triggered a major refinancing surge, cf. Hansen and Pedersen (2003), boosted consumer spending, and from 1993 the sum of the impact of fiscal policy over several years had a positive influence on the level of activity, cf. Ministry of Finance (2000). Finally, an international upswing and improved competitiveness resulted in rising exports. The labour-market reforms helped ensure that rising demand for labour was met by increased supply and that the upswing resulted in rising employment rather than growing wage pressure, which would adversely affect competitiveness.

In Germany, the situation surrounding the reforms was different. Consumer spending was subdued, due in part to slow income growth – only 4 per cent over a 10-year period (2001-11), whereas the gross domestic product, GDP, increased by 11 per cent – and government finances did
not allow for an accommodative fiscal policy. Thus, unlike the Danish reforms, the German reforms were not met by rising domestic demand, and the level of unemployment remained high. This resulted in limited wage increases and ultimately to improved German competitiveness. Not until international growth accelerated did German demand increase as a result of rising exports, and unemployment started to fall.

THE DANISH AND GERMAN REFORMS

The Danish labour market reforms in the 1990s and the German reforms in the 2000s have several common characteristics. Both governments adopted a more active labour-market policy by, for instance, streamlining placement services, and the unemployment benefit period was reduced. This increased incentives to seek employment.

Focus on an active labour-market policy
The active labour-market policy is based on the concept of the unemployed having a right and duty to enrol in a job activation scheme. As part of the Danish as well as the German reforms, the requirement to register as a job seeker and sanctions against unemployed individuals, who did not accept an offer of job activation, were made more rigorous. Furthermore, requirements with respect to geographical and professional mobility were raised. As for the Danish reforms, in particular, the period within which job activation would start was reduced (in particular for young people without a qualifying education), and job activation schemes were extended to include cash benefit recipients, cf. Box 2. The active labour-market policy gave the jobless an increased incentive to look for work, which reduces structural unemployment, i.e. unemployment in a neutral cyclical situation, cf. Rosholm and Svarer (2008).

Moreover, subsidised employment played a significant role in both Denmark and Germany. In Denmark, the schemes were primarily directed at long-term unemployed and individuals with reduced working capacity. Flexible working arrangements and sheltered jobs were introduced for individuals with reduced working capacity as well as older worker jobs and service jobs\(^1\) for long-term unemployed seniors. In Germany, subsidy schemes helping unemployed start their own business and subsidies to businesses hiring unemployed persons over the age of 55 were introduced. In addition, subsidies to so-called mini and midi jobs were increased. Individuals holding these low-income "mini" jobs are exempted, in part or in full, from tax and social security contributions.

---

\(^1\) The service job scheme was discontinued in 2002, and service jobs are therefore no longer available.
**Box 2**

### Active labour-market policy

**Denmark**
- **More rigorous availability requirements**
  - More rigorous geographical mobility requirements (1998)
  - Obligation to accept job not within own profession after three months of unemployment (1999)
  - Increased obligation to register as job seeker at a job centre on first day of unemployment (1999)

**Germany**
- **More rigorous availability requirements**
  - Increased duty to register as job seeker and availability requirement (Hartz I)
  - Unemployed required to accept any "reasonable job" offer, the definition of which was extended (including increased geographical mobility requirement) (Hartz I)
  - More rigorous and more flexible sanctions against unemployed not cooperating with job centre (Hartz I)

**Job activation**
- **Same right and duty to participate in job activation for cash benefit recipients as for unemployment benefit recipients (1993)**
- **Introduction of individual action plans for unemployed (1994)**
- **Right and duty to participate in training after six months for individuals under the age of 25 without vocational training (1996)**
- **Increased sanctions on refusal to accept offer of job activation (1995 and 1996)**
- **Right and duty to participate in job activation after two years of unemployment for unemployment benefit recipients over the age of 25 (1996)**

**Subsidised employment**
- **Introduction of flexible working arrangements for individuals with reduced working capacity and sheltered jobs for recipients of disability pension**
- **Introduction of older worker jobs for long-term unemployed seniors**

### Subsidised employment

**Denmark**
- **Introduction of flexible working arrangements for individuals with reduced working capacity and sheltered jobs for recipients of disability pension**
- **Introduction of older worker jobs for long-term unemployed seniors**

**Germany**
- **Subsidies for unemployed individuals who establish their own business (Ich-AG, Hartz-II)**
- **Income limit on mini jobs – subsidised jobs exempted from tax and social security contributions – raised from 325 to 400 euro, and the maximum weekly number of working hours of 15 is discontinued (Hartz II)**
- **Midi jobs are introduced – subsidised jobs paying 400-800 euro a month; the exemption from tax and social security contributions is gradually reduced (Hartz II)**

### Unemployment compensation

**Denmark**
- **Discontinuation of the right to regain entitlement for unemployment benefits by participating in job activation (1994)**

**Germany**
- **Unemployment benefits for the long-term unemployed, in particular, are reduced, due in part to the discontinuation of the intermediary rate between the unemployment benefit rate and the cash benefit rate (Hartz IV)**
### Box 2

- **Unemployment benefit period fixed at seven years (1994);** since then reduced on several occasions, most recently to two years. The so-called passive period was reduced and finally discontinued.
- **Reduced rate of unemployment benefits for unskilled workers under the age of 25 after six months of unemployment.**
- **Unemployment benefit period reduced to 12 months (from 26 months) for unemployed individuals under the age of 54 and to 18 months (from 32 months) for the 55-64-year olds (2006).**
- **ALG II for young people under the age of 25 living with their parents is reduced from the full rate (2006).**

#### Flexibility and job security

- Relaxation of terms of temporary employment, in particular for temporary staff.
- Increasingly decentralised wage formation.
- Increasingly flexible rules on where to place hours worked throughout the year.
- **Deregulation of rules on temporary staff, including discontinuation of re-employment ban and the maximum duration of employment (Hartz I).**
- **Deregulation of terms of temporary positions by for instance discontinuing limits on the extension of temporary contracts and the duration of temporary employment.** (Ongoing process since late 1990s)

#### Improvement of placement services

- Decentralisation of activation effort to regional labour market councils.
- Mandatory individual action plan for all unemployed (1994).
- **More in-depth availability assessment of cash benefit recipients (1998).**
- **Improved coordination of placement services through restructuring efforts (Hartz III).**
- Updating of job centre organisational structure.
- Definition of individual goals for each job centre, and centres are allowed greater freedom in meeting these goals.
- Individual action plans specifying offer to and duties of the unemployed in terms of job search and training.
- **Strengthening of competition between job centres by allowing unemployed persons who are not able to find work through public job centres to use private centres.** Private job centres are paid a bonus for every unemployed person they help find a job.
- Introduction of subsidies allowing temping agencies to hire jobless.

---

Reduced unemployment benefit periods
Another essential element of the Danish and German labour market reforms was reduced unemployment benefit periods. In Denmark, the rules regulating the right to regain entitlement for unemployment benefits were tightened, including by discontinuing the right to regain such entitlement by participating in a job activation scheme. This gave the unemployed an increased incentive to go from job activation to employment. In Germany, the intermediary benefits between unemployment benefits and cash benefits were discontinued, and the unemployment benefit period was reduced.

In Denmark, the monthly cash benefits payable to individuals over 25 with no duty of support amount to approximately kr. 10,000, whereas in Germany the monthly basic rate, which applies to singles without children, is approximately kr. 2,800 (374 euro) plus the cost of a suitable home and heating. The low rate explains in part why the pay-rate variation is more pronounced in Germany than in Denmark.\(^1\)

Relaxation of rules applying to temporary employees
For quite some time, the Danish labour market has been characterised by only limited job security (i.e. considerable flexibility in the right of employers to lay off employees), cf. Chart 3. The low level of job security, the high compensation rate (in particular in the case of low-paid jobs) in the event of short-term unemployment, and an active labour-market policy constitute the elements of the Danish "flexicurity" model, cf. Pedersen and Riishøj (2007).

To improve German labour-market flexibility, the rules on temporary employees were significantly relaxed by, for instance, making it easier to enter into fixed-term contracts. In addition, the limits on the extension of temporary contracts and the duration of temporary employment were discontinued. The above initiatives have resulted in significantly reduced job security for temporary employees in Germany since the late 1990s, cf. Chart 3 (right). However, the reforms did not make it easier for businesses to dismiss permanent employees. On the contrary, their job security increased, cf. Chart 3 (left). The trade unions accepted increasingly decentralised wage formation and lower wage increases\(^2\) in return for increased job security through, for instance, higher severance pay.

The widening gap between the degree of job security enjoyed by permanent and temporary employees creates a dual labour market in

---
\(^1\) Measured, e.g., by the ratio of full-time employees earning less than two thirds of the median income.  
\(^2\) A breakthrough was the so-called "Pforzheim" agreement of 2004, when the metal workers union accepted that employers were allowed to depart from the collectively agreed wages to protect future jobs and investments.
Germany. Employers are more reluctant to hire employees on permanent contracts as the cost of firing is high, and they therefore offer temporary contracts. A dual labour market increases the risk that the skills of temporary employees are not upgraded to the same extent as those of permanent employees.

**CONSEQUENCES OF THE LABOUR-MARKET REFORMS**

In Denmark and Germany, the labour-market reforms of the 1990s and 2000s, respectively, reduced structural unemployment. In Denmark, it has dropped by more than 50 per cent since the reforms were introduced, cf. Chart 1. In Germany, structural unemployment for the period 2011-15 is estimated to be approximately two percentage points below the level of 2001-05, cf. Deutsche Bundesbank (2012).

As a result of the labour-market reforms, long-term unemployment declined drastically in both countries, cf. Chart 4. In Denmark, the trend should be seen in light of the fact that with the introduction of the transitional allowance in 1992 and labour-market leave schemes in 1994 employees were offered a better opportunity to retire from the labour market. This had a short-term positive effect on unemployment, without employment rising to a similar extent. In Germany, on the other hand, the long-term unemployed found it increasingly difficult to retire from the labour force through disability pension.

The reforms also resulted in a more than 50 per cent drop in youth unemployment in both countries, cf. Chart 5. In Denmark, several of the reforms were targeted specifically at young people – the so-called youth effort. The effort included increased focus on job activation and compul-
LONG-TERM UNEMPLOYMENT

Chart 4

1,000 persons

1987 1989 1991 1993 1995 1997 1999 2001 2003 2005 2007 2009 2011

Denmark

Germany (right-hand axis)

Note: For Denmark, the number of long-term unemployed is stated as net unemployed with a degree of unemployment of more than 80 per cent in the year in question. No data are available for 1999-2000. Part of the decline in the number of individuals with a net degree of unemployment of more than 80 per cent is explained by increased use of job activation. Similar data are not available for Germany, and consequently long-term unemployment is stated as the number of individuals who have been unemployed for more than one year (according to random sample LFS unemployment). Unemployment figures are not comparable.


UNEMPLOYMENT RATE AMONG INDIVIDUALS UNDER 25

Chart 5

Per cent

Denmark

Germany (right-hand axis)

Note: The illustrated Danish youth unemployment rate is net unemployment rate, whereas for Germany questionnaire-based ILO unemployment rate is shown. The levels of the two unemployment concepts are not directly comparable. The net unemployment ratio is the sum of non-activated unemployment and cash benefit recipients ready to enter the labour market as a ratio of the labour force. 1996, 2000 and 2007 are subject to data breaks. Figures from 2007 onwards are based on own seasonal adjustment.

Source: Eurostat, Statistics Denmark and own calculations.
sory education as well as reduced transfer income for young people. Germany introduced reduced cash benefits for young unemployed people under 25 living with their parents. Prior to the reforms being introduced, retirement schemes meant that labour-market attachment among seniors was low. The reforms increased efforts to prevent seniors from dropping out of the labour market by focusing on increased use of job activation and by reducing the incentive to retire. Consequently, more seniors were included in the labour force. OECD member countries experience a positive correlation between changes in the labour force and changes in employment, cf. Chart 6. In the short term, causality may run both ways, but over a prolonged period an increase in the labour force will be reflected in increased employment, cf. Danish Economic Councils (2011).

In Denmark, the incentive for seniors to remain in the labour force was not increased until in the mid-1990s, following the introduction of the initial labour-market reforms and the drop in unemployment. The introduction of the transitional allowance for long-term unemployed between 55 and 59 in 1992, however, meant that seniors retired from the labour force, and the employment rate among 55-59-year olds fell, cf. Chart 7 (left). In 1994, the scheme was extended to include the 50-54-year olds, and in 1996 new entries into the scheme were no longer accepted. This meant an increase in the labour supply and proved a decisive factor in the employment rate of 55-59-year olds starting to rise again in 1996.
In Germany, the cash benefit period was reduced overall, also for the 55-64-year olds, and the option for unemployed individuals to receive disability pension was drastically limited. At the same time, subsidies to businesses willing to hire unemployed over 55 were introduced. In Germany, the reforms caused a dramatic rise in the employment rate of the 55-59-year olds as well as the 60-64-year olds from a level well below the OECD average, cf. Chart 7.

As a result of the German reforms, placement services were updated, making it easier for job seekers and businesses to get into contact, as

---

**Note:** Employment rates as defined by ILO.

**Source:** OECD.

---

**Beveridge Curve for Denmark and Germany**

Chart 8

---

**Note:** Because of data limitations, Danish data prior to 2010 are not available. Unemployment figures indicate national, registered degrees of unemployment. With respect to Denmark, net unemployment is used. The figures for the two countries, therefore, are not directly comparable.

**Source:** Reuters EcoWin, Eurostat and Statistics Denmark.
confirmed by the fact that the German Beveridge curve, illustrating the correlation between unemployment and the number of vacancies, fell in 2007-08, cf. Chart 8. The curve typically describes a negative slope, as a high level of unemployment means that businesses can hire labour more easily, and therefore the number of vacancies is low. Factors such as improved placement services, increased job activation efforts and reduced unemployment benefits will also cause the curve to move inwards. The Danish labour-market reforms, too, include initiatives that are expected to have caused the Beveridge curve to move inwards. This, however, cannot be illustrated by available data.

LABOUR-MARKET FLEXIBILITY AND REACTION TO THE CRISIS

Despite many similarities in the labour market reforms, there are still important structural differences between the Danish and German labour-market. One of the more significant differences is the rights of employers to lay off employees. Because of this difference, the labour markets in the two countries have reacted differently to the economic crisis. In Germany, adjustments to reduced demand for labour were reflected in reduced working hours, whereas in Denmark the level of employment declined, cf. Chart 9.

LABOUR-MARKET ADJUSTMENT SINCE THE 2ND QUARTER 2008

<table>
<thead>
<tr>
<th>Employment Index, Q2 2008 = 100</th>
<th>Working hours Index, Q2 2008 = 100</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q1 2012</td>
<td>Q2 2008</td>
</tr>
<tr>
<td>Q1 2012</td>
<td>Q1 2008</td>
</tr>
<tr>
<td>Denmark</td>
<td>Germany</td>
</tr>
</tbody>
</table>

Note: Working hours are stated as the current sum of working hours for the preceding four quarters. Employment is the number of individuals in employment.

Source: Statistics Denmark and Reuters EcoWin.
There are several reasons why adjustments in the German labour market focused on the number of working hours: It is costly to lay off employees, accumulated overtime could be taken as time in lieu, and the options for introducing reduced working hours were favourable. During the boom preceding the crisis, overtime had been accumulated because the combination of increased use of flexible working hours and a high level of job security for regular employees proved an incentive for employers to use overtime rather than take on new employees.

Furthermore, the rules applicable to the use of reduced working hours, known as "Kurzarbeit", were relaxed during the crisis (see Box 3), and compared with past economic downturns more businesses took advantage of the scheme. As close to 80 per cent of individuals engaged in "Kurzarbeit" worked in the manufacturing industry, which saw only a temporary setback, the number of working hours normalised fairly quickly after the crisis, and employment started to rise.

Generally, considerable flexibility in terms of the number of working hours is deemed positive in order to prevent unemployment in the event

<table>
<thead>
<tr>
<th>OPTIONS FOR REDUCED WORKING HOURS</th>
<th>Box 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>In Germany, the Kurzarbeit scheme offers employers the option to use reduced working hours in times of limited activity. Under the scheme, businesses experiencing limited activity can apply for permission from the job centres to reduce employee working hours. If the application is granted, the state compensates employees for the outstanding salary by covering 60-67 per cent of the lost income. The basic difference between flexitime and Kurzarbeit is that Kurzarbeit affects all the business' employees, and the decision to work reduced hours is a joint decision, usually made at the recommendation of the management. Flexitime is managed by employees on an individual basis, and working hours may vary considerably between employees. Kurzarbeit has been known in the German labour market for decades, but it became considerably more popular during the economic downturn following the financial crisis than during the recessions in 1996-97 and 2001-04, due in part to the fact that the rules regulating Kurzarbeit were relaxed during the crisis. In the past, businesses could take advantage of Kurzarbeit for up to six months with the option of a six-month extension. During the crisis, the total period was extended to 24 months. The requirements for when businesses could take advantage of Kurzarbeit were relaxed as well, and industrial corporations, in particular, were given an incentive to use the scheme as the government subsidy was raised.</td>
<td></td>
</tr>
<tr>
<td>In Denmark, the option of reduced working hours is less flexible. The work distribution scheme offers businesses an opportunity to reduce working hours for up to 13 weeks with an option of extension. Employees receive supplementary unemployment benefits as compensation for loss of income. Use of the scheme peaked in 2009, when close to 32,000 individuals received supplementary unemployment benefits for up to 13 weeks and almost 9,000 for more than 13 weeks. Subsequently, use has dropped considerably.</td>
<td></td>
</tr>
</tbody>
</table>
of negative shocks to the economy. Flexibility in terms of the number of working hours, however, tends to keep employees in the same businesses, thus adversely affecting mobility between sectors and businesses. This puts a damper on labour-market adjustment when the change in demand is of a more permanent nature. In order for a temporary reduction of working hours to be a success, therefore, demand must drop only briefly and then pick up again. This was the case in Germany, where exports declined from mid-2008 until mid-2009 and then normalised. Whether shocks to the economy are temporary or permanent is difficult to predict.

During the years leading up to the crisis, the Danish construction industry experienced a long-term boom, and then demand dropped permanently. Consequently, it seemed appropriate not to retain labour within the industry by introducing reduced working hours. At present, employment in the construction industry is at the level of the early 2000s.

Flexibility in the employers' right to lay off employees not only increases mobility between sectors. It also makes employers less reluctant to hire, as they know that they can lay off employees later. This makes it easier to join the labour market, and has a positive effect on structural unemployment. On the other hand, there will be periods of high unemployment, cf. Nellemann and Pedersen (2012).
LITERATURE

Beier, Niels Christian and Michael Sand (2005), The German labour market, Danmarks Nationalbank, Monetary Review, 2\textsuperscript{nd} Quarter.


The Economic Council (2002), Danish Economy, autumn.

The Economic Council (2007), Danish Economy, spring.

Danish Economic Councils (2011), Danish Economy, spring.


Hansen, Niels Lynggård and Erik Haller Pedersen (2003), Reasons for the upswing in 1993-94, how significant was fiscal policy?, Danmarks Nationalbank, Monetary Review, 3\textsuperscript{rd} Quarter.


Nellemann, Peter Beck and Erik Haller Pedersen (2012), Developments in the Danish labour market in recent years, Danmarks Nationalbank, Monetary Review, 2\textsuperscript{nd} Quarter, Part 1.

OECD (2012), Economic Surveys: Germany

Pedersen, Erik Haller and Johanne Dinesen Riishøj (2007), Flexicurity – The Danish labour-market model, Danmarks Nationalbank, Monetary Review, 4\textsuperscript{th} Quarter.
