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Germany's Labour Market Policies

How the Sick Man of Europe Performed a Second Economic Miracle

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Introduction: A Sick Man's Recovery

Not even two decades ago Germany was widely derided as 'the sick man of the Euro' (The Economist 1999). A 'slow-motion country' (Franz and Immerfall 2003), stagnant, and ridden by political paralysis in reforming its permanent problem (Trampusch 2003), the rigid labour market. Times have changed, and Germany has since been praised as an 'economic superstar' (Dustmann et al. 2014), a 'jobs miracle' (Krugman 2009), and a 'labour market miracle' (Burda and Hunt 2011). It has come to be held up as a 'strong reference model for other countries' and for 'effective, evidence-based policymaking' (Rinne and Zimmermann 2013: 18, 19).

How has this big change of fortune and reputation been achieved? This chapter tells the story of how the turnaround was the product of a combination of structural reforms from 2002 onwards and short-term measures in face of the global recession starting in 2008. Both sets of measures reinforced one another, as they both followed an approach of 'putting work first' (i.e. maximizing employment).

The prioritization of employment implied a paradigm shift in Germany, which had a long-standing reputation as a passive welfare state. The step change towards active and rapid integration into work as a policy priority was triggered by the so-called Hartz reforms, implemented between 2002 and 2005. Job search assistance and monitoring gained importance, whereas ineffective job creation schemes were abolished or reduced. These activation-focused reforms successfully tackled structural unemployment and increased the overall employment rate. They strengthened Germany's economic resilience during the 2008 economic crisis, though crucial in mitigating the impact of the recession on Germany's labour market were the short-time work allowance, a time-limited state subsidy, and instruments of working-time flexibility at the firm level to adjust working hours to match a decline in demand, as well as two closely spaced stimulus packages in 2008 and 2009.

The German success story is one of good reform crafting, political leadership, and astute macro-economic crisis management benefiting from the fortuitous

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circumstances in which it occurred. It is also a tale of winners and losers. The next section will discuss the substantive thrust as well as the contested nature of German labour market policies. A political assessment of the Hartz reforms classifies them as a conflicted success, one that was shaped by significant contestation between supporters and opponents and yet enjoyed broad public support and legitimacy (for the measures taken during the recession).

Assessment: A Conflicted Success

The change in German labour market policies was underpinned philosophically by the 'work first' approach that has made inroads into macro-economic theory and policy since the 1990s. The approach is defined by its overall philosophy that any job is a good job and that the best way to succeed in the labour market is to join it. Employment is both the goal and the expectation (Brown 1997). The goal to lower unemployment *and* to increase employment meant a paradigm shift in German welfare state's policy philosophy, which traditionally had been dominated by income maintenance concerns. High unemployment had long been addressed by taking surplus labour out of the labour market using early retirement schemes, and shifting the unemployed to benefits and programmes that did not conduce towards swift reintegration into the labour market (Eichhorst et al. 2006).

Programmatic Assessment

Programmatically the German labour market policies of the 2000s were a great success to the extent that they delivered on their core purpose: they significantly enhanced employment, reduced unemployment, and continued to do so even during the 2008 economic crisis. The Hartz reforms' explicit focus on integration into work increased the overall matching efficiency and the flexibility of the German labour market. By enhancing commodification, the degree to which individuals are dependent on the market for income and compensation (Esping-Andersen 1990), more unemployed took up less-paid work (Bonin 2013: 148), which resulted in smaller wage pressure during collective negotiations. Combined with a decrease in collective agreements this led to an average reduction of 2 per cent of unit labour costs in Germany between 2000 and 2007, compared with an average increase of 22 per cent amongst all other OECD countries in the same period (Dingeldey 2007; Caliendo and Hogenacker 2012; Mohr 2012). These measures resulted in a decrease of unemployment that started in 2005 and that became even more impressive when it continued following the global recession of 2008/9. Figure 15.1 highlights Germany's remarkable record when compared to that of the average of the EU fifteen states.

The reforms enabled the effective tackling of unemployment even during the worst recession in post-war history which acted as a major test for the economy's robustness (Rinne and Zimmermann 2013). Stronger incentives to work and better matching between labour demand and supply in the period before the recession were considered as one of the main reasons for the mild increase in unemployment during this time (Caliendo and Hogenacker 2012). In addition, stimulus packages, the short-time work allowance, and instruments to increase working-time flexibility proved to be successful, both from an economic and socio-political point of view (Bothfeld et al. 2012). By enabling German firms to retain skilled workers and securing individuals' on-the-job skills, these measures were in line with a work first approach. Subsequently, the positioning of German firms on a global scale recovered and Germany experienced its highest levels of employment ever (Hassel 2015), spurred on by the rising employment rates of elderly and female workers in particular (see Figure 15.2).

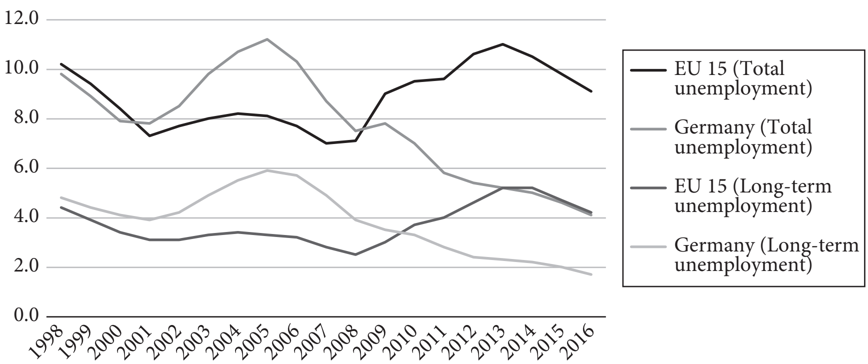

Figure 15.1 Germany's and EU unemployment rates, 1998–2016 (percentage of active population)

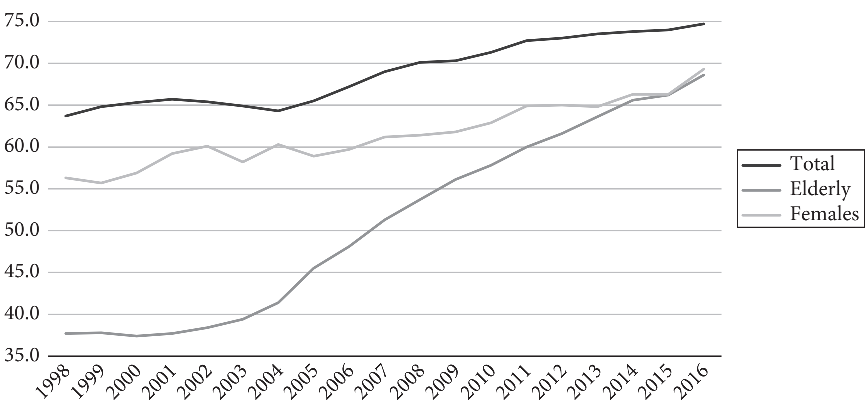

Figure 15.2 Germany's employment rates, 1998–2016 (percentage of population)

Process Assessment

In terms of process assessment, Germany's labour market policies successfully contrast the difficulty of accomplishing significant change in public policies. Historical institutionalism assumes initial choices to increase the cost of adopting once-possible alternatives; formal and informal 'veto-points' tend to lock existing policy arrangements into place and push reform agendas in the direction of incremental adjustments to existing arrangements (Pierson 2001). The processual success was to disrupt path dependency and incrementalism by circumventing stalemate in the corporatist policymaking with the convening of a commission, the Hartz Committee, to prepare a reform of the labour market. Although the restructuring of policy design processes enhanced the problem-solving capacity, it reduced procedural justice since social partnership negotiations serve the legitimization of government actions; governments especially incorporate trade unions into policymaking and implementation for their own political support (Hassel 2009).

Political Assessment

In political assessment terms, Germany's labour market reforms were not a complete but more like a 'conflicted success' (McConnell 2010). Their passage and impacts were heavily contested between supporters and opponents, particularly their goals of recalibration and cost containment in labour market policies. While business and employer associations as well as conservative and liberal parties supported the Hartz reforms, unions, social welfare organizations, leftist parties, and parts of the public criticized social cutbacks. The case suggests that unambiguous, balanced, un-muddied policy success is hard to achieve in the 'new politics of the welfare state', where restructuring 'generally requires officials to pursue unpopular policies that must withstand the scrutiny of both voters and well-entrenched networks of interest groups' (Pierson 1996: 143–4).

Not only does a trade-off between different success dimensions exist (in our case programmatic at the cost of process and political performance), but perspectives necessarily differ. Success is subjective; there is a high level of conflict over whether the policy has succeeded or failed. Depending on whether the focus is on the success resulting from specific measures such as the lowering of unemployment rates, or the failures associated with their outcomes such as a growing low-wage sector, supporters and critics portray the paradigm change initiated with the Hartz reforms as either a 'blessing' (Straubhaar 2012) or a 'misery' (Dörre 2013). The assessment differs between scholars focusing on macro-economic effects who argue that a more flexible German labour market was necessary (Krugman 2009; Straubhaar 2012; Bonin 2013) and those focusing on social impacts assessing them as a 'producer of poverty' (Butterwegge 2015) and a 'working-poor trap' (Unger 2015).

Identifying the winners and losers of the last two decades of German labour market policies is a complex task. While economy overall and employers are clearly on the winning side, labour market outsiders also benefited from measures such as job placements and counselling (made available to the unemployed without the right to claim social insurance benefits). Until 2005, the granting of active measures was according to the principle of equivalence between contributions and benefits restricted to (former) labour market participants who qualified for social insurance-based schemes (Gronbach 2012: 47–8). In the conservative welfare regime (Esping-Andersen 1990), labour market insiders benefit from such a status-preserving policy—even at the cost of higher job entry barriers for outsiders (Klenk 2012). The Hartz reforms' partial deviation from the conservative regime (Spohr 2016) placed formerly well-earning unemployed in a worse position. Germany's elaborate schemes of status-protecting income replacement were reduced to twelve months, respective eighteen months for older unemployed. However, job insiders, in particular skilled workers in the manufacturing sectors, benefited from the short-term allowance and the stimulus packages aiming at job security.

Endurance Assessment

Conflicted success is still a 'success' in the sense that policy norms and instruments survived intact (McConnell 2010: 58–61). Indeed, until now the most controversial parts of the Hartz IV law have not been terminated or substantially changed and no fundamental revision of the work first paradigm has occurred. The relative robustness of success can also be illustrated by highlighting the fact that during the economic recession, unions and employer organizations were reincorporated into policymaking to build a broad political coalition. The social partners' rapid consensus to implement the short-time work allowance is regarded as a fundamental criterion for the success of this measure, since it was embedded in other flexibility strategies at the firm level (Bogedan 2012; Eichhorst and Weishaupt 2013). So, over time, both the inclusiveness (a process component) and breadth and depth of the societal legitimacy (a political component) of German labour market policies have improved. The overall endurance of success can therefore be rated highly.

Policy Narrative: A One-Two Punch on Unemployment

Stalemate: German Labour Market Policies in the 1990s

German Labour market policies have traditionally been shaped by values and characteristics of the Bismarckian social security system. Since this model is primarily financed by contributions, it pursues an equivalence of contributions and benefits. In doing so, the German welfare state is a prime example of the conservative welfare regime, for which the preservation of social status is central (Esping-Andersen 1990). This manifested itself most clearly in its dualist system of unemployment benefits, where entitlements varied according to an applicant's previous employment record. While those without entitlement to social insurance benefits received the means-tested *Sozialhilfe* (social benefit), previously permanently employed were granted generous income-oriented benefits of long duration. For up to thirty-two months of unemployment, the contribution-based *Arbeitslosengeld* (unemployment benefit) functioned as wage substitution and was followed by the *Arbeitslosenhilfe* (unemployment assistance), an income-oriented benefit usually notably above the social benefits.

The pronounced status-preserving function of German labour market policies had four adverse consequences for the integration of the unemployed into work. First, linking unemployment benefits to the former salary set a high reservation wage, which some economists and politicians assume to dampen incentives to take up work although no empirical findings prove this lock-in effect (Bothfeld et al. 2012: 342). Second, the unemployed were only obliged to take up work matching their qualifications and experience. The principle of occupational protection defined the suitable job an unemployed had to accept as more or less adequate to the position held before. Third, policies aimed to secure employment of the contribution payer perceived as (male) breadwinner. During periods of rising unemployment, the priority was on excluding certain groups from the labour market. Early retirement schemes lowered employment rates of the elderly, and tax advantages for married sole earners acted as incentives for one spouse to not work (Heinze 2006: 53). These measures curtailed market participation of the elderly and women (see Figure 15.2). Fourth, employment promotion and labour market protection focused on (male) skilled workers. The downside of this approach is growing social inequality and labour market segmentation between regular and discontinuously occupied persons, particularly a near-permanent exclusion of low qualified labour (Bothfeld et al. 2012).

Whereas at the beginning of the 1990s unemployment was relatively low in Germany, it rose between 1991 and 1998 from 5.5 to 9.8 per cent, which was particularly concerning since the EU average level of unemployment remained constant at the same time. This relative deterioration could mainly be attributed to the consequences of the German reunification in the year 1990. The originally West German labour market regulation that was adopted after unification excluded large parts of East Germany's often low-skilled workforce, since their productivity growth lagged behind their wage growth (Heinze 2006). In this unique situation, a massive expansion of job creation schemes and short-time work were regarded as a necessity to compensate the economic losers of Germany's reunification. That attempt, however, brought no large-scale reintegration into the labour market (Heinelt and Weck 1998; Heinelt 2003).

A low employment rate in combination with high expenditures on labour market policies increased non-wage labour costs in Germany's contribution-based unemployment insurance system. High labour costs represent a competitive disadvantage in the European Common Market and act as a barrier for labour market outsiders by hampering the expansion of employment in the low-wage sector. For example, the slow growth of jobs in the service sector was considered as a reason that a large part of the population remained inactive (Heinze 2006) and may have contributed to an increase in long-term unemployment from 3.1 per cent in the year 1993 to 4.7 per cent five years later.

Concerns about the state of the labour market dominated Germany's 1998 federal election campaign. After sixteen years the coalition of Christian Democrats (CDU/CSU) and Liberals (FDP) led by Chancellor Helmut Kohl that had overseen unification was voted out of office and replaced by a coalition of Social Democrats (SPD) and the Greens. In his new government's first policy statement, Chancellor Gerhard Schröder (SPD) named the high unemployment rate the most pressing and painful problem (Schröder 1998) and promised to reduce the number of unemployed from 4.2 million to less than 3.5 million within his first term. Unemployment policy was now *Chefsache*, and the necessary reform effort would be driven by the Chancellery.

Grouped around the German Chancellery were the main advocates of work first policies who touted labour market reform as the solution to the problems of low employment, high expenditures on benefits, and the absence of incentives and assistance for the unemployed to find work (Spohr 2015, 2016). The so-called 'Blair/Schröder manifesto'—co-authored by Schröder and British Prime Minister Tony Blair, made a first attempt to set a 'new supply-side agenda for the left'. It gave priority to 'investment in human and social capital' in combination with policies according to 'the principle of rights and responsibilities going together'. Long-term unemployed were expected to reintegrate into the labour market. Additional policies to 'make work pay' for individuals and families as well as the introduction of a low-wage sector were announced (Blair and Schröder 1999).

However, the defined goals of equal opportunity, social integration, and full employment challenged the Bismarckian perception of a status-preserving welfare state. Labour market deregulation and the principle that social rights entail the duty to reintegrate into work were new at the time in Germany. Hence, the Blair/Schröder manifesto met with resistance from sections of Schröder's own Social Democratic party, the unions, and the public (Schmidt 2000; Heinelt 2003). The critics focused on preserving existing jobs through high dismissal protection and by reducing labour supply via early retirement—even though this raised entry barriers for outsiders (Klenk 2012). The size and vehemence of the backlash led Chancellor Schröder to a momentary retreat. This was part of a pattern. Particularly in Germany, where the broad middle class's sense of entitlement protects the welfare state from radical reforms

(Merkel 2001), efforts to reduce expenditure by cutting benefits or tightening eligibility can threaten broad voting blocs. The political costs of adopting radical reforms were considerable, and hence incremental, path-dependent policy evolution was the norm (Pierson 2001).

The corporatist structure of Germany's prevailing policy style formed another hurdle for deep policy change. German corporatism is characterized by large interest organizations cooperating amongst themselves and with ministers, parliamentarians, members of the civil service, and representatives of interest groups. Particularly in labour market policy, proposals for change are more often than not pre-cooked and smoothed over in negotiations between trade unions and employer groups. Public policymaking in effect becomes a function of bargaining between the social partners rather than the political programme of the government of the day. Those 'social partners' naturally only reach settlements that are to their mutual advantage (Lehmbruch 1979; Czada 2003).

Initially, Schröder's red-green coalition government relied on this established pattern of policymaking and proposed a tripartite social pact, the *Bündnis für Arbeit* (Alliance for Jobs). As part of crafting this pact, the Chancellery set up a benchmarking group to identify proposals for an enhancement of the employment rate. The group suggested to widen the low-wage sector by introducing non-tariff zones, and to strengthen the incentives to take up low-paid jobs by tightening eligibility and integrating the two types of benefit schemes for long-term unemployed (*Arbeitslosenhilfe* and *Sozialhilfe*) on a low level (Fels et al. 1999). Fearing an erosion of standard wages (Patzwaldt 2007), the unions vetoed these proposals. In general, given the social pact's goal of cost containment, the proportional interest representation of government, unions, and employers in the pact's steering committee resulted in a permanent stalemate. The social partners were simply unwilling to make concessions (Schmid 2003), revealing the institutional limitations of corporatist bargaining: despite the growing need for deep reform, none was forthcoming.

This stalemate persisted throughout the coalition's first four-year term. Although the Chancellery was aware that much more needed to be done in labour market policy, in the run-up to the 2002 federal elections no one in the coalition was willing to touch this political 'hot potato'. This confirmed Tufte's (1978) assumption that cutbacks are mostly made after elections, while before them governments are prone to implement social policies to the benefit of voters (see also Vis 2010, 2016).

A First Punch: The Hartz Reforms

In a situation where welfare state restructuring requires governments to pursue policies that are unpopular among voters and interest groups, timing is important.

At certain times, circumstances may make it much easier to get a policy adopted than at others. Such a 'window of opportunity' when change is possible (Kingdon 2003; Zahariadis 2007) opened in January 2002. Uncovered manipulated statistics in the Federal Labour Office (FLO) caused a political scandal (*Vermittlungsskandal*) and highlighted labour market policies to be ineffective. The FLO had falsified its success rate, claiming it had found work for around half of the unemployed while in fact it had only placed less than one in five of its clients into work. A subsequent investigation found that 70 per cent of employment cases were being mishandled (Gaskarth 2014: 10).

This high-profile scandal provided Chancellor Schröder with both the incentive and the momentum to momentarily circumnavigate corporatist structures and seize the initiative on labour market policy. He convened a blue-ribbon commission to prepare a reform of the FLO. The so called 'Hartz Committee' (after its chair Peter Hartz, a human resources executive at the Volkswagen AG and a well-known advocate of new employment programmes) became the key actor in the policy design process. Ostensibly coordinated by the Ministry of Labour, overall control of the Committee's work remained at the Chancellery, operating discreetly in the background (Schmid 2003).

The Hartz Committee helped to circumvent the veto-prone corporatist policy formulation. The recent scandal had delegitimized the social partners who were involved in the implementation of policies and in the administration of the FLO. Although some members of the commission were employed by the peak bodies of unions and employers, they were handpicked by the Chancellery and Peter Hartz. They were selected according to whether they took a sanguine view of free market forces, were willing to compromise, and agreed to not represent the interests of their associations. Notably, the two most important employers' organizations, the German Confederation of Employers' Associations (BDA) and Federation of German Industry (BDI), as well as the German Confederation of Trade Unions (DGB) were not included. The incorporation of technical expertise and reduced participation of interest groups enabled a more evidence-based approach to design policies that had been consistently rejected by organized interests within the *Bündnis für Arbeit*. The other side of the coin of this more constrained and top-down approach was that key stakeholders felt excluded and claimed the process lacked legitimacy.

In June 2002, Peter Hartz released interim conclusions to test the public opinion. On the wings of broadly positive responses in mass media, among economic actors and in academia, Schröder announced that the Hartz Committee's concepts would be inscribed into law, even before the commission had drawn up its full report. The final report was released six weeks before the 2002 election. Its thirteen 'innovation modules' recommended a shift towards an activating labour market policy aiming at a rapid integration into work (Kommission Moderne Dienstleistungen am Arbeitsmarkt 2002). Schröder campaigned on his commitment to the Hartz reform package, announcing if he were to be re-elected Chancellor, it would be a key component of the coalition agreement in the case of re-election. It proved to be a vote-winner: indeed, public support for the Hartz Concept contributed to what ended up as surprising electoral victory of the red-green coalition.

The decision-making process was shaped by a steering group formed to force the reforms through including Chancellor Schröder, Peter Hartz, and Wolfgang Clement, head of the new Ministry of Economics and Labour. Strategic concessions to the unions and to the conservative majority in the *Bundesrat*—Germany's upper house representing the federated states (*Länder*)—ensured the bills' unusually speedy passage (Spohr 2015: 193–4). At the same time, the reform package was carefully sequenced; those measures that were politically and technically easiest to implement were adopted first to enhance momentum and create 'quick wins' (Gaskarth 2014).

The Hartz agenda was legislated in four laws. The first and the second law came into effect on 1 January 2003. *Hartz I* introduced stricter availability criteria by redefining the concept of 'reasonable employment'. Its interpretation meant that the long-term unemployed had to accept almost any job offer regardless of their former living standards or their achieved educational status. In addition, the burden of proof determining whether a job offer was reasonable was reversed: it was no longer the employment agency making the case for the reasonableness of the job offered; instead the client had to demonstrate its unreasonableness. At the same time, *Hartz I* increased the support for vocational education and deregulated temporary work by setting up *Personal-Service-Agenturen* (staff services agencies) operating as temporary employment agencies to place unemployed with employers. *Hartz II* introduced new schemes to subsidize employment in short-term and part-time roles (*Minijobs* and *Midijobs*) with higher thresholds for taxes and social insurance payments for employees and less worker protection, as a means to encourage employers to hire more staff. A grant for entrepreneurs, known as *Ich-AG* (Me, Inc.), was introduced to encourage unemployed people to start their own businesses.

The first two Hartz laws had an ambivalent impact. Although more long-term unemployed took up work and the low-wage sector expanded as intended, temporary work, *Mini-* and *Midijobs* hardly built a bridge into regular employment (Beckmann 2019), but rather forced people into low-wage jobs, thus leading to a growing number of 'working poor'.

Hartz III came into effect on 1 January 2004 and reformed job centres according to the New Public Management philosophy to put a stronger emphasis on job search. It increased the number of employment agents significantly to improve job placement. This organizational restructuring enabled a better matching of unemployed with measures supporting job search and training. It has since come to be regarded as one of the most impactful reforms (Bonin 2013).

The most controversial element of the reforms and the main reason for the conflicted nature of its success came into effect with *Hartz IV* on 1 January 2005. The maximum duration of the insurance-based unemployment benefit (*Arbeitslosengeld I*) was reduced to eighteen months for persons older than 55 and twelve months for regular unemployed. Since then, only the short-term unemployed receive an earnings-related benefit at 60–67 per cent of their previous net income, depending on family status, and the long-term unemployed were only entitled to the tax-funded and means-tested *Arbeitslosengeld II* (*ALG II*, commonly known as *Hartz IV*), which integrated the former *Arbeitslosenhilfe* and *Sozialhilfe* into a new unemployment benefit at the level of basic social assistance. For people in this category any job offer could be deemed reasonable. *ALG II* is means-tested, including property value, which serves as an additional incentive to take up lower paid jobs before falling into long-term unemployment. Especially among the highly qualified, this contributed to a significant decline in short-term unemployment (Clauss and Schnabel 2008).

Hartz IV became the symbol for the break with the principles of the Bismarckian 'social insurance state'. While the Christian-Democratic and Liberal opposition parties and employers supported the reforms, trade unions and welfare organizations protested against cuts in unemployment benefits. Opposition was strongest in East Germany where the long-term unemployed had been entitled to relatively high and unlimited earnings-related benefits, a legacy of GDR-era full employment policies. The flat-rate benefit *ALG II* was perceived as a severe loss of entitlement (Eichhorst et al. 2006). Voter discontent with the Hartz reforms eventually resulted in a significant decline in political support for the Social Democrats and in the autumn of 2005 the red-green government was defeated in general elections.

The period following the passage and implementation of the *Hartz I–IV* laws was characterized by ongoing programme evaluation as well as abortive attempts to wind back certain measures. In 2007, the so-called 'grand coalition' of Christian Democrats and Social Democrats led by Chancellor Angela Merkel extended the maximum duration of the insurance-based *Arbeitslosengeld I* for the elderly up to twenty-four months. Although the government justified the move as a necessary correction in the interest of social justice, it also reconfirmed its commitment to the work first approach by introducing wage subsidies of up to 50 per cent and one-year grace periods for firms hiring unemployed of over 50 years of age.

Effective programme evaluation underpinned periodic fine-tuning of the reforms. The Labour Market Instruments Reorientation Act (*Gesetz zur Neuausrichtung der arbeitsmarktpolitischen Instrumente*) of 21 December 2008 reduced the range of policy instruments and made them more manageable for employment agencies. Job creation and rotation schemes that had had little impact were terminated; other measures that had shown potential were reinforced. Successful instruments for temporary work, activation and job placement were merged in a single measure (*Maßnahmen zur Aktivierung und beruflichen Eingliederung*, § 45 SGB III). A new budget for job search assistance (§ 45 SGB III) was introduced, uniting existing support to take up vocational training or work (Oschmiansky and Ebach 2012; Rinne and Zimmermann 2013).

A Second Punch: Tackling Recession

Following the Hartz reforms the German labour market made impressive progress in reducing unemployment. Long-term unemployment decreased whereas employment of elderly workers increased (as shown in Figures 15.1 and 15.2). Low-skilled labour became more productive. These developments put the economy into a relatively strong position when in late 2008 the crisis hit the country (Rinne and Zimmermann 2012). The 'Great Recession' of 2008–9 was the worst global recession since the 'Great Depression' in the 1930s. It caused a general economic decline, particularly in North America and Europe, and changed the context of German labour market policies. The first consequences became visible in Germany's main economic pillars: exports and manufacturing. At the end of 2008, order volumes in the metal and the chemical industry declined dramatically by 35 and 20 per cent respectively (Haipeter 2012: 392–3) and posed a threat to Germany's fledgling economic recovery.

The government reacted in November 2008 with a relatively modest stimulus package of 11.8 billion euros. It included tax reliefs for firms and private households to stabilize consumption and an extension of the short-time work allowance (*Kurzarbeitergeld*) from twelve to initially eighteen months. The short-time work allowance is a time-limited state subsidy from the Federal Employment Agency to adjust working hours due to a cyclical decline in demand. Its extension was appreciated by employers as well as unions, since it had proven to be effective in past crises. Given the speed and depth of the global economic downturn, unions demanded another stimulus package just weeks after the first one was announced. They suggested a scrapping bonus for old passenger cars to stimulate consumers to buy new ones (Brenke 2010; Eichhorst and Weishaupt 2013).

In December 2008, a crisis summit was held to stem the tide. For the first time in years the government resurrected the corporatist scenario and invited top officials from employers' associations and unions as well as senior corporate leaders to the Chancellery. This *Konjunkturgipfel* was designed to incorporate the social partners in the policy design, but stopped short of trying to revive old-style social pacts as an institutionalized pattern of policymaking. No mutual commitments or regular consultations ensued from the summit (Rehder 2009: 270; Haipeter 2012). The main purpose of the summit was to orchestrate a show of unity and dramatize that the crisis was being managed responsibly.

At the peak of the crisis, unions and employer associations formed an alliance of convenience to achieve a superordinate goal: maintain Germany's industrial strength while securing employment. The global recession mainly affected Germany's export-oriented manufacturing sector, where skilled labour in the best-managed and successful companies had become increasingly scarce. Against the broader background of population ageing and expected future shortages of skilled labour, firms had a strong interest in retaining their qualified workforce even while exports were momentarily falling. This aligned with the unions' lobbying for measures to secure employment and to stimulate demand while riding out the crisis (Haipeter 2012: 391–3; Rinne and Zimmermann 2012).

Capitalizing on this convergence, in January 2009 the government launched a second stimulus package, worth 50 billion euros. It encompassed public investment in education, training, and infrastructure. The duration of the short-time work allowance was expanded to twenty-four months and restructured with the Federal Employment Agency footing half of the social insurance contributions bill. In addition, a car allowance rebate system (*Abwrackprämie*, 'cash for clunkers') subsidized the acquisition of new cars, supporting car manufacturers on a global scale with a particular focus on the protection of skilled workers in export-oriented industries. This measure alone is estimated to have saved at least 20,000 jobs (Eichhorst and Weishaupt 2013: 321–2; Hassel 2015: 119).

However, the crucial labour market policy in mitigating the recession's impact was short-term employment, a policy that had been used immediately after German reunification to curb rising unemployment (Heinelt and Weck 1998; Schmid 2017). Its theory was that keeping people in jobs contributes to the maintenance of skills, because a longer time in unemployment devalues human capital. The same logic was applied in 2009. To improve employees' employability, the short-time work allowance was constructed in a way that costs for firms were lowest when short-term employment was combined with qualification measures (Bogedan 2012). At its peak, 1.14 million workers were protected from unemployment through the scheme, mostly in the manufacturing sector (Seeleib-Kaiser 2015: 192).

German firms also did their share of the work, which proved crucial to Germany's exceptional labour market performance during the economic crisis. They chose to keep rather than shed labour. Drawing on a suite of flexible labour market instruments that had evolved incrementally over the past thirty years, firms had some margin for manoeuvre in using internal flexibility to protect their investment in skilled workers (Caliendo and Hogenacker 2012: 13; Reisenbichler and Morgan 2012). Accordingly, at the peak of the crisis, in May 2009, nearly one million workers in the metal industry (more than one in four) were in short-term employment (Haipeter 2012: 399).

The short-time work allowance and the instruments of working-time flexibility are estimated to have preserved between 600,000 (Brenke 2010: 45; Eichhorst and Weishaupt 2013: 322) and 1.2 million jobs (Haipeteter 2012: 401). From the employees' perspective, these measures helped them keep their jobs. From the firms' perspective, it had a long-term positive effect on unit labour costs. With demand bouncing back by 2010, German firms were in a great position to step in, and the German economy experienced the highest employment levels ever (Hassel 2015: 120–1).

Conclusions: Lessons, and Challenges

What broader insights and lessons emerge from the German experience in labour market policy? It should be acknowledged that policy mixes like the Hartz reforms—activating the unemployed, improving their employability, and making low-skilled labour productive—had already been implemented quite successfully in social democratic Scandinavian welfare states such as Denmark and Sweden as well as in liberal Anglo-Saxon systems such as the United Kingdom and the United States since the 1980s. Clearly, these work first measures have proved to be transferable across different economic contexts, and for that reason both the European Employment Strategy and the OECD Jobs Strategy promote them.

The second part of the German success story—its measures taken during the economic crisis—is more contingent upon its pre-existing economic model (Hassel 2015). This limits how broadly this strategy can be applied to other countries where conditions such as an export-oriented economy and a system of industrial relations that prioritizes job security over wage increases do not apply. Tariff policies regulations taken by the social partners before the crisis enabled firms to keep their workforce, but such options for a collective reduction or redistribution of work time do not exist in many other countries. In addition, it is doubtful whether securing jobs through a flexible management of working time would have proved sustainable and effective had the crisis not been cut short by the export-driven upswing since the second half of the year 2009. Thus, astute macro-economic crisis management went hand in hand with considerable luck, which cannot be replicated (Haipeter 2012: 402; Knuth 2015).

Despite these limitations in generalizing this case as a blueprint for labour market policy success, four lessons might be drawn for policy design, political management, and policy leadership. The first lesson is to implement a policy idea, not an ideological dogma. Neither 'austerity' nor 'deregulation' has been at the centre of the reforms. Actually, money spent on labour market policies has not been reduced but redistributed from passive benefits to job seeker services and activating measures for the unemployed and other target groups (Spohr 2015: 200). The deregulatory component of the Hartz reforms (e.g. the cutting of dismissal protection) was modest and was not essential to their success. Indeed, the Hartz reforms have mostly been about bringing people into real work rather than keeping them on benefits or occupied in public employment and training programmes. The same goes for 'austerity' measures: there were no spending cuts for their own sake, but rather adjustments and consolidation of previous spending levels (Rinne and Zimmermann 2013; Knuth 2015). At the same time, there was purposeful, growth-oriented public investment. Even though economic liberals warned against repetition of the failures of a Keynesian policy when the first calls for stimulus packages occurred (e.g. Straubhaar et al. 2009), the German government successfully implemented a 'virtually Keynesian employment policy' (Schmid 2017: 14) in line with its Hartz-led work first approach. Its crisis measures were generally short-term, closely monitored, and included education and training. The use of public resources to foster growth was successful because it was combined with structural labour market reforms.

A second lesson is that flexible adjustment of the policy instrument mix makes an important contribution to reaching the overall policy objectives (Sabatier and Weible 2007). Ongoing programme evaluation provided early warning of ineffective policy instruments, which were then duly terminated, reduced in scope, or eclipsed by shifting the weight of the effort towards other instruments (Rinne and Zimmermann 2013: 17–19). It was of fundamental importance for Germany's labour market success to adjust instruments to changing circumstances and new information once the new paradigm was put into practice. As Chancellor Schröder had observed early on, 'trial and error is an important principle here. It seems to become even more important when we see how complex these industrialized societies are these days' (Fröhlich 2000: 140). This gave licence to a preparedness to correct even recently implemented measures. Today, hardly any of the instruments introduced with *Hartz I* and *Hartz II* are being applied, as Germany's economic circumstances have changed.

Third, to secure success over time a 'strategic centre' with a stable guiding coalition of key actors is important (Rüb et al. 2009). The modernist faction of the red-green coalition grouped around the German Chancellery acted as a policy entrepreneur (Kingdon 2003; Zahariadis 2007), advocating work first policies as solutions for the problems of the German labour market of the late 1990s. After the *Vermittlungsskandal* opened a window of opportunity to set a work first agenda, it began to act as a strategic centre steering the policy vision towards realization. Policy continuity was enhanced in the switchover to the grand coalition following the 2007 elections by the SPD holding on to the labour market portfolio. Olaf Scholz, who as the Social Democrats' secretary general had campaigned for the Hartz reforms, became minister of labour and social affairs. He acted as the main driver of prolonging the short-term employment allowance and setting up the car allowance rebate scheme. Acting in tandem with Frank-Walter Steinmeier, who had risen from head of the Chancellery under Schröder to deputy-chancellor in Merkel's grand coalition government, Scholz imposed the stimulus packages, deftly sidestepping concerns from parts of Merkel's CDU/CSU, the senior coalition partner.

Fourth, strategic sequencing of processes is an important precondition for introducing reforms in difficult structural and institutional contexts. Dismantling the corporatist structures had to take place before the 'adhocratic' structure of the Hartz Committee could gain the weight that it did. Unusually in German politics, the composition of the Hartz Committee was not about inclusion and consensus but about expertise and a will to compromise—a logic of selecting players in collaborative problem-solving efforts that is more conducive to policy innovation (Crosby et al. 2017). Once the work first paradigm was enshrined in the Hartz reform laws, it became important to reincorporate the social partners to enhance the legitimacy of the new policies and to ensure their effective implementation. Furthermore, Germany's job miracle also resulted from the timely reactivation of old corporatist practices and virtues during the economic recession (Haipeter 2012). The broad alignment of labour and capital that was forged in 2008–9 helped to avert a labour market crisis through rapid consensus to implement the short-time work allowance (Bogedan 2012: 139; Eichhorst and Weishaupt 2013: 313).

Can the German success continue? We should not forget that the case portrayed here has been a conflicted success. Even to date, there is no societal consensus on the core objectives of labour market policies, and there is a widespread sense of injustice. The new normal of basic income support and the duty to reintegrate into *any* work jars with long-held normative principles of status preservation and contribution-equivalence in the German welfare state. The silent shift in values implicit in the Hartz reforms was never satisfactorily legitimized (Eichhorst et al. 2006; Bothfeld et al. 2012). Today, more than five million German workers are in precarious jobs. Temporary work—Mini- and Midijobs—and the subsidizing of low wages with social benefits have contributed to one of the world's fastest growing low-wage sectors. It has proven to be a working poor trap (Unger 2015), and the jury is still out on the effectiveness of subsequent compensatory measures—such as the introduction of a statutory minimum wage (Knuth 2015).

A further challenge over the next decades lies in the potential clash between technological change demanding a large supply of workers with new skill sets and the ageing of the German population which will reduce overall labour supply substantially (Caliendo and Hogenacker 2012). Hence, German labour market policies need to further improve general qualification and employability of the workforce, also regarding the medium- and long-term impacts of the demographic 'jolt' resulting from the 2015–16 refugee inflows, which present yet another major contingency testing the robustness of Germany's labour market policies. The Hartz reforms focused primarily on job integration and the stimulus packages during the economic crisis preserved and enhanced the skills of workers already employed. Labour market access is a necessary but not sufficient condition for social integration (Bothfeld et al. 2012: 343). Sustained investment in human-capital oriented policies will be needed to keep the former sick man healthy in future, and to lift the prospects of the hard core of two million unemployed whose predicament continues to cast a shadow over the German job miracle.

Additional version of this case

The case study outlined in this chapter is accompanied by a corresponding case study from the Centre for Public Impact's (CPI) Public Impact Observatory—an international repository of public policies assessed for their impact using CPI's Public Impact Fundamentals framework. CPI's framework provides a way for those who work in or with government to assess public policies, to understand why they were successful, so key lessons can be drawn out for future policy work. The case can be easily located in the CPI repository at www.centreforpublicimpact.org/observatory.

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