TCO GRANSKAR #6/15

Flawed Role Model?

The Economic Performance of Germany and Sweden

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Content

Sammanfattning på svenska

Tysklands arbetsmarknadspolitik målas allt oftare upp som en förebild för Sverige och andra europeiska länder att följa efter. Men hur framgångsrik har egentligen den tyska modellen varit? Går det att tala om ett tyskt sysselsättningsunder?

Sverige har traditionellt haft både lägre arbetslöshet och högre sysselsättningsgrad än Tyskland. Det senaste decenniet har den bilden förändrats. Arbetslösheten i Tyskland är idag lägre än i Sverige och sysselsättningsgraden är på nästan samma nivå i de båda länderna.

Denna studie visar emellertid att det finns en rad skäl som talar för att Sverige inte ska följa det tyska exemplet. Den ekonomiska utvecklingen i Tyskland under perioden 1995-2013 var betydligt sämre än den i Sverige, med lägre tillväxt i BNP och produktivitet, konsumtion och investeringar. Tvärtemot den gängse uppfattningen var också utvecklingen på den tyska arbetsmarknaden betydligt svagare än den i Sverige.

Det var framför allt lönebildningen där Tyskland skiljde från Sverige. I Sverige har lönerna de senaste decennierna ökat i god takt, både nominellt och realt. I Tyskland stagnerade löneutvecklingen under samma tid och en omfattande låglönemarknad växte fram. Tyskland har idag den kanske högsta andelen arbetande fattiga i Europa.

Den tyska lönemoderationspolitiken har inte heller inneburit några nya jobb. Antalet arbetade timmar minskade i Tyskland under åren 1995-2013 medan de ökade med 12 procent i Sverige. Även i tjänstesektorerna, som detaljhandel, hotell och restaurang och transport, minskade arbetade timmar i Tyskland medan de ökade i Sverige. Att antalet sysselsatta trots allt steg i Tyskland förklaras av stadigt minskande medelarbetstid. Man delade helt enkelt på jobben. Tyskland har idag den lägsta medelarbetstiden i hela OECD-området

Den svaga reallöneutvecklingen i Tyskland lade en våt filt över den inhemska efterfrågan. Hushållens disponibla inkomst och konsumtion stagnerade. Stigande vinstandelar i näringslivet ledde inte heller till ökade investeringar. Tvärtom har investeringsutvecklingen varit mycket svag i Tyskland under hela perioden.

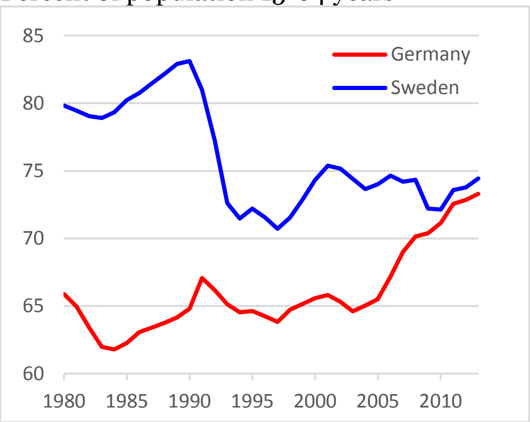
Slutsatsen blir därför att det inte går att tala om ett tyskt sysselsättningsunder. Nedgången i den tyska arbetslösheten förklaras främst av att befolkningen i arbetsför ålder har fallit, medelarbetstiden minskat och allt fler delar på allt färre jobb.

Introduction

The Swedish labour market has historically had a better track record than that of Germany. The employment ratio of the working age population has persistently been higher in Sweden and for extended periods substantially so. In 1990, the employment ratio was 83 percent in Sweden while it was 64 percent in Germany. The difference narrowed considerably after the crisis in the 1990's but remained stable at 8-10 percentage points in the early 2000's. Unemployment was also normally higher in Germany than in Sweden, with the exception of a few years in the 1990's.

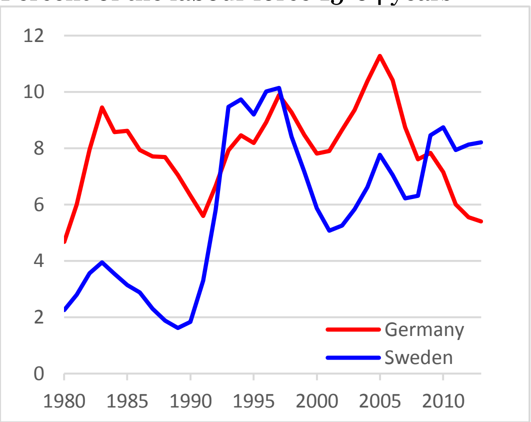
This picture has however changed dramatically in the years after 2005. The employment ratio in Sweden appeared stagnant around 74 percent while it surged in Germany (see figure 1). By 2013, the difference between the countries had fallen to a mere percentage point. Swedish unemployment likewise appeared to trend upwards during these years, while it plummeted in Germany. By 2013, unemployment seemed stuck around 8 percent in Sweden while it had fallen to almost 5 percent in Germany (see figure 2).

Figure 1. Employment ratio
Percent of population 15-64 years



Source: Labour Force Survey, OECD

Figure 2. Unemployment rate
Percent of the labour force 15-64 years



Source: Labour Force Survey, OECD

There is a statistical break in the German series due to the reunification in 1991.

This rather dramatic change in the relative performance of the labour markets of the two countries has by some observers been attributed to the German labour market reforms, known as the **Hartz reforms**, implemented in Germany in 2003-2005. Germany was hailed in wide circles, both domestically and internationally, as a new role model for labour market reforms. Rinne and Zimmermann described Germany as the "North Star" of labor market policy, Dustmann et al. called it an "Economic Superstar" while Schneider and Graef spoke of a "Jobs Miracle".[1]

A closer look at the relative performance of the German and Swedish economies and labour markets, however, casts serious doubts about this conclusion. The German unemployment rate did not fall because of an increase of demand for labour, as a result of wage moderation induced by the labour

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[1] Rinne, Ulf and Klaus F. Zimmermann (2013), "*Is Germany the North Star of Labor Market Policy*?", IZA Discussion Paper No. 7260, March 2013
Dustmann, Fitzenberger, Schönberg and Spitz-Oener (2014), "*From Sick Man of Europe to Economic Superstar: Germany's Resurgent Economy*", Journal of Economic Perspectives-Volume 28, Number 1
Schneider, Stefan and Bernhard Graef (2010), "*Germany's jobs miracle: Short-time work, flexible labour contracts and healthy companies*", Deutsche Bank Research, April 27, 2010

market reforms. On the contrary, *hours worked* fell in Germany (although only marginally so) 1995-2013 while it increased substantially in Sweden. In terms of hours worked, the performance of the German labour market was among the weakest of all OECD countries during this period.[2]

Thus, the German “jobs miracle” in reality created no jobs.[3] Hours worked fell even in the German service sectors, while they increased in Sweden.[4]

German unemployment fell primarily because of a significant reduction in *average hours worked per employee* and a dwindling working age population. While the reduction in working hours made sense during the financial crisis 2008-10, this has been a long-standing feature of the German economy.

In neither of these two respects does the German model appear to be a role model to be followed by Sweden or any other country. Contrary to the views expressed by most Swedish economists, the German experience shows that a reduction of working time and “jobs sharing can indeed reduce unemployment. It is, however, the view of this writer that such a policy would be very detrimental to the Swedish welfare society. Without a continued increase in hours worked in the total economy, the scale of the public sector social commitments would have to be reduced.

Apart from exports, the Swedish economy outperformed the German economy in virtually every single aspect. The growth rate of Swedish GDP, productivity and hours worked outpaced Germany by a wide margin. Swedish private consumption and investments increased faster.

Labour market reforms

Germany

Unemployment in Germany increased almost continually from early 1970’s until the mid - 2000’s. A sudden reversal in the unemployment trend followed the implementation of the *Hartz labour market reforms,* carried out between 2002 and 2005. These reforms, however, were generally less fundamental than is often assumed.

The Hartz I and Hartz II reforms were implemented in 2003 and aimed at reducing labour costs through wage subsidies. Social security contributions were eliminated for so-called *Mini-jobs*, paying up to 400 euro per month, and reduced for Midi-jobs, paying between 400 and 800 euro per month. Previously strict rules on temporary employment were deregulated. The *Hartz III* implemented in 2004, involved reforms of the Federal Employment Office, with increased emphasis on activation and matching.

The fourth Hartz reform encompassed an overhaul of the unemployment benefit system, reducing the maximum period of income insurance to 12 month (24 months for people over the age of 50). After the income-dependent benefits expire, the unemployed are referred to means-tested “unemployment assistance” which has been merged with the general social security system. Long-term unemployed could now also be obliged to accept “1 euro-jobs”, jobs earning 1 euro per hour on top of unemployment assistance.

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[2] Hours worked fell even more in Japan, Portugal, Czech Republic, Denmark, Korea and Greece.
[3] Knuth (2014), Matthias, *Labour market reforms and the "jobs miracle" in Germany*, European Economic and Social Committee
[4] Sectors G-I (trade, accommodation, food services and transportation)

Sweden

Labour market reforms were implemented in Sweden after the crisis in the 1990's. Restrictions on temporary employment contracts were substantially eased. Unemployment benefits were reduced, both as a result of a cut in the *nominal* replacement ratio from 90 to 75 percent (later reverted to 80 percent) and by a freeze the maximum benefit ceiling, previously indexed to manufacturing workers wages. Since 1993 the ceiling has only been raised once (2002) leading to a substantial erosion over time of the *effective* replacement ratio.[5]

When the four non-socialist parties forming the coalition called the "Alliance" won the parliamentary elections in 2006, a comprehensive reform package was quickly adopted, under the catchphrase "it must pay to work". The reforms were based on the conclusion that the main problem on the Swedish labour market was that the incentives to take up jobs were too weak.

Tax reductions on working incomes were introduced that explicitly excluded taxable benefits, such as unemployment and sickness benefits and old age pensions. The reform was carried through in four steps and contributed to a significant increase in household disposable income.

Unemployment benefits were further cut and eligibility rules were made stricter. The employees' contributions to the financing of the unemployment benefit funds were sharply increased (sometimes by hundreds of percent) and were differentiated between sectors, according to the unemployment rate prevailing in each sector. Unemployment benefits had previously largely been financed by social security contributions.

One perhaps unintended effect of the dramatic increase in employees' contributions to unemployment funds, was that half a million members opted out of the insurance scheme. About 200 000 union members chose to leave the unions during the same period.

The implicit but only rarely explicitly formulated idea was that the measures would create a down-ward pressure on the wage level, especially at the lower end of the wage scale. This thinking was based on a faulty understanding of the Swedish wage formation model.

Although Swedish wage agreements are formally fragmented into hundreds of different sectors and professions, in practice they have been highly coordinated since the late 1990's, both by unions and employers' organisations. Most wage agreements thus continued to adhere to the nation-wide benchmark wage increases, agreed to by the manufacturing sector social partners. A low wage sector similar to that of Germany has therefore not developed in Sweden.

Various forms of subsidized employment were also introduced in Sweden, while regular labour market programs were cut back. Income tax deductions on domestic services introduced a very substantial subsidy of labour costs in this sector. Employers hiring long term unemployed or recent immigrants received substantial subsidies (so-called "New-start-jobs"). Reductions of social security contributions for all young employees (below 26 years of age) reduced labour costs by 12 percent. The VAT rate for restaurants was reduced from 25 percent to 12 percent, as an incentive to promote job creation in this sector.

Unemployment benefits

Comparing replacement rates across countries is difficult due to intricate interactions of eligibility rules, nominal replacement rates, benefit ceilings and durations, as well as the existence of complimentary systems of social and housing benefits.

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[5] The Swedish Social democratic – Green Party government has included an increase in the unemployment benefit ceiling in the 2016 budget bill to be decided by parliament in December, 2015.

According to an IMF study, the Hartz reform was estimated to have had almost no effect on net replacement rates for the short-term unemployed (up to a year) but reduced those for the long-term unemployed from 57 percent to 46 percent on average.[6]

The change in the Swedish unemployment benefit system was substantially more fundamental. The effective after-tax replacement ratio for middle income earners was reduced from 90 percent in 1990 to less than 50 percent in 2012. By that time, only wage earners at the lower end of the income distribution would receive the stipulated nominal replacement rate of 80 percent.

According to a European Commission estimate, the replacement ratio of Germany and Sweden was roughly equal in 2010 (68 percent in Sweden and 66 percent in Germany). This estimate was based on calculations on synthetic typical households and included full take-up of housing and other social security benefits.[7]

The coverage of the unemployment benefit systems, however, differed greatly between the two countries. In Sweden only 35 percent of the unemployed received unemployment benefits in 2010 while 84 percent of the German unemployed did so.[8] The dramatic fall in the coverage of the Swedish unemployment benefit system can only partially be traced back to changes in policy.

Employment protection legislation

Employment protection legislation remained very similar throughout the period in Germany and Sweden. Both countries moved from comparatively strict rules on **temporary employment** in the 1980's to below OECD average in the 2000's but the exact timing of the reforms differed somewhat (see figure 4). According to the OECD *Index of Employment Protection Legislation,* regulations on **regular employment contracts** remained quite strict in both countries. In Germany, rules were made somewhat stricter while they were marginally relaxed in Sweden (see figure 3).

Figure 3. Employment Protection Legislation – regular contracts

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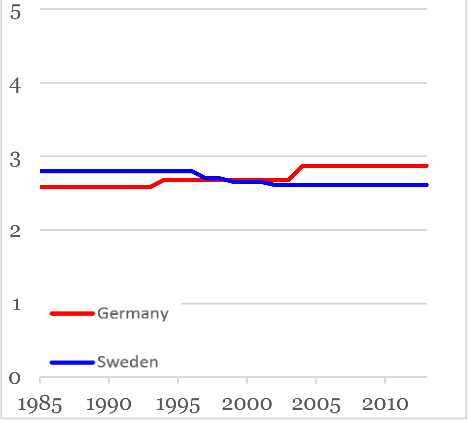

Source: OECD

Figure 4. Employment Protection Legislation - temporary employment

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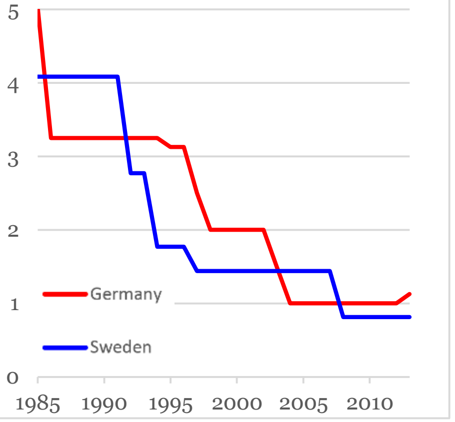

Source: OECD

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[6] Krebs, Tom and Martin Scheffel (2013), "*Macroeconomic Evaluation of Labor Market Reform in Germany*", International Monetary Fund, IMF working paper WP/13/42
[7] EU Commission (2014), "Employment and Social Developments in Europe 2013", table 2, p. 137
[8] EU Commission (2014), Table 2, p. 137

There has been several studies evaluating the effects of the Hartz reforms on the performance of the German labour market. For an overview of this literature, see chapter 6 in Fichtl (2015).[9] The evidence collected so far seems to indicate a rather mixed picture. It is, however, the view of this writer that the German labour market reforms were not radically different from similar reforms in Sweden and thus cannot explain the different economic development of the two countries.

Wage development and industrial relations

The most striking difference between Sweden and Germany in the past two decades has been in wage development. In Germany real wages measured as compensation per employee did not grow at all in spite of a positive productivity trend. In Sweden real wages generally followed productivity.

German wage moderation did not start with the Hartz reforms or even with German reunification. In fact, low wage and consumer price inflation has been a regular feature of German post-world war experience. All through the Bretton-Woods system, the "currency snake" and the European Exchange Rate Mechanism (ERM), Germany repeatedly had to revalue its currency due to lower domestic inflation, than that of other participating countries. Sweden was until early 1990's, a polar case, with higher domestic inflation and repeated currency devaluations.

Germany accumulated a modest current account deficit in the years after the reunification. This fuelled claims that the conversion Deutsche mark exchange rate to the euro had been set too high, putting German industry at a competitive disadvantage. There was therefore a widespread understanding in German society, even among unions, that German wages were too high and had to come down relative to the other euro countries.[10]

The German current account deficit quickly turned into a growing surplus, thereby creating deficits in several other euro-countries. This macro-economic imbalance in turn was one of the main factors leading to the euro crisis 2011.

There were also geopolitical dimensions to German wage moderation. The German social-democratic government apparently identified a significant political opportunity with the introduction of the euro. Lower relative labour costs would enhance the competitive position of German industry, create a current account surplus that could not be revalued away and thus enhance Germany's political influence within the European Union.[11]

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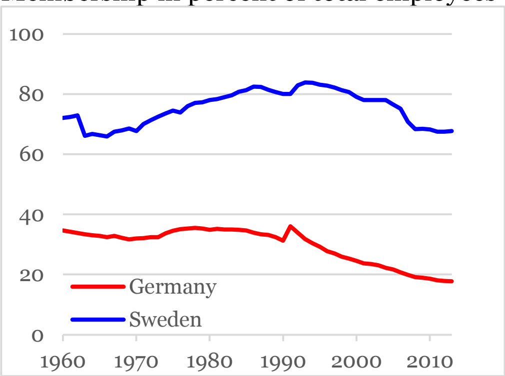
[9] Fichtl (2015), "Mini- and Midi-Jobs in Germany", FORES Policy Papers 2015:3

[10] See for example Gumbrell-McCormick and Hyman (2015), "*International Trade Union Solidarity and the Impact of the Crisis*", EUROPEAN POLICY ANALYSIS 2015:1 Swedish Institute for European Policy Studies

[11] "Schroeder… predicted in early 1998 — a year before the euro was born — that Germany's industrial and economic dominance in Europe would increase because Germany's inflation rate would be lower than other European countries, which would no longer be able to devalue become of their adherence to EMU, leading to a big improvement in German competitiveness and industrial strength. That is exactly what has happened…Schröder writes in his book that Germany has a special obligation to strengthen the single currency because it has "reinforced Germany's dominance — contrary to the intentions of [former French President François] Mitterrand"",
David Marsh, "*Once a skeptic, Schroeder says Germany needs the euro*", Market Watch, Feb 17, 2014

Figure 5. Trade union density

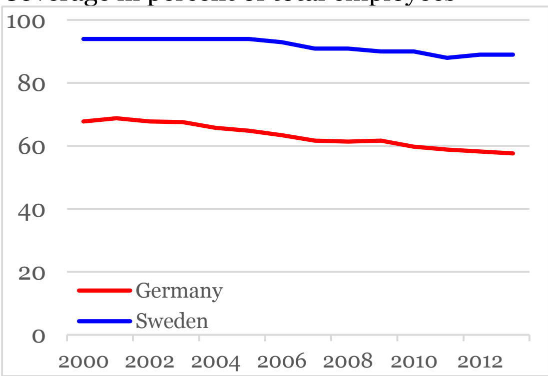
Membership in percent of total employees



Source: OECD

Figure 6. Collective bargaining agreements coverage

Coverage in percent of total employees



Source: ILO

No doubt, the labour market reforms introduced by the German government played an important role for German wage formation. The Hartz reforms explicitly aimed at promoting the growth of the already substantial low wage sector in the country.[12]

The perhaps most important reason why German wages have been growing so slowly in the past 20 years has been a general weakening of the German trade union movement and a gradual erosion of collective bargaining system.

Collective bargaining was undermined both by a steady fall in the coverage of collective agreements and the widespread introduction and use of "opening clauses" at the firm level. These clauses enabled local agreements, which undercut sector agreements. Wage drift was generally negative during this period. This has been true especially in eastern Germany and in the growing low wage service sector. Collective bargaining was also undermined in the manufacturing industry, by fragmentation through out-sourcing and widespread use of temporary agency workers.[13]

Another striking difference between the two countries was the steady growth of a low wage sector in the German labour markets, with no comparable development in Sweden. Wage inequality certainly increased in Sweden as well during this period. The basic principles of Swedish wage formation, however, survived the crisis of the 1990's and was actually reinforced with the *Manufacturing agreement* of 1997. The wage increases negotiated in the manufacturing sector are used as a benchmark in all sectors of the economy and is jealously defended by both employers' organizations and unions.

The statutory minimum wage introduced in Germany in 2015 was set at euro 8.50. Sweden has no statutory minimum wage but only collectively negotiated sectoral minimum wages.[14] The lowest agreed minimum wages in Sweden at the time was euro 13.33. According to somewhat shaky calculations made by *Eurofound* 24 percent of all Germans earned less than 60 percent of the median wage while only 7 percent of Swedes did this.[15]

[12] Gerhard Schroeder, "*Agenda 2010 - The Key to Germany's Economic Success*", Social Europe, 23/04/2012
[13] Bispinck and Dribbusch (2011), "Collective bargaining, decentralisation and crisis management in the German metalworking industries since 1990", WSI Discussionpaper No. 177
[14] Schulten, Müller and Eldring, "Chapter 10 - Prospects and obstacles of a European minimum wage policy", in Van Gyes and Schulten (2015), *Wage bargaining under the new European Economic Governance*, figure 3.
[15] Schulten, Müller and Eldring (2015), figure 6.

Macro-economic developments

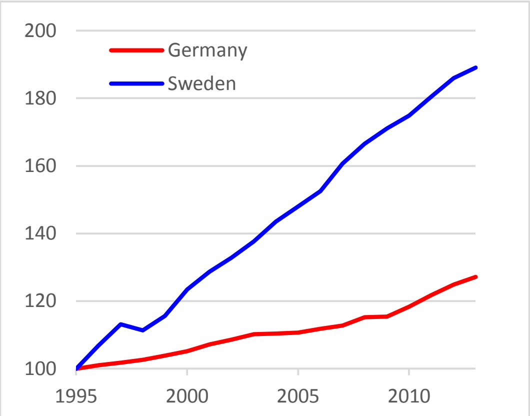
Wage growth

Although very different in size, the German and Swedish economies share several important characteristics. They are both highly competitive export-oriented economies. Both countries experienced serious economic problems in the 1990's, resulting in high unemployment. In the German case, it was connected to the unification in 1991. In Sweden, it was the currency and banking crises in the early 1990's. Both countries experienced deep recessions followed by slow and protracted recovery accompanied by labour market reforms.

Gross Domestic Product per capita in purchasing power parity terms has been on similar levels in the two countries, around USD 42 000 in 2013. Sweden has gradually improved its relative position from 8 percent below that of Germany in 1995 to 2 percent above in 2013.

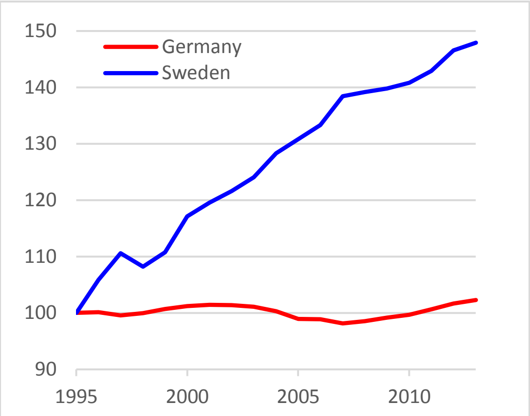
The two economies however differed dramatically in one very important aspect. Wages increased much faster and more equally in Sweden than in Germany. Since 1995 the nominal compensation per employee has grown by more than 89 percent in Sweden, while in Germany it has only grown by 27 percent (see figure 7). In real terms the difference between the two countries was even more striking. Deflated by the consumption expenditure deflator, real wages have grown by 48 percent in Sweden, but only by 2 percent in Germany (see figure 8).

Figure 7. Compensation per employee
Nominal, index, 1995 = 100



Source: OECD

Figure 8. Compensation per employee
Real, index, 1995 = 100

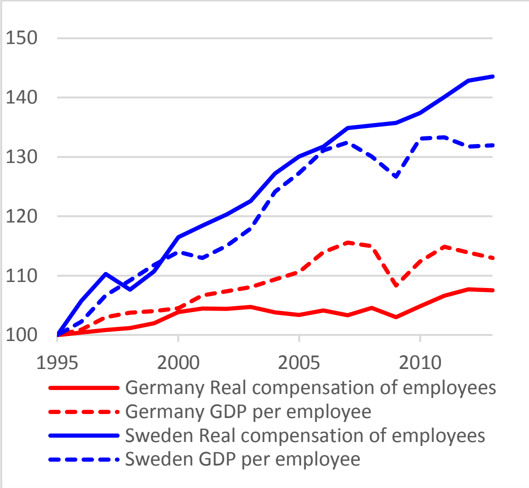


Deflated with consumption expenditure deflator

Source: OECD

The drastic difference in wage growth between the two countries would have important implications for the macro-economic performance of the two countries. The price competitiveness of the German export industry was substantially improved. German and Swedish export industries are not always direct competitors but the relative change in labour costs no doubt strongly benefitted the German export industry and similarly penalized the Swedish industry. The German wage stagnation, however, reduced domestic demand and thus contributed to an overall weaker development in Germany.

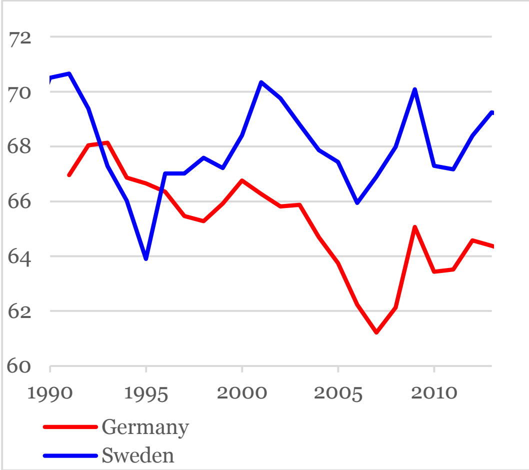
Figure 9. Labour costs and productivity



Deflated by the GDP deflator

Source: European Commission (AMECO)

Figure 10. Labour cost share of GDP



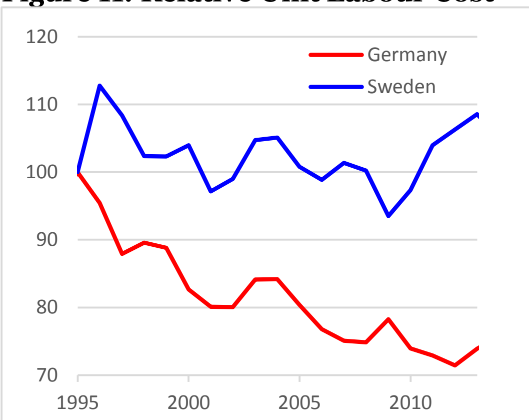
Nominal GDP at factor costs

Source: European Commission (AMECO)

The effects, however, were moderated by considerably faster productivity growth in the Swedish economy. In Sweden Gross Domestic Product per employee grew by 32 percent 1995-2013 while it only grew by 13 percent in Germany (see figure 9). Real labour costs increased by 44 percent in Sweden in the same period but by less than 8 percent in Germany.[16] The wage share of GDP in Sweden was an historic low in 1995. It then increased rapidly and remained fairly stable around 68 percent on GDP. In Germany the wage share has continued to trend downwards, reaching 64 percent by 2013 (see figure 10).

Sweden has had a floating exchange rate regime since 1992, while Germany is part of the euro area. The SEK-Euro exchange rate has been volatile at times but has shown no tendency for sustained depreciation or appreciation (see figure 12). Although the competitive position of the Swedish economy has deteriorated with respect to Germany this has not been the case compared to the euro area as a whole. The Krona depreciated sharply during the global financial crisis 2008-10 but regained its strength as a result of the euro crisis.

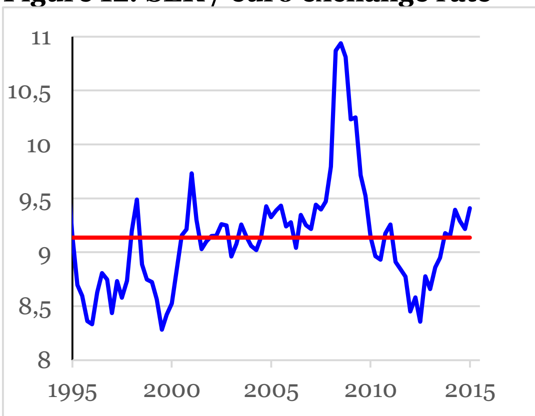
Figure 11. Relative Unit Labour Cost



Competition-weighted in common currency

Source: OECD

Figure 12. SEK / euro exchange rate



Red line: average 1995-2013

Source: ECB

[16] Nominal compensation per employee deflated with the GDP deflator.

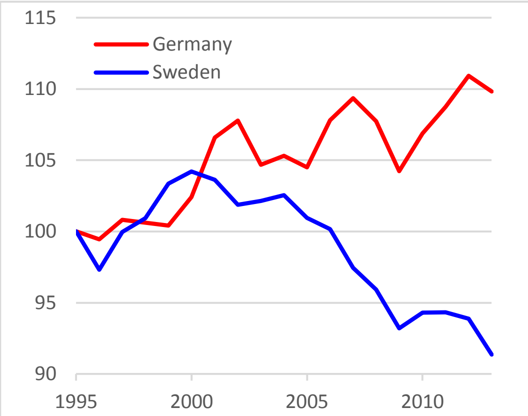
The competitive position of Germany has improved by more than 25 percentage points since 1995 in relation to its competitors, as measured by the OECD's Relative Unit Labour Costs while that of Sweden deteriorated somewhat or remained unchanged in the same period (see figure 11).

Demand

During the period, Germany has gained export market shares while Sweden has lost shares, especially after 2001 (see figure 13). The volume of German exports of goods and services almost tripled while Swedish exports grew less but still by an impressive 130 percent.

Figure 13. Export market shares

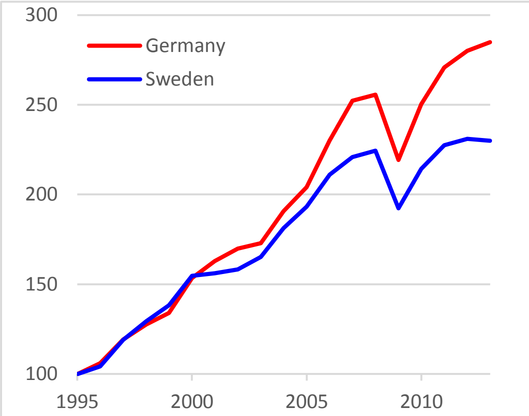
Index, 1995 = 100



Source: OECD

Figure 14. Exports of goods and services

Index, 1995 = 100

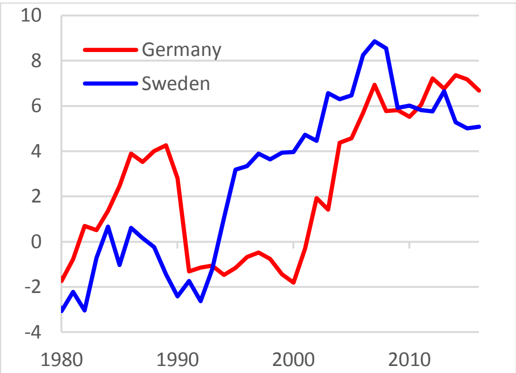


Source: OECD

The German export industry no doubt benefited from the improved competitive position, brought about the combination of wage moderation and its participation in the currency union, which prevented a German currency appreciation. This improved competitiveness mainly came at the expense of the other euro area countries. Such a strategy could hardly be successfully copied by a country like Sweden, since its floating exchange rate would then likely appreciate.

Figure 15. Current Account

Percent of GDP



Source: OECD

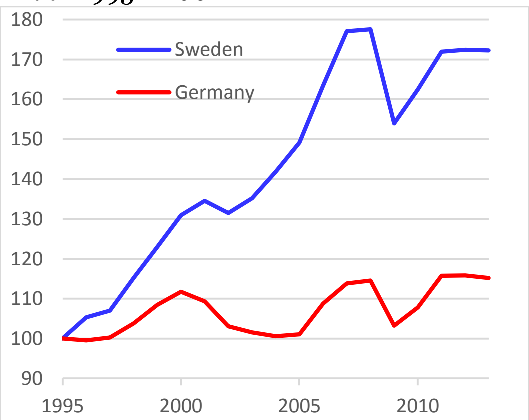
The developments of costs and prices are not the only factor – or indeed perhaps not even the main factor – determining the extraordinary performance of the German export industry. According to an analysis by the European Commission, differences in the price competiveness trends as measured by Unit Labour Cost could explain surprisingly little of the differences in trade development across Europe in the boom years 2000-07. Wage increases above productivity showed little correlation with the evolution of either of the trade balance or of the loss or gain of world market shares. The strong divergences in trade development was mainly attributed to differences in savings and by resulting capital flows.[17] The relatively stronger German export performance, compared to that of Sweden, may therefore only partially be explained by improved cost competitiveness.

According to a Commission analysis, there could however be important indirect effects from a wage moderation policy. A slower wage growth increases the profitability of domestic firms, which should enhance investments and thereby fuel future productivity growth and product quality development. This claim was explicitly made in a Commission comparison between France and Germany concerning macro-economic imbalances.[18]

The Commission conjecture seems to receive very little support in a comparison between Germany and Sweden. Investments remained remarkably sluggish in Germany throughout the period. While Swedish investments grew by 72 percent in real terms over the period, German investments grew by little more than 15 percent (see figure 16).

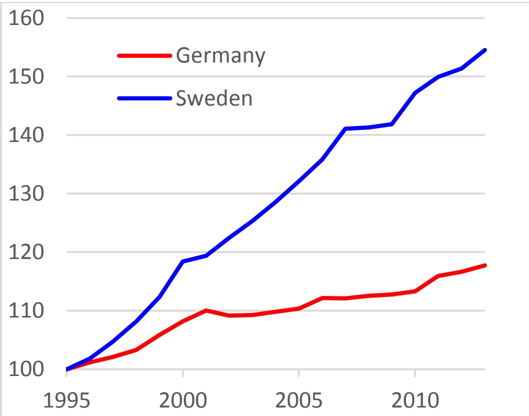
Since real wages in Germany hardly grew at all during the period, neither did disposable income. The scope for private consumption growth therefore was extremely limited. Private consumption grew by 55 percent in Sweden but only by 18 percent in Germany (see figure 17).

Figure 16. Gross fixed capital formation
Index 1995 = 100



Source: OECD

Figure 17. Private consumption
Index 1995 = 100



Source: OECD

Labour market

The demand for labour in Sweden started to grow in 1998 and continued to grow for more than a decade, though it fell temporarily after the ICT crisis in 2001 and the financial crisis in 2008. By 2013 the number of hours worked had increased by 12 percent since 1995. In Germany hours

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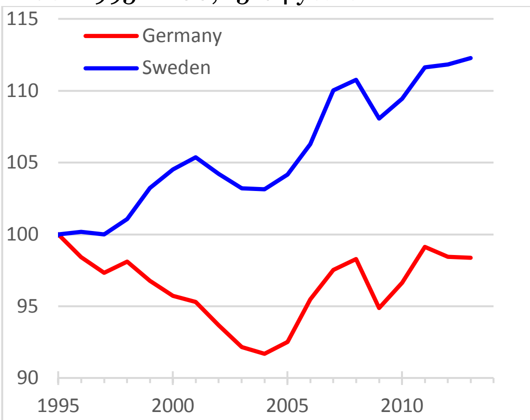
[17] European Commission, *European Competitiveness Report 2010*, Commission staff working document, SEC(2010) 1276, p.28-41
[18] See European Commission, *Macroeconomic Imbalances – France 2013*, p.35.

worked continued to fall until 2005, after which they grew by almost the same rate as in Sweden. But for the whole period 1995-2013 hours worked in Germany actually decreased (see figure 18).

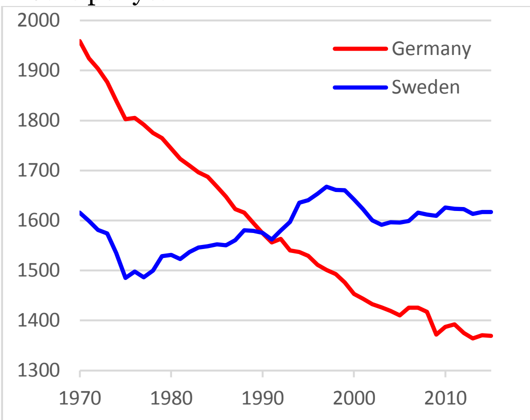
The German labour market differs from the Swedish labour market in one very important aspect. In Germany the number of hours worked per employee has declined steadily since at least the beginning of the 1960's. In Sweden hours worked fell until the middle of the 1970's. Since then it has increased slowly but persistently. In 2013 the average hours worked per year and employee was more than 1600 hours (corresponding to 31 hours per week) in Sweden but less than 1400 hours (27 hours per week) in Germany (see figure 19).

Figure 18. Hours worked
Index 1995 = 100, 15-64 years



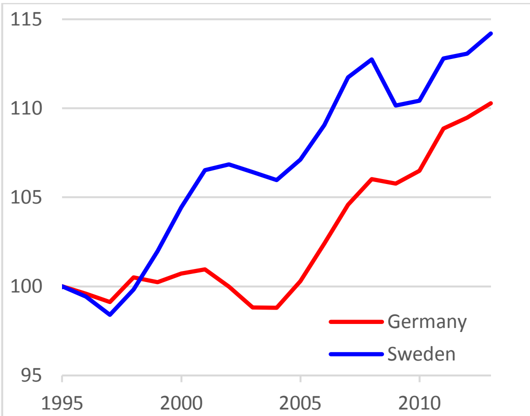
Source: Labour Force Survey (OECD)

Figure 19. Hours worked per employee
Hours per year



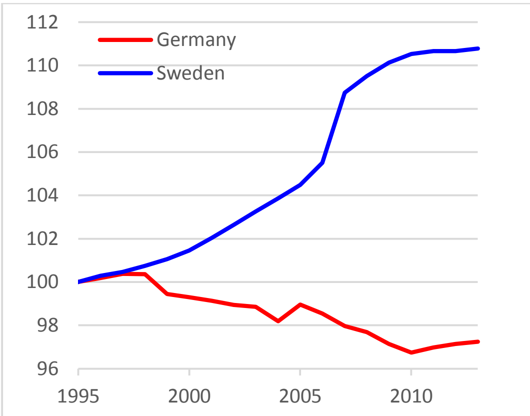
Employment started to grow in Sweden already in 1998 but not until 2005 in Germany (see figure 20). German employment, however, grew faster after 2005. This difference is wholly explained by the relative fall in German average working hours, as the number of hours worked did not increase faster in Germany than in Sweden. Over the whole period 1995-2013 employment grew by 14 percent in Sweden and 10 percent in Germany.

Figure 20. Employment
Index 1995 = 100, 15-64 years



Source: Labour Force Survey (OECD)

Figure 21. Working age population
Index 1995 = 100, 15-64 years

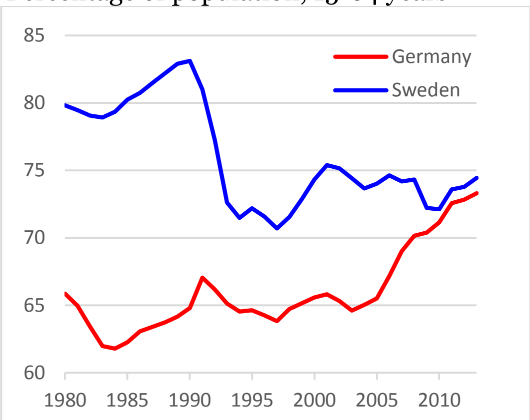


Source: Labour Force Survey (OECD

The total number of employed grew by 4.1 million between 2003 and 2013. At the same time, the number of persons in marginal employment (mini- and midi-jobs) grew by 2.2 million.[19]

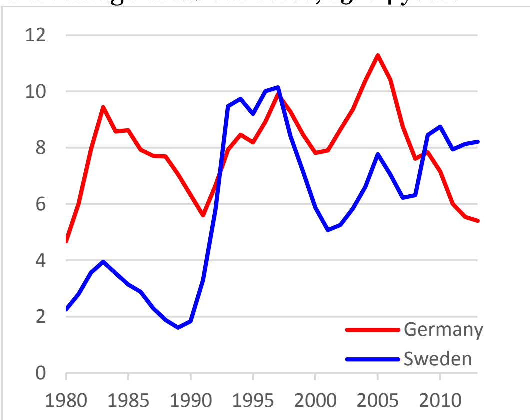
The working age population (15-64 years old) increased by almost 11 percent in Sweden while it decreased by 3 percent in Germany (see figure 21). This explains why the originally quite substantial difference in in the employment ratio between the two countries narrowed so dramatically over the period, in spite of the weaker German over-all employment performance (see figure 22).

Figure 22. Employment ratio
Percentage of population, 15-64 years



Source: Labour Force Survey (OECD)

Figure 23. Unemployment rate
Percentage of labour force, 15-64 years



Source: Labour Force Survey (OECD)

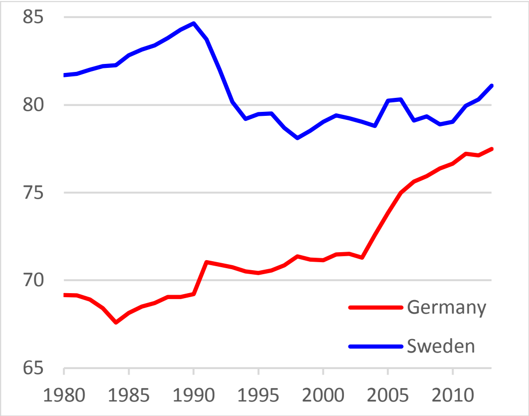
In some respects, however, the improvements on the German labour market was indeed remarkable. The participation ratio (labour force to population) increased from 70 percent in 2003 to more than 77 percent in 2013 (see figure 24). While still being ahead, the Swedish increase was much more modest.

The expansion of the mini-jobs sector appears to have been an important contributing factor in Germany. Employees in marginal employment (mini- and midi-jobs) are dominated by categories normally outside the labour force, such as housewives, students and retired persons. Only 11 percent of the total were unemployed, which is a surprisingly low figure.[20]

Despite the substantial reduction of overall German unemployment, long-term unemployment remains a serious problem in this country. The share of persons being unemployed for more than a year (of total unemployment) has been around 50 percent in Germany while is has been below 20 percent in Sweden since 2008 (see figure 25).

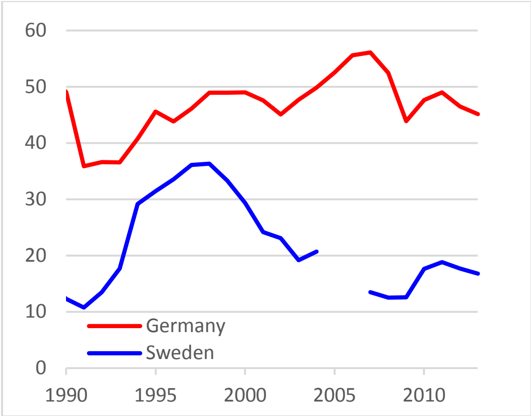
[19] Fichtl (2015), "Mini- and Midi-Jobs in Germany", FORES Policy Papers 2015:3, page 50
[20] Fichtl (2015), page 27

Figure 24. Participation ratio
Percentage of population, 15-64 years



Source: Labour Force Survey (OECD)

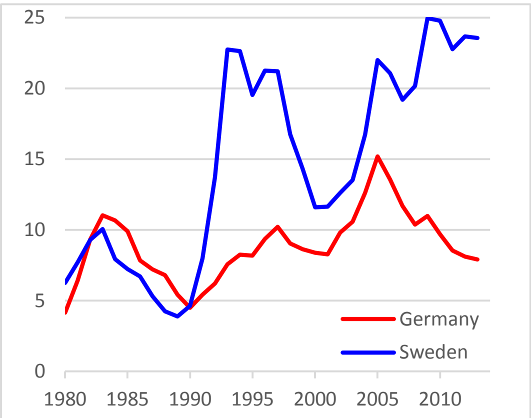
Figure 25. Long term unemployment
Share of unemployed for more than 1 year of total unemployment



Source: Labour Force Survey (OECD)
Missing data for Sweden for 2005 and 2006

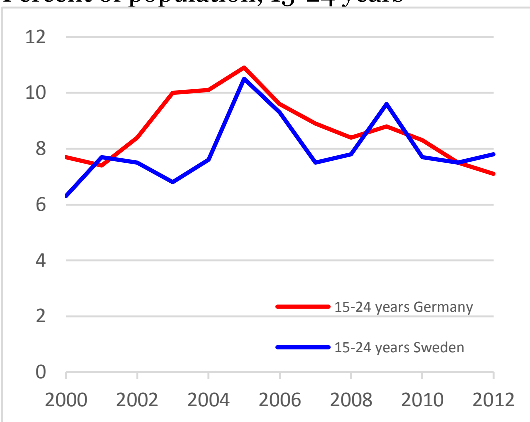
Youth unemployment (15 – 24 years old) has been much larger in Sweden than in Germany since the beginning of the 1990's. The difference narrowed substantially after 1997 but started to grow again after 2004. In 2013 youth unemployment stood at 24 percent in Sweden while it was only 8 percent in Germany (see figure 26, page 17). Part of this difference can be explained by structural features of the two countries education systems and labour markets. Swedish full-time students looking for side jobs constitute a large proportion of Swedish youth unemployment. The alternative NEET-measure – Not in Employment, Education or Training – show no large or persistent differences between the two countries (see figure 27).

Figure 26. Youth unemployment
Percentage of labour force, 15-24 years



Source: Labour Force Survey (OECD)

Figure 27. Persons not in employment, education or training (NEET)
Percent of population, 15-24 years

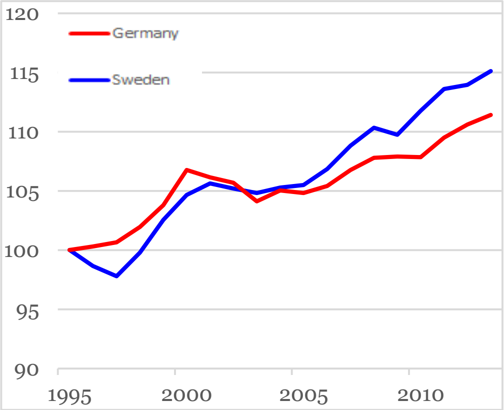


Source: Eurostat

Hours worked increased more rapidly in Sweden in most sectors of the economy than in Germany. Surprisingly, this was true even for the service sectors where most of the low wage jobs in Germany are found. Hours worked incresed by 12 percent in this sector in Sweden while they declined by 5 percent in Germany (see figure 28). The difference between the two countries was smaller in terms of number of people employed. Employment in the service sector incresed by 15 percent in Sweden and 11 percent in Germany (see figure 29). Average hours worked thus fell in this sector in both countries in this sector but considerably less so in Sweden.

Figure 28. Employment in service sectors

Index 1995 = 100

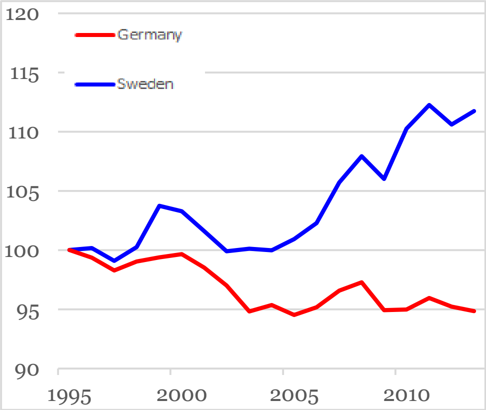


Sectors: trade, accommodation, food services and transportation (ISIC G-I)

Source: Productivity and ULC by main economic activity, OECD

Figure 29. Hours worked in service sectors

Index 1995 = 100



Sectors: trade, accommodation, food services and transportation (ISIC G-I)

Source: Productivity and ULC by main economic activity, OECD

Concluding discussion

The performance of the Swedish labour market has for decades been seen as superior to that of the German labour market. Unemployment has generally been lower, except for a few years in the 1990's, and the employment ratio has generally been much higher. Over the span of a few years in the 2000's all this changed. The German unemployment rate fell well below that of Sweden while the German employment rate reached within a percentage point below that of Sweden.

The Hartz labour market reforms are widely credited for turning the German labour market around and reversing a trend of several decades of increasing unemployment. The German labour market reforms were widely hailed as a role model, both in Sweden and elsewhere in Europe.

Comparable labour market reforms were also introduced in Sweden during this period, based on subsidized labour costs, reduced and more stringent unemployment benefits and relaxed employment protection legislation for temporary contracts.

It is hardly likely that the mostly minor differences in Swedish and German labour market reforms can explain the differences in macro-economic performance. An exception may have been the German reforms in marginal employment (mini- and midi-jobs). Sweden did not introduce any comparable reforms in this area.

Marginal employment in Germany grew substantially after 2003, mostly attracting persons normally outside the labour force (house wives, students and retired persons) but comparatively few unemployed. It is therefore likely that the expansion of the marginal employment market mainly contributed to the growth of labour force participation, rather than to a decline in unemployment. It is unclear to what extent the growth of marginal employment represented a substitution of regular employment or a genuine increase in employment/hours worked.[21]

The Swedish and German economic performance, however, differed in one important aspect, namely in wage formation. Germany experienced a general wage moderation and the expansion of a substantial low wage market. In Sweden however both nominal and real wages grew rapidly throughout this period and wage growth remained much more even across sectors.

This study compares the macro-economic performance of Sweden and Germany from 1995 to 2013. Germany's export performance was certainly superior to that of Sweden, partly explained by slower wage growth and thus enhanced competitiveness. But wage moderation also impeded German domestic demand. German real wages, household disposable income and private consumption stagnated. Contrary to expectations, higher profit shares seemingly did not stimulate investments. Investment growth remained significantly lower in Germany than in Sweden.

Germany's performance was also markedly inferior to that of Sweden in terms of GDP and productivity growth. Even more remarkable is the fact that while hours worked increased by 12 percent in Sweden during this period, they actually fell in Germany. Hours worked in Sweden grew faster than Germany in most sectors of the economy, including the low wage service sector. The German "jobs miracle" was therefore more apparent than real. Only a handful of OECD countries actually performed worse than Germany in terms of hours worked during this period.

The reason why employment grew at all in Germany was that average hours worked per employee fell, while it grew in Sweden. Unemployment also declined because the German working age population fell while it grew in Sweden.

Apparently, wage moderation did not create any jobs in Germany. Instead, German unemployment declined because of reduced working hours and shrinking working age population.

Even more surprisingly, the German policy of expanding the low-wage sector does not appear to have been successful when compared to Sweden. Hours worked in the service sectors mainly affected by this policy, such as wholesale and retail trade, accommodation, food services, transportation and storage, increased by 12 percent in Sweden but actually fell in Germany by 5 percent.

The German wage moderation policy was hardly the success story it was described as.

[21] See Fichtl (2015), chapter 6, for an overview of the literature.

Appendix: Data

To ensure comparability between the two countries, the same definition and source (usually: OECD) of each variable has been used even if these sources could, arguably, be considered inferior in some instances to alternative national definitions used.

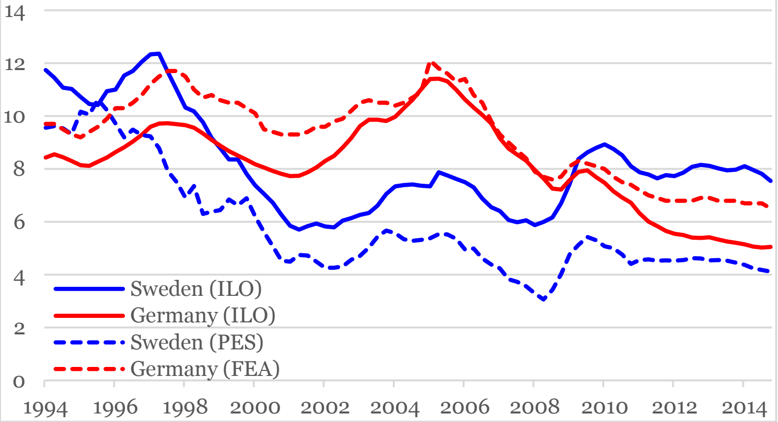
Wage cost statistics

National Account data are taken from OECD. Swedish employers have to pay payroll taxes on wages that are not earmarked for any specific purpose and thus is not defined as social security contributions but as indirect taxes according to National Accounts. This so-called *Allmän löneavgift* ("general wage levy") has increased from 1 percent of wage costs 1995 to 9.9 percent 2013. These payroll taxes are not included in OECD's definition of the Labour Compensation Rate but are included in Swedish national statistics. This means that Swedish data on real and nominal wages as well as Unit Labour Costs and the wage share are biased downwards. Correcting Swedish data for this bias however would only reinforce the conclusions of this report.

Unemployment statistics

In this report, the unemployment concept used is the ILO definition of the Labour Force Survey, as reported by the OECD. The ILO definition is also the most commonly used unemployment statistic in Sweden. The number of unemployed registered with the *Public Employment Services* (PES) is however also widely used. The PES statistics have been consistently lower than the ILO numbers. The main reason for this is the large number of full time students looking for side jobs but who are not entitled to unemployment benefits and therefore do not register with the PES. In 2014 ILO unemployment stood at 7.9 percent while PES unemployment stood at 4.2 percent.

Figure 30.
Unemployment measures
Labour Force Survey (ILO) and national definitions



Sources: OECD, PES, FEA

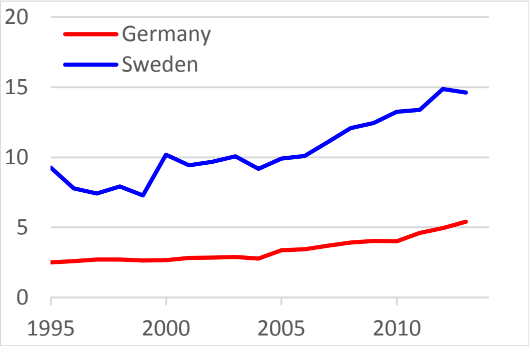
In Germany, the registered unemployment from the *Federal Employment Agency* is the most commonly used unemployment statistic. The FEA statistics have normally been higher than that of the ILO measure. In 2014 ILO unemployment stood at 5.1 percent while FEA unemployment stood at 6.7 percent. The main reason for this discrepancy is the very narrow ILO definition of employment and hence of unemployment. One hour of work per week is enough to qualify as being employed and hence not considered unemployed. Many Germans qualify for unemployment benefits even if working. According to a report by the German trade union confederation DGB 1.4 million employed Germans receive unemployment benefits, because their wages remain below the social security norm. A full 350,000 of these even work full time.[22]

A comparison based on registered unemployment would not come out as favourable to Germany as that of the ILO measures. Register-based statistics on unemployment remains lower in Sweden than in Germany. But even according to these statistics German unemployment has improved more since 2006 than Swedish unemployment.

Employment among older than 64

Labour market data are taken from the OECD data set *Labour Force Survey by Age and Sex*. The comparison is limited to the age group 15-64 years. This would imply a bias if the representation of age groups older than 64 years differs substantially between the two countries. This is probably more important for employment than unemployment, which tend to be negligible among the older age groups.

Figure 31. Employment to population ratio +65 years of age



Source: OECD

Employment among people older than 65 years of age appears to be consistently larger in Sweden than in Germany. Both countries show a comparable strong positive trend in recent years. Employed persons above 65 years of age corresponded to 3.2 percent of total employed in Sweden and 2.3 percent in Germany. This implies that abstracting from this older group will not bias the comparison to any significant extent.

[22] Deutscher Gewerkschaftsbund [German Trade Union Confederation] Federal Executive Board, *Labour market reforms in Germany - Precarious employment and low wages*, Berlin, 03/04/2015

TCO – The Swedish Confederation of Professional Employees

Comprises 14 affiliated trade unions.

The 1.3 million members of these unions are professional and qualified employees who share a major responsibility for important functions in society, although in a wide variety of occupations. They work in all parts of the labour market, for example in the schools, healtchcare, trade, the media, the police, industry, IT and telecom. Over 60 percent of the members are women. Approximately half of the members work in the private sector and half in the public sector.

TCO is independent in party-political terms and the basic tasks are, together with the affiliated unions, to organise and recruit professional and qualified people in working life, to promote and defend the needs and interests of the members in the social debate and the decision-making process, to safeguard trade union rights and freedoms and to represent the affiliated unions in international trade union work.

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