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Employment Duality in Germany**

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## ABSTRACT

### **Not So Standard Anymore? Employment Duality in Germany\***

This paper gives an overview of the transformation of the German labour market since the mid-1990s with a special focus on the changing patterns of labour market segmentation or 'dualization' of employment in Germany. While labour market duality in Germany can partially be attributed to labour market reforms promoting, in particular, non-standard forms of employment and allowing for an expansion of low pay, structural changes in the economy as well as strategic choices by employers and social partners also play a prominent role. Our main argument is that the liberalization of non-standard contracts has contributed to the expansion of overall labour market inclusion and job growth in Germany and that at least some forms of non-standard work provide stepping stones into permanent regular jobs. Atypical contracts do not necessarily undermine the dominance of standard employment relationships and job quality in this primary segment but rather form a supplementary part of employment in sectors that depend on more flexible and maybe cheaper forms of labour.

JEL Classification: J21, J31, J42

Keywords: Germany, labour market reforms, dualization, non-standard work

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## 1. Introduction

Up until the mid-2000s Germany was often perceived as a country of high unemployment and medium labor force participation at best (Manow and Seils 2000). However, over the last few years, in particular in the aftermath of the Great Recession in 2008-09, this picture has changed dramatically (Rinne and Zimmermann 2011; Eichhorst 2014; Caliendo and Hogenacker 2012; Dustmann et al. 2014). This does not hold only for the perception of outside observers but also for real changes in Germany's labour market performance, which is now fundamentally different from the situation in the late 1990s and early 2000s. Yet, the origins of some of the trends that have become more apparent in recent years can be traced to then. Furthermore, and in contrast to most other developed countries that were affected heavily by the global economic crisis, Germany was able to weather the recession with neither an increase in unemployment nor a decline in the number of jobs. In fact, Germany currently shows a record level of employment significantly above the employment figures reported in earlier years. This includes both an increase in the absolute number of people in employment and the employment rate. At the same time, while standard employment has recovered somewhat since mid-2005, we see a rising share of non-standard and low-pay employment (Eichhorst and Marx 2011).

This paper assesses the contribution of atypical work or non-standard employment to the development of the German labour market. We show that, when focussing on fixed-term contracts, non-standard employment mostly affects job entrants in the private sector, apprentices and mainly young employees in the public, academic or social sector. Transition probabilities to permanent jobs are quite high for entrants into the private sector and for vocational graduates, though less so in the public, academic and social sectors. Agency work is mostly concentrated in basic occupations in the manufacturing sector and some office services with limited prospects for transitioning to permanent jobs. Self-employment without employees is concentrated in the crafts and the creative sectors, while high female shares in part-time work is overrepresented in all occupations. In the German case, a major dividing line lies between regular, permanent part-time and marginal part-time jobs. The secondary segments of the labour market are clearly characterized by sectoral (in particular services) and demographic (migration background, gender, educational level) patterns. This pattern of segmentation seems to become more important over time as the labour market expands, sectoral shifts occur, employers' room to manoeuvre increases, and working conditions also react to industrial relations/organization and labour demand/supply patterns.

A parallel development can also be shown with pay inequalities. Clearly, the low pay sector has grown in Germany as has the overall pay dispersion. While it is true that non-standard contracts in general have a higher share of low pay earners than standard employment, the variation of pay amongst employees on full-time open-ended contracts has increased as well. Here, the coverage by collective agreements makes a major difference. Firms not covered by collective agreements tend to show larger pay dispersion; accordingly, the share of companies and workers not covered by collective agreements has risen continuously. Generally binding sectoral minimum wage agreements, which have become more widespread recently, have some limiting effect here.

The implications of segmentation are somewhat ambiguous though. First, one has to note that the core of the labour market in Germany is still characterized by employment stability and decent wages, in particular in skill-intensive service and manufacturing sectors covered by collective agreements and social protection. This is the backbone of the German economic model and has proven to be both adaptable and competitive in a globalized economy. It has also stabilized domestic demand during the recent economic crisis. The same is true for the continuously growing service sector which is now responsible for about three quarters of total employment. Furthermore, one has to note that stability and flexibility of employment are shared unequally across sectors, occupations and socio-economic groups. With respect to the crisis, for example, employment stability in the core manufacturing segment was achieved via short-time work and working time accounts; whereas flexible workers, i.e. temporary agency workers and fixed-term contract holders, were made redundant. Both short-time work schemes and unemployment benefits can be seen as important automatic stabilizers that helped navigate a difficult time and pave the way for a quick recovery. Still, it is true that the secondary segment of non-standard jobs faces major employment risks and acts as an additional buffer that eases the adjustment pressure on the core. Yet, non-standard jobs contribute to better labour market access and additional job creation, which generates additional income from work. Flexible types of contracts also contribute to wage moderation in collective agreements and overall competitiveness.

For the foreseeable future we can expect a persistent dualization of the German labour market; yet, there are stronger demands for some reregulation at the margin of the employment system, in particular, calling for a narrowing of the regulatory gap between some forms of non-standard employment and for a binding wage floor.

## **2. Why and how labour market dualization matters**

Continental European countries have a peculiar pattern of labour market regulation that is centred around a well-protected core of permanent employees benefiting from relatively strict dismissal protection, large shares of collective bargaining coverage and full integration into social insurance. This model of organizing employment has been complemented by a flexible part of the labour market after a broad movement to deregulate and encourage the take-up of so-called non-standard or atypical forms of employment. This pattern of labour market reforms has been pursued by policy makers in order to create a flexible margin of the labour market that is expected to facilitate job growth without questioning the institutional stability of the core of the labour market, which is supported by incumbent workers and trade unions (Boeri 2010; Palier and Thelen 2010). While non-standard forms of work can in fact allow for the creation of additional jobs, in particular in smaller firms and service occupations, they eventually result in a well-defined secondary segment of employment where transitions to permanent or regular employment can be difficult and less attractive working conditions such as contract type, employment stability or pay deviate from the standard. This divergence is also prevalent for socio-economic groups that typically enter this secondary segment with respect to age, gender, skill level or nationality. Hence, dualization can be seen as a strategy of institutional reform creating a secondary institutional arrangement as well as an empirical phenomenon, in terms of actual employment patterns, that result from the changes in rules and the interaction of employers and employees in certain parts of the labour market (Emmenegger et al. 2012).

The major dividing line for labour market segmentation in different countries, however, is not easy to identify as different forms of standard and non-standard employment exhibit some features of instability, limited professional perspectives, low pay or other elements of ‘precariousness’ that are typically influenced by the respective national pattern of regulation and employment practices. It would also be misleading to automatically identify ‘good’ jobs with standard (open-ended full-time) contracts and to consider all non-standard contracts as ‘bad’ or inferior in terms of job quality that can be measured in terms of pay levels, perceived or actual job stability and the probability of promotion to a standard contract.

Still, one major and quite straightforward criterion for the distinction of labour market segments, at least in Continental Europe, is the type of employment contract. The crucial

division lies between open-ended full-time contracts, identified as ‘standard employment’, as the primary part of the labor market on the one hand and all other types of contracts such as fixed-term contracts, (marginal) part-time, temporary agency work or self-employment on the other. Importantly, this distinction must also take into account the differences that exist in terms of employment logic, labour market perspectives or socio-economic groups affected.

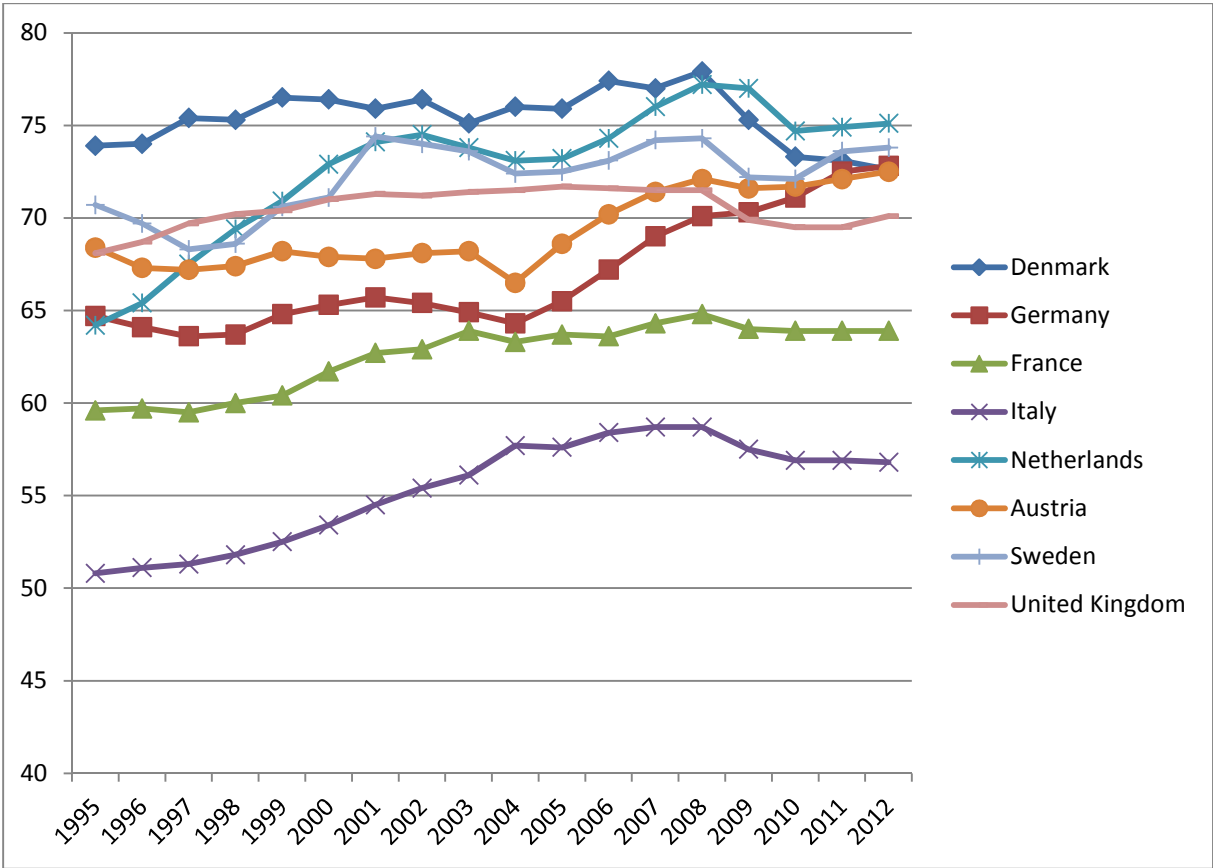
Furthermore, the pay dimension is also relevant and potentially parallel to differences in the type of contract. Typically, some sectors are less organized in collective bargaining and therefore more prone to wage flexibility at the lower end, quite in contrast to a well-organized core. Pay is, therefore, also an alternative form of flexibility to contract type. Hence, it seems fair to say that dual labour markets are based both on the duality of standard vs. non-standard contracts and on differences in pay. To assess the extent of dualization we can therefore take into account the working conditions of different segments of the labour market, i.e. the distance between the core and the margin, on the one hand and transition probabilities on the other hand.

### **3. Main developments of the German labour market**

#### **3.1 Employment and unemployment**

The current situation of the German labour market cannot be understood without a view of the major restructuring since the mid-1990s. Over the last two decades or so, both levels and structures of employment and unemployment have changed substantially. Looking at total employment figures and the overall employment rate one can see a major increase since the mid-2000s. The German employment rate increased significantly since the middle of the last decade, reaching more than 72% in 2012. This rate is substantially higher than the long-standing average of around 65%, which was characteristic for the 1990s and early 2000s (see figure 1), making Germany now above the UK and in line with countries such as Denmark, Sweden and Austria.

**Fig. 1: Employment rates in selected European countries**

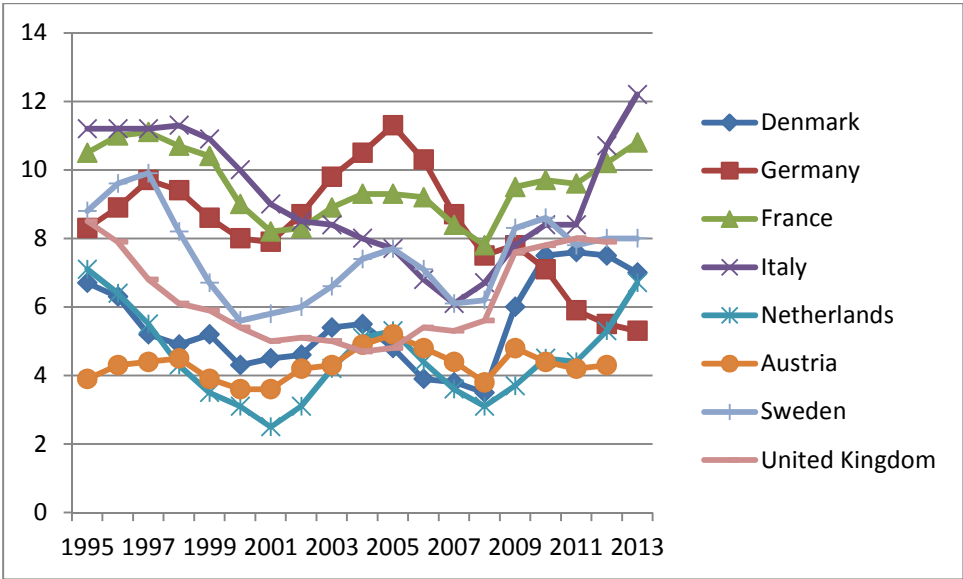


Source: Eurostat.

In parallel, unemployment declined dramatically since 2005, even during the crisis period 2008-09. In absolute figures, German unemployment is now less than 3 million, down from a record level of 5 million in early 2005. Standardized unemployment was less than 6 percent of the labour force since 2011, currently one of the lowest rates in Europe. That also means that massive and apparently persistent unemployment increases in the mid-1990s and early 2000s could be reversed.



**Fig. 2: Unemployment rates, 1995-2014, in selected European countries**



Source: Eurostat.

Employment rates still vary significantly between genders; however, based on headcounts, the gap between women and men has closed significantly during the 2000s. Women contributed massively to the overall increase in the employment rate, while male employment rates have been stagnant at best. Women are now much better integrated into the labour market than they were in the 1990s. However, this is not the case for full-time equivalent contracts. Here, the huge increase in different forms of part-time work, which is largely occupied by women, is related to a persistent gender gap that arises with a more substantial labour market participation of females.

The overall employment increase was also partially driven by a massive increase in the employment rate of older workers, between the ages of 55 and 64 in particular, from less than 40% in the 1990s to about 60% most recently. Employment creation in Germany has been most beneficial to those with medium and higher educational levels where there have been some significant increases in jobs in the 2000s. At the same time, the employment rate of low-skilled people was more or less stable between 40% and 50%, which is significantly below the employment levels of medium and high skilled people in Germany.

**Table 1: Labour market developments in Germany, 2000-2012**

GEO/Time	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Employment rate (15 to 64 years)	65.6	65.8	65.4	65.0	65.0	65.5	67.2	69.0	70.1	70.3	71.1	72.5	72.8
Unemployment rate (15 to 64 years)	8.0	7.9	8.7	9.8	10.5	11.3	10.3	8.7	7.5	7.8	7.1	5.9	5.5
Full- time equivalent employment rates of men and women													
In Total	65.6	65.8	65.4	65.0	65.0	65.5	67.2	69.0	70.1	70.3	71.1	72.5	72.8
Men	72.9	72.8	71.8	70.9	70.8	71.3	72.8	74.7	75.8	75.4	76.0	77.3	77.6
Women	58.1	58.7	58.9	58.9	59.2	59.6	61.5	63.2	64.3	65.2	66.1	67.7	68.0
Employment rates by age group													
15 to 64 years	65.6	65.8	65.4	65.0	65.0	65.5	67.2	69.0	70.1	70.3	71.1	72.5	72.8
15 to 24 years	47.2	47.0	45.7	44.2	41.9	41.9	43.5	45.4	46.6	46.0	46.2	47.9	46.6
25 to 54 years	79.3	79.3	78.7	77.9	78.1	77.4	78.8	80.3	80.9	80.8	81.5	82.8	83.2
55 to 64 years	37.6	37.9	38.9	39.9	41.8	45.5	48.1	51.3	53.7	56.1	57.7	59.9	61.5
Employment rates by educational level													
All levels	65.3	65.7	65.4	64.9	64.3	65.5	67.2	69.0	70.1	70.3	71.1	72.5	72.8
Pre-primary, primary and lower secondary education	55.3	44.9	43.6	42.6	40.7	42.3	44.1	44.8	45.6	45.3	45.4	52.7	52.7
Upper secondary and post-secondary non tertiary education	69.9	69.9	69.8	69.0	68.2	69.4	71.2	73.1	74.0	73.9	74.7	76.0	76.4
First and second stage of tertiary education	83.0	83.2	83.0	82.9	82.6	82.8	84.2	85.3	85.7	86.3	86.7	87.6	87.6
Unemployment and Long-term Unemployment													
unemployment	8.0	7.9	8.7	9.8	10.5	11.3	10.3	8.7	7.5	7.8	7.1	5.9	5.5
long- term unemployment	4.1	3.9	4.2	4.9	5.9	6.0	5.8	4.9	4.0	3.5	3.4	2.8	2.5

Source: Eurostat.

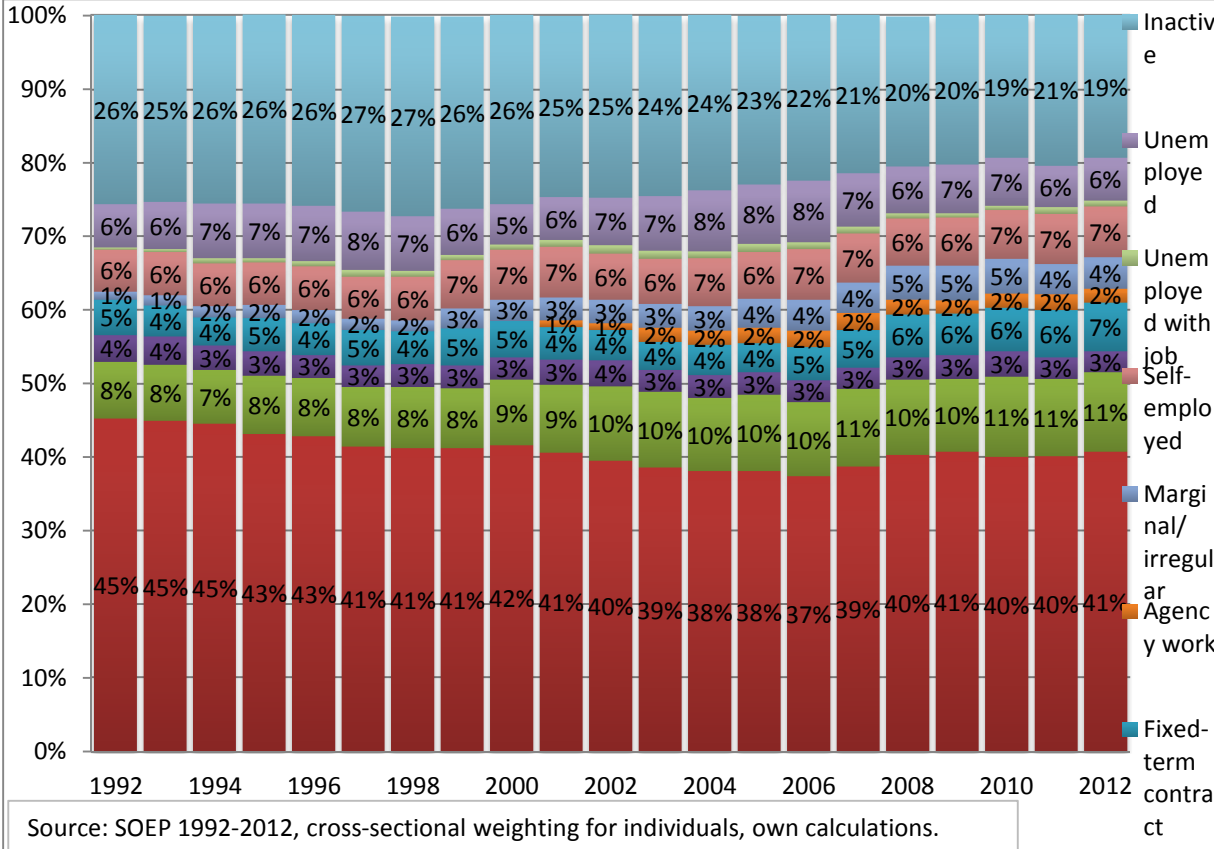
The group-specific pattern is most pronounced with unemployment by educational level where there is a substantially and persistently higher risk of unemployment faced by low-skilled workers. Medium skilled workers with either upper secondary schooling and/or a vocational degree have about an average risk of being unemployed while highly skilled workers (i.e. with a tertiary degree) see virtually full employment. Lack of skills is probably the most important risk of exclusion in the German labour market.

### 3.2 A structural transformation of the German employment system

While overall employment grew, a mixed picture emerges of the German labour market developments when taking into account persistent issues such as long-term unemployment, a predominantly part-time based employment pattern of mostly women, and issues with respect to labour market integration of low-skilled people. This can be analysed more in depth by looking at different forms of standard employment and atypical work. First, one has to note that in Germany, and somewhat in contrast to general perceptions of widespread precarious

employment, the number of standard employment contracts declined in the early 2000s, restabilising only in recent years. It is now only slightly below the level of the mid-1990s. At the same time, particularly in the early 2000s, Germany experienced an increase in the number of different types of non-standard employment along with a steady decline in inactivity.

**Fig. 3: Working-age population by employment status, 1992-2012**



Therefore, the overall employment increase was accompanied by an increase in the share of non-standard contracts and a relative decline of standard employment (only if measured as a share in total employment). Still, standard employment, defined as permanent full-time work, is the most prominent type of contract in Germany, as figure 3 clearly shows. Along with the growth of low pay, this more widespread use of non-standard contracts is a major factor of labour market segmentation or dualization in Germany. The increase in ‘atypical’ jobs is partly due to sectoral change in favour of private service sector jobs, but it was also facilitated by some deregulation of legal provisions governing those jobs. Particularly striking is the massive increase in the number of part-time workers covered by social insurance and regulations that standardize working conditions. Additionally there has been an expansion of

marginal part-time work with gross earnings up to 450 EUR per month. The latter can be attributed to a peculiar emerging employment pattern in some private services in reaction to the availability and expansion of the Minijob arrangement. Fixed-term contracts have remained at a medium level over recent years, with rates at about 7 to 8 percent of total employment (excluding about the same share of fixed-term apprenticeship contracts). Increased dynamism is behind the development of temporary agency work, although it is still a quite small segment of the labour market with about 2.5 percent of total employment. The expansion of agency work is mostly due to substantial reforms and related restructuring of companies in the manufacturing sector since the mid-2000s. Quite notably, finally, is the increase in the number of self-employed people without employees.

These developments can hardly be understood without taking into account the sectoral and occupational changes that occurred over the last 10 to 15 years (see also Eichhorst et al. 2013). From table 2 we can see the divergence in the shares of different forms of non-standard or atypical work across economic sectors. Some sectors rely heavily on marginal part-time work (private households, accommodation and food service, other services), fixed-term contracts (health and social services, but also education), freelance (arts and professional activities) or temporary agency work (classified as a separate sector here).

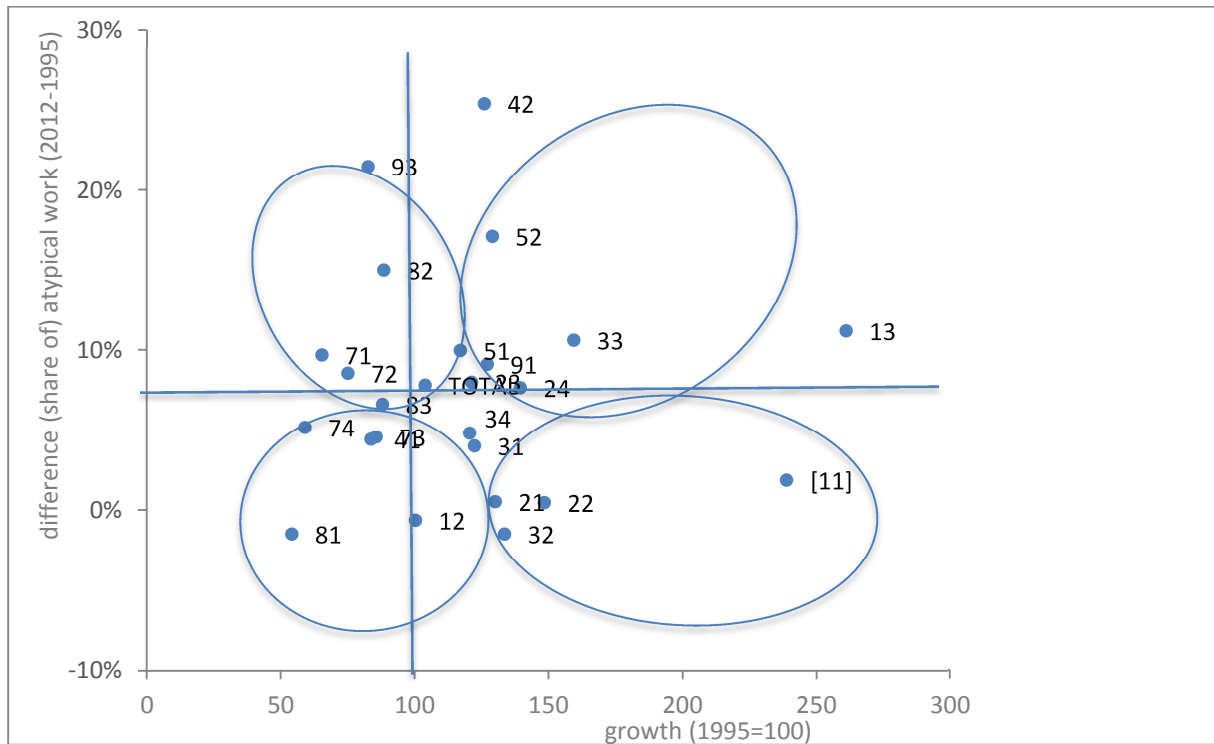
**Table 2: Shares of different types of employment by sector in %, 2010**

	self-employed without employees	self-employed with employees	standard employment relationship	fixed-term contract	part-time employment	marginal employment	Temporary agency work
Private households	5.8	0.5	12.5	4.8	65.4	51.0	0.0
Other economic activities	6.9	4.5	42.6	14.1	21.6	14.7	10.6
Agriculture and forestry	21.0	13.3	30.1	4.7	6.0	4.9	0.0
Accommodation and food service activities	4.2	10.5	39.1	8.8	21.7	15.3	0.9
Arts, entertainment and recreation activities; other services	17.7	5.7	38.9	9.0	17.4	10.8	0.8
Professional, scientific and technical activities	16.8	10.6	45.3	4.9	10.3	3.8	0.6
Human health and social work activities	3.6	4.5	53.7	10.1	18.5	7.6	0.6
Wholesale and retail trade; repair of motor vehicles	5.0	5.7	54.3	6.2	17.6	9.6	1.1
Education	4.9	0.8	56.6	12.9	15.0	4.5	0.5
Information and communication activities	10.7	3.3	59.2	5.2	8.7	4.9	0.8
Construction	8.7	9.0	61.2	4.3	6.2	3.4	1.4
Financial and insurance activities; real estate activities	7.7	4.9	64.5	3.0	11.3	3.3	1.3
Real estate activities	2.0	2.2	49.2	4.9	7.2	3.9	1.2
Mining and quarrying	1.4	2.2	75.6	4.9	5.6	3.1	3.2
Energy, water, waste management	1.4	1.1	78.1	6.1	3.7	1.8	4.8
Public administration, defense, social security	0.0	0.0	73.3	5.9	8.3	2.2	0.5

Source: Federal Statistical Office.

Furthermore, we can see from the scatter plot in figure 4 that in some service sector occupations job growth was achieved at the expense of a larger share of atypical workers in the respective occupation. This holds for customer service clerks (occupation 42 in ISCO-88), salespersons (52), personal and protective service workers (51), sales and service elementary occupations (91) and teaching associate professionals (33), i.e. low- to medium-skilled service workers with direct customer contact and public sector employees.

**Fig. 4: Atypical work and employment growth by occupations (ISCO-88), 1995 - 2012**



Source: SOEP, weighted, dependent employment only, without agriculture (ISCO 61, 92) and armed forces (ISCO 01), own calculations. [] unreliable, number of cases insufficient (<30 cases).

Despite larger shares of atypical work, job tenure in Germany is quite stable at a relatively high level and has increased rather than decreased in recent years. According to OECD data, average tenure increased from 10.3 to 11.5 years between 2000 and 2011. Thus, one may not conclude that the German labour market has become extremely volatile. Yet, there is some pattern of polarization emerging with longer tenure of prime-age and older workers (also due to the postponement of retirement) and greater shares of mainly younger workers with shorter tenure, in particular in the bracket below 6 months. This is confirmed by table A1 that shows that flows into but also out of employment are particularly pronounced for young people (and the low skilled). But overall, the tenure structure is quite resilient in Germany.

Addressing another dimension of segmentation, table 3 shows the increase in pay dispersion among male and female full-time workers in Germany according to OECD data. The data show that Germany now has a sizeable low pay sector (below two thirds of the median gross hourly pay). Pay dispersion and low pay also grew more for women than for men. If we add in non-standard contracts, the low pay sector is even bigger. Low pay is now a widespread

phenomenon in Germany particularly affecting non-standard workers and certain medium and low-skilled occupations (see table 4, Kalina and Weinkopf 2012).

**Table 3: Pay dispersion and low pay incidence in Germany**

	2000	2005	2011	Difference 2011-2000
<b>All persons</b>				
Low Pay Incidence	15.9	18.3	18.37	2.47
Decile 5/Decile 1	1.699	1.869	1.867	0.168
Decile 9/Decile 1	3.0456	3.1786	3.341	0.2954
Decile 9/Decile 5	1.7926	1.7006	1.79	-0.0026
<b>Women</b>				
Low Pay Incidence	25.1	30.7	26.93	1.83
Decile 5/Decile 1	1.7182	1.8333	1.87	0.1518
Decile 9/Decile 1	2.8001	3.1597	3.164	0.3639
Decile 9/Decile 5	1.6297	1.7235	1.692	0.0623
<b>Men</b>				
Low Pay Incidence	11.4	12.2	13.51	2.11
Decile 5/Decile 1	1.6674	1.6932	1.755	0.0876
Decile 9/Decile 1	3.0441	2.8793	3.186	0.1419
Decile 9/Decile 5	1.8256	1.7005	1.816	-0.0096

Source: OECD Employment Statistics Database.

**Table 4: Low pay by type of job**

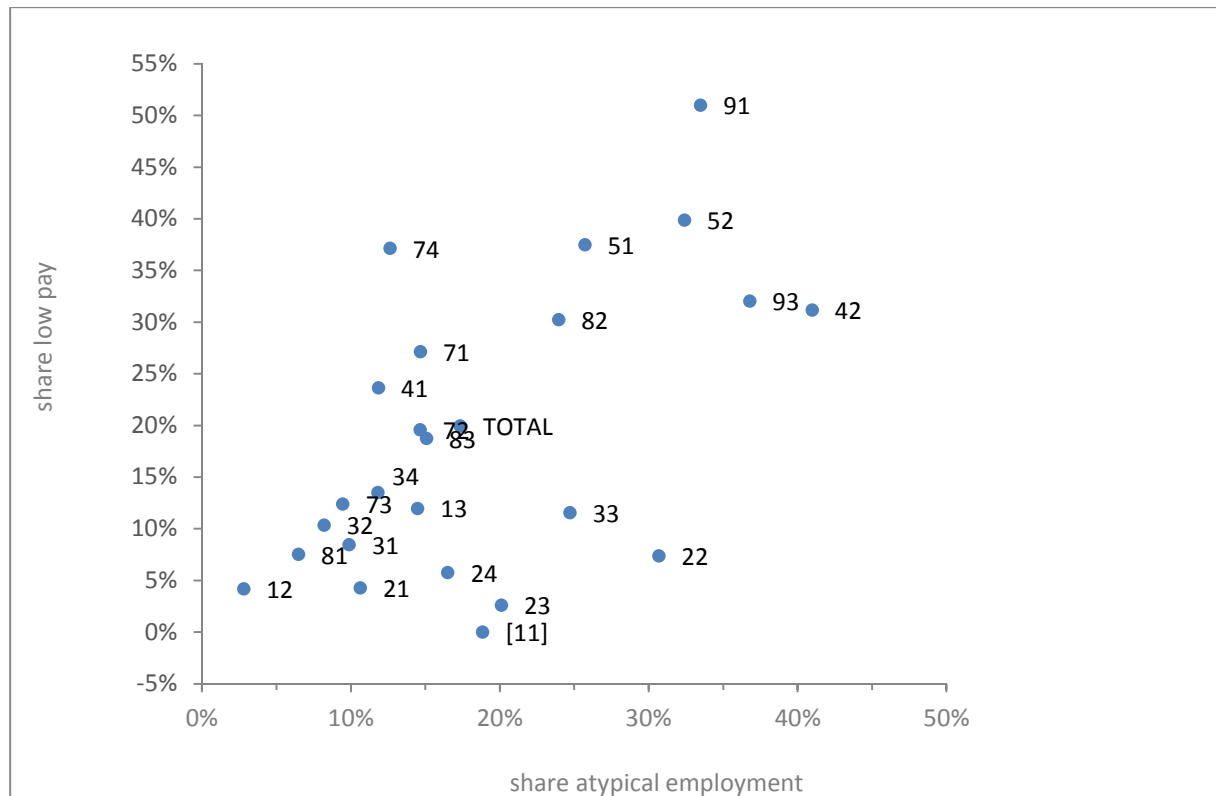
	Total	Standard employment	Non-standard contracts				
			All non-standard contracts	Part-time work	Fixed-term contracts	Marginal part-time work	Temporary agency workers
<b>Total</b>	<b>20.6</b>	<b>10.8</b>	<b>49.8</b>	<b>20.9</b>	<b>33.5</b>	<b>84.3</b>	<b>67.7</b>
Women	26.5	15.1	47.6	19.2	35.5	84.8	72.9
Men	15.8	8.1	53.7	34.3	31.6	83.4	65.4
Less than upper secondary education	52.8	22.7	77.8	44.7	62.2	88.1	85.5
Upper secondary education	17.7	12.1	39.4	17.1	36.2	77.2	57.6
Tertiary education	1.7	0.5	8.3	2.7	5.7	61.4	20.7
<b>Selected occupational groups</b>							
Academic occupations	3.0	1.0	10.5	3.5	5.7	64.9	/
Technicians and equivalent non-tech. occupations	7.6	4.0	24.9	4.7	17.3	68.1	29.2
Office clerks	23.4	10.9	48.1	13.2	39.4	80.3	62.5
Service and sales occupations	42.3	28.4	65.4	30	58.3	88.6	72.1
Crafts	16.1	11.1	48.7	32.6	31.3	81.0	47.6
Machine operators and assemblers	23.7	17.1	60.6	33.2	39.7	89.3	63.0
Labourers	61.5	39.7	79.2	56.3	70.7	90.3	89.2

Source: Federal Statistical Office.

Finally, with respect to employment conditions, atypical work and low pay tend to go together in many occupations, as figure 5 shows. Again, the most affected are mainly those occupations where employment growth was associated with an increased share of atypical contracts (42, 51, 52, 91) and agency assigned work contracts (93).



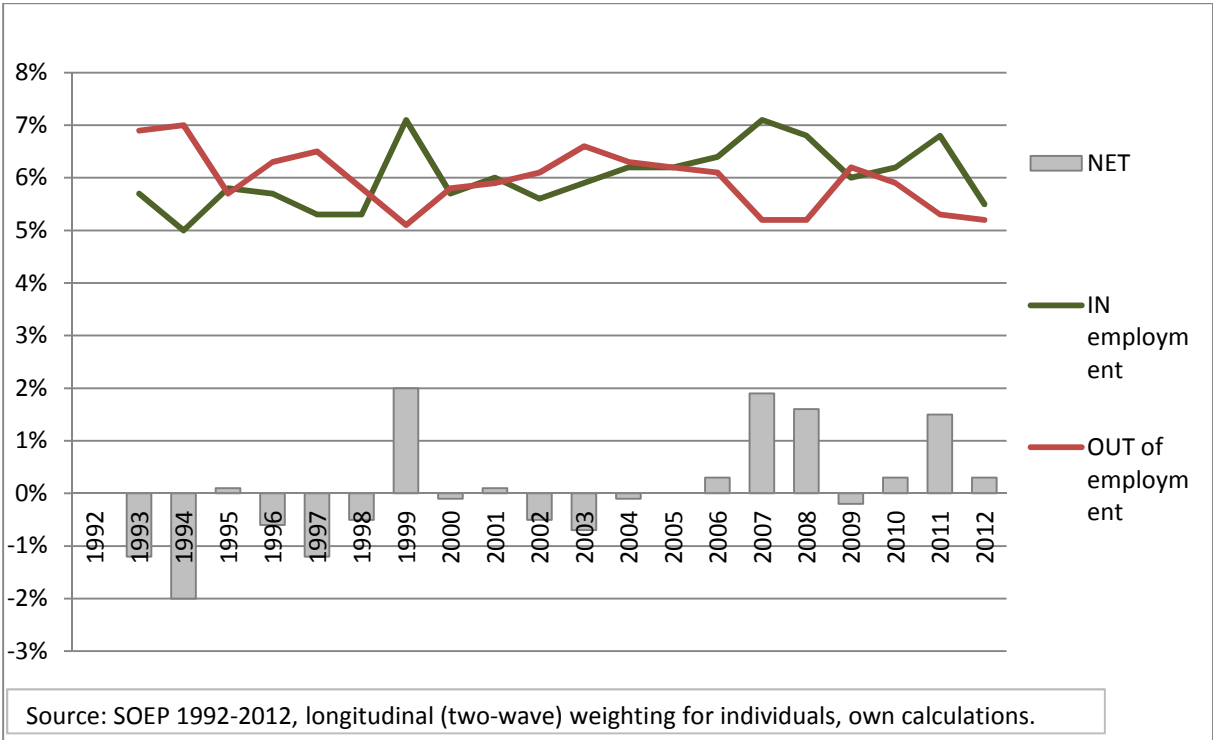
**Fig. 5: Atypical work and low pay by occupations**



Source: SOEP, weighted, dependent employment only, without agriculture (ISCO 61,92) and armed forces (ISCO 01), own calculations. [] unreliable, number of cases insufficient (<30 cases).

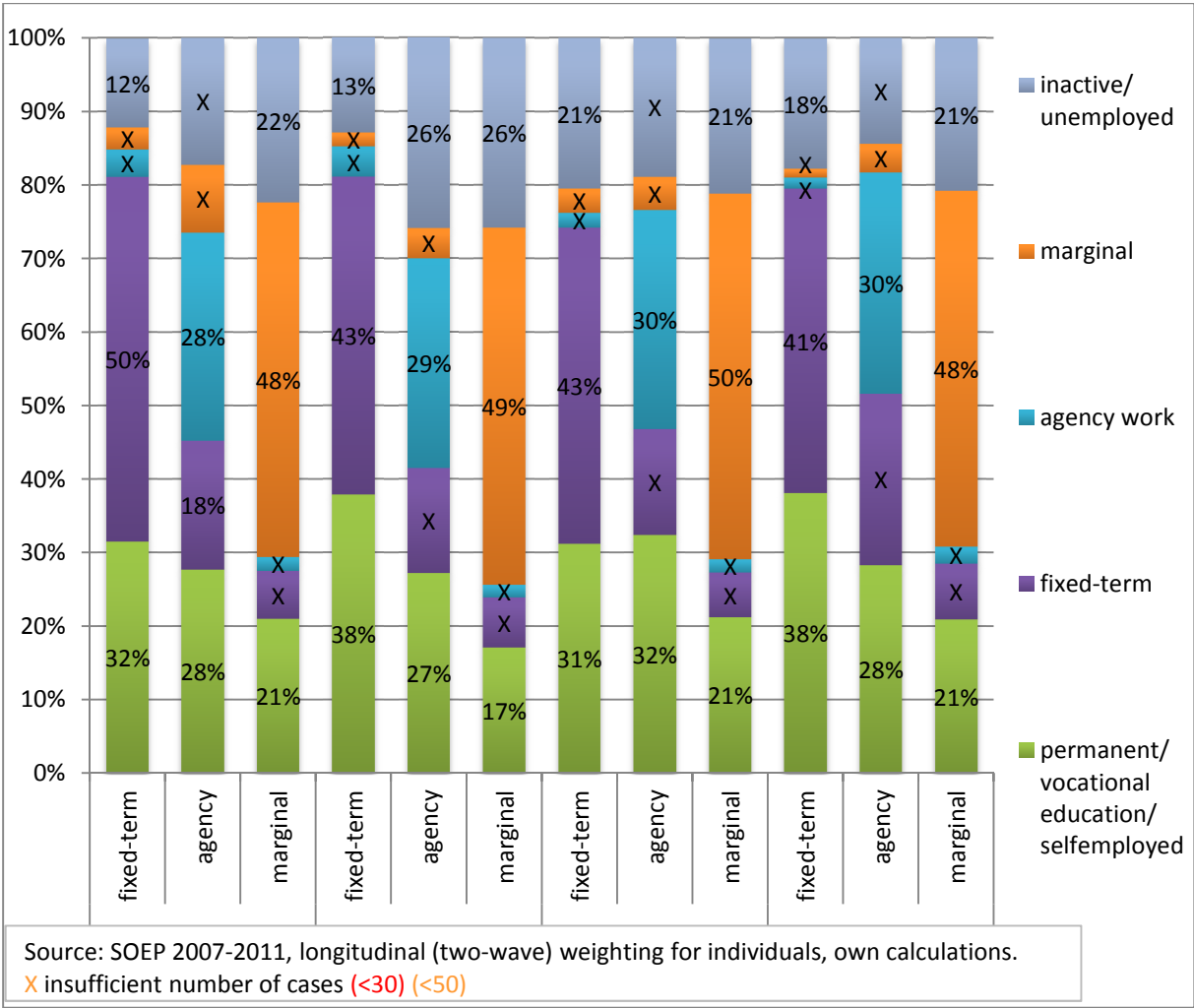
In line with the overall increase in the number of jobs and people in employment, inflows into employment have been larger in recent years than flows out of employment.

**Fig. 6: Inflows and outflows of employment**



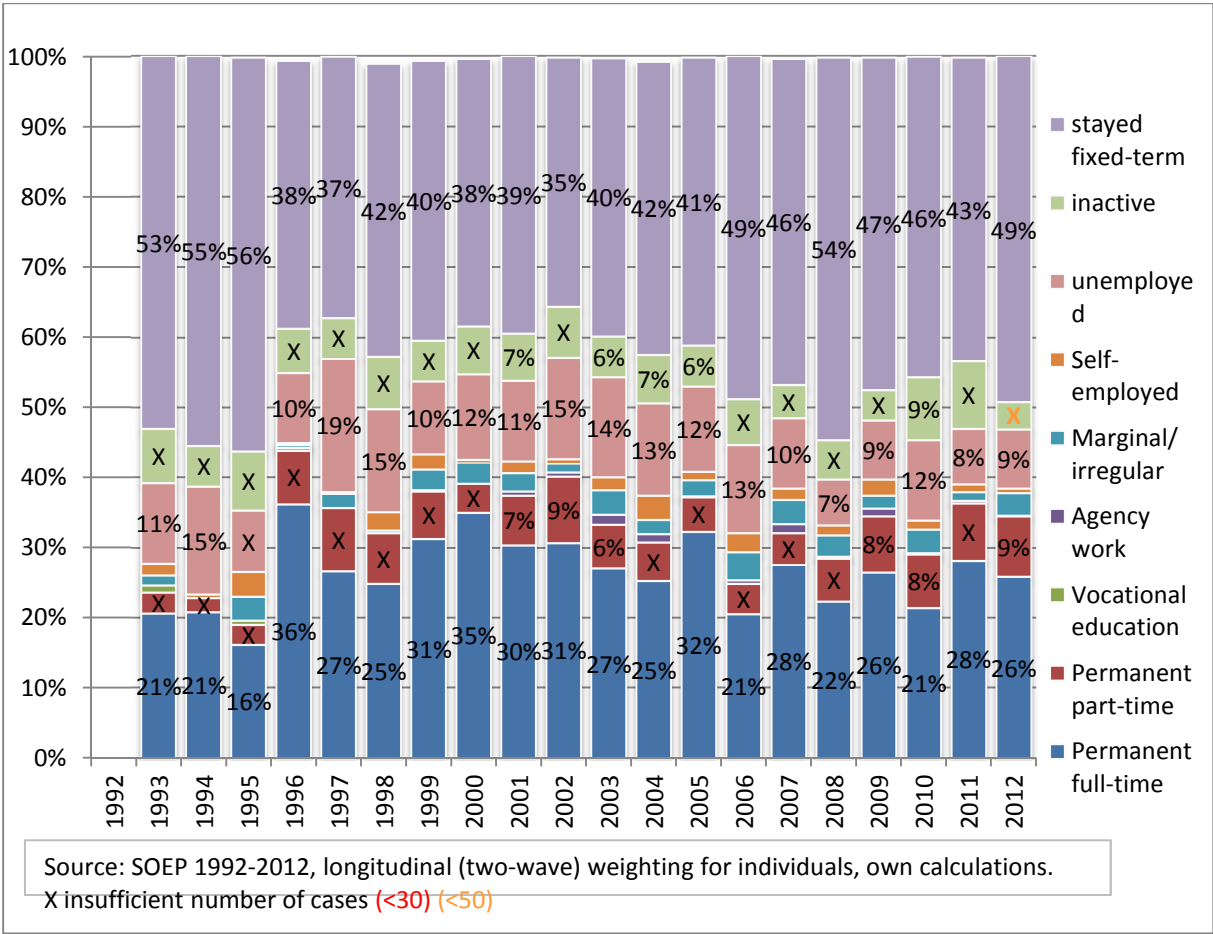
Regarding mobility between different types of jobs, figure 6 shows year-to-year flows from non-standard contracts in the preceding year to the labour market status in the current year for 2008 up to 2012. These descriptive data show for example that during the period under scrutiny, about one third of all fixed-term contract workers moved to an open-ended contract (including vocational education or self-employment) in the subsequent year while 40 to 50% remained in a fixed-term contract. About 30% of all agency workers had left that status in the subsequent year in favour of a permanent full-time or part-time job, vocational training or self-employed status. Persistence is quite high with marginal work, however, where about 50% of all marginal part-time workers remained in that category.

**Fig. 7: Flows from non-standard work in the previous year**



Taking a longer time perspective, as figure 7 shows, flows from fixed-term contracts to permanent jobs occur in about one third of all cases on a year-to-year basis with some notable cyclical variations. Over the last years, however, staying in a fixed-term employment status became somewhat more frequent.

**Fig. 8: Flows from fixed-term contracts**



We can further see in table 5, covering the last five years (2007 to 2011), that about 71% of all working-age people in Germany did not experience non-standard work (fixed-term, marginal part-time or agency work), about 47% have always been in stable ‘insider’ jobs over a five-year period, and around 11% have not been in employment at all. Only a small group cumulates longer phases of non-standard work.

**Table 5: Frequency of atypical employment between 2007 and 2011**

How often in atypical employment - on a yearly basis (in percent)	
<b>(0) never</b>	<b>70.93%</b>
<i>never, always inside employment</i>	47.20%
<i>never, always outside employment</i>	10.80%
<i>never, switching between employment and unemployment/ inactivity</i>	12.93%
<b>(1) only once</b>	<b>12.42%</b>
<b>(2)</b>	<b>7.20%</b>
<b>(3)</b>	<b>3.95%</b>
<b>(4)</b>	<b>3.70%</b>
<b>(5) always</b>	<b>1.80%</b>

Source: SOEP, own calculations.

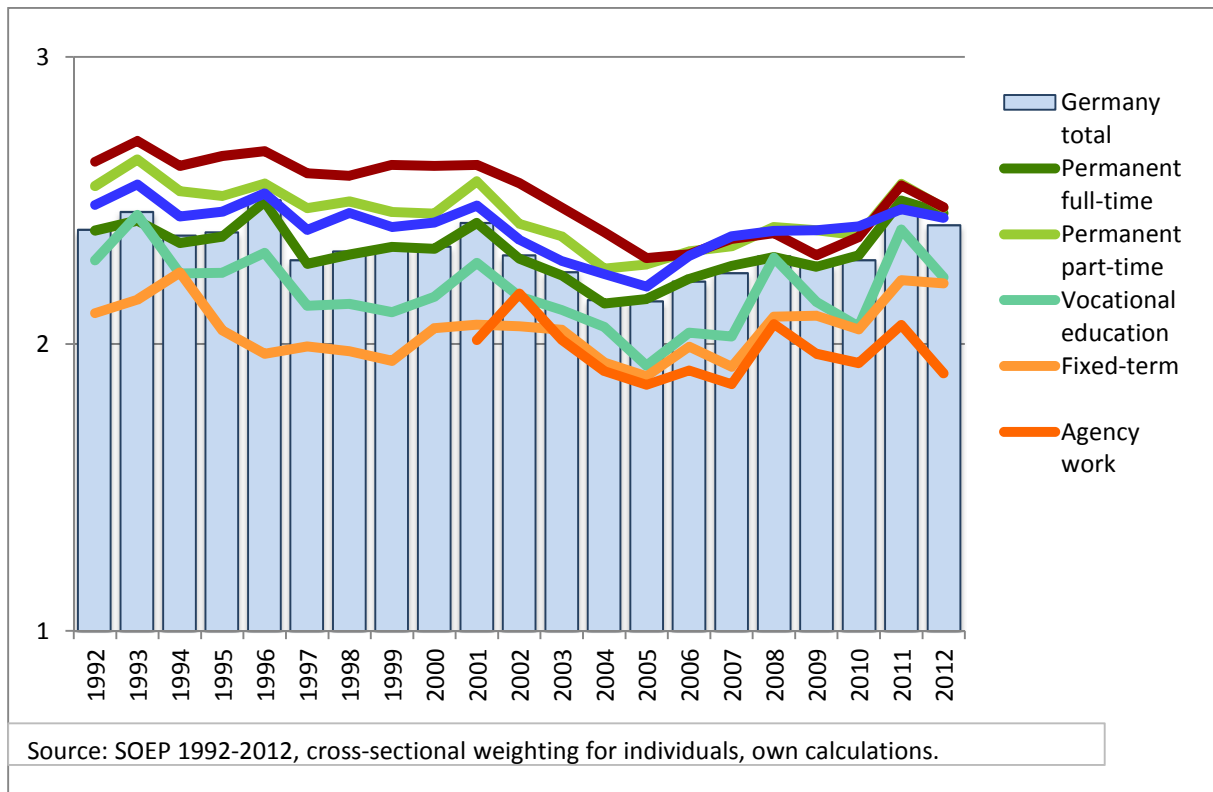
Going beyond descriptive evidence, a large body of recent research has analysed both wage gaps and transition probabilities between atypical and standard employment types. Regarding wage gaps experienced by fixed-term workers, a recent study shows that, controlling for personal characteristics and occupational and firm-specific effects, there is a wage gap of about 10% attributable to the type of contract (Pfeifer 2012). With respect to temporary work agency employees, controlling for individual characteristics, there is a considerable raw wage gap stemming from differences in the collective agreements of agency firms and user firms, tasks, skills and experience amounting to about 40 to 50% (Baumgarten et al. 2012). Controlling for socio-economic characteristics of workers and job characteristics, the corrected wage gap has been estimated at around 32% in the past (Jahn 2010); but taking into account tenure and work experience it was estimated at around 15% to 22% for full-time agency workers (Lehmer and Ziegler 2011). Part-time work is also characterized by a wage gap after correcting for worker and job characteristics (Wolf 2010). Furthermore, there is some evidence that marginal part-time workers receive significantly lower gross hourly wages than other part-time workers (Voss and Weinkopf 2012).

Research now shows that transitions from a fixed-term to a permanent contract is relatively frequent in Germany, in particular for young people entering the private sector for whom fixed-term contracts (outside genuine apprenticeships which make up for about half of all fixed-term contracts) can be seen as an extended probationary period, while continuous renewals of fixed-term contracts are even more widespread in the public, academic and social sector where specific conditions prevail (Bellmann et al. 2009; Hohendanner 2010; Boockmann and Hagen 2005; Lehmer and Ziegler 2010). Mobility from temporary agency

work to permanent (direct) employment is more problematic, however, given the distinct institutional arrangement and functional logic of agency work in Germany (Baumgarten et al. 2012; Spermann 2011; Kwasnicka 2008; Holst et al. 2009; Lehmer and Ziegler 2010; Crimmann et al. 2009). With respect to part-time work, we see significant employment stability of (voluntary) part-time work in Germany, which can also be perceived as a standard employment contract at reduced weekly hours. Yet most part-time workers likely prefer to expand their working time (Holst and Seifert 2012). Mobility barriers that exist with respect to marginal part-time work can be attributed to the prohibitive marginal tax rates experienced at the threshold earnings level in this segment (Eichhorst et al. 2012; Freier and Steiner 2008). Mobility from low pay to higher wages is more frequent with younger and better skilled workers as well as male workers in general, in particular if they can leave (i) firms with large segments of low paid jobs and (ii) unskilled service occupations (Mosthaf et al. 2011).

A similar picture emerges with respect to job insecurity where we do see a cyclical pattern, but no long-term increase in job worries. The most recent period has rather led to higher perceived employment security. The self-employed, but also permanent dependent employees and marginal part-time workers, who are not totally reliant on income from work, are less worried than fixed-term and agency workers as shown in figure 9.

**Fig. 9: Average Worries about Job Security by Employment Type**  
 (1 = very concerned ... 3 = not concerned at all)



#### **4. The role of institutional reforms**

Besides structural change and strategic behaviour of market actors, in particular employers, labour market institutions and reforms play a major role in shaping the functioning of the German labour market, specifically regarding atypical work. While there is major stability around the institutional provisions governing standard employment contracts, there have been major structural changes mainly affecting non-standard or 'atypical' jobs.

Regarding open-ended full-time contracts, dismissal protection has remained more or less at the same level as it used to be in the 1990s. Reforms marginally liberalising dismissal protection by lifting the company size threshold and narrowing the social selection criteria for fair dismissals introduced in the mid-1990s were undone in the late 1990s and partially restored in the early 2000s. Apart from that no major changes were implemented on the legislative side. Social protection of fully socially insured permanent employees has changed,

however, in particular by shortening the maximum duration of unemployment insurance benefit receipt for older workers, a cut from 32 to 18 month and later extended to 24 months again.

More important for the development of standard contracts was the restructuring of collective bargaining and company-level strategies. First, beginning in the 1990s, sectoral negotiations linking wages, working time and job stability were mostly characteristic of the core manufacturing sector in Germany. This led to increased flexibility within collective agreements regarding pay and working time adjustment. In the medium and long run, these steps of restructuring contributed to regaining competitiveness in the export-oriented sector and the relative stabilization of standard employment contracts for the core labour force, albeit at conditions which are less 'rigid' and more flexible than in the past. At the same time, however, manufacturing employers also promoted outsourcing and offshoring, thereby redrawing the borders of the core workforce more narrowly. One has to note further that major employment gains in standard employment contracts occurred in the private service sector, most notably in highly skilled occupations, which offset the stagnating and rather shrinking employment capacity of the manufacturing sector. However, collective bargaining coverage is much lower in many of the most dynamic private services, which also contributes to the increase in wage dispersion and low pay (Dustmann et al. 2009; Dustmann et al. 2014).

With respect to non-standard contracts, a number of changes have shown medium and long run consequences of some deregulation at the margin of the labour market. These changes were more significant than legislative modifications of the standard employment contract, i.e. dismissal protection. First, over the last three decades, starting in the mid-1980s, fixed-term contracts have been liberalised in a step-wise manner with only a few smaller steps reversing parts of the deregulatory path. Currently, fixed-term contracts without having to provide a valid reason are legal in Germany for up to two years with the possibility of up to three renewals. However, since 2000/01 it is no longer possible to have a fixed-term contract with the same employer if fixed-term employment had already taken place in the past. Furthermore, since the mid-2000s fixed-term employment without having to provide a valid reason is basically unrestricted when hiring older unemployed individuals and during the first years of a business start-up. Fixed-term contracts are also feasible in cases of a valid reason, of course. In the public sector project-related funding is often taken as a reason to employ workers only on a temporary basis; and in the academic sector, specific legal provisions allow for extended periods of fixed-term employment up to 12 years. One has to note, however, that

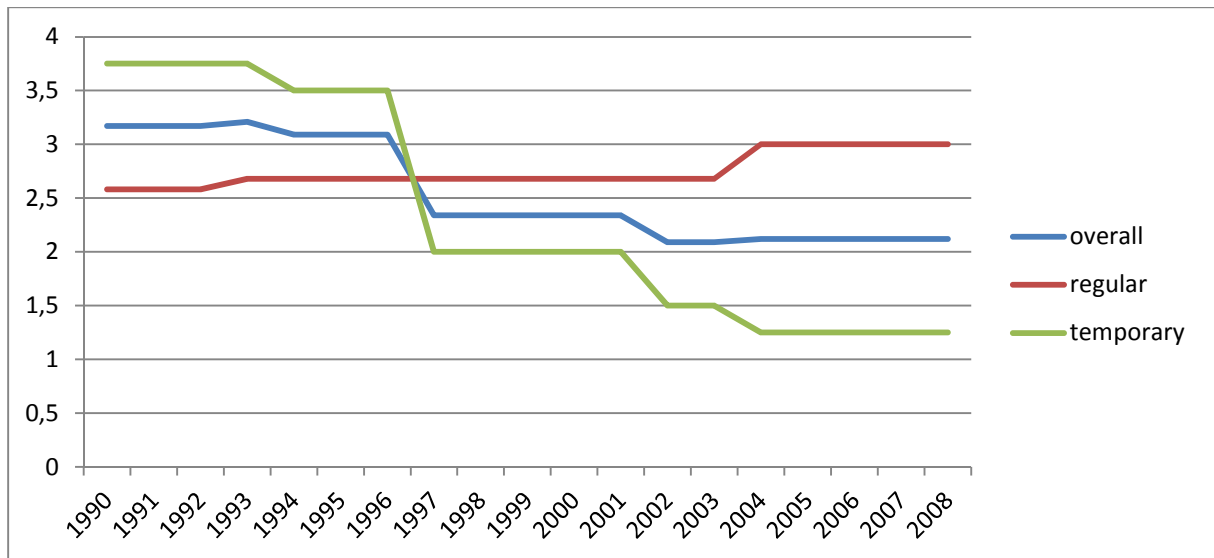


dismissal protection for permanent staff is even stricter in the public sector than in the private one. It is extremely difficult to fire civil servants and public employees with certain tenure. This also explains the reluctance of public employers to convert temporary into permanent jobs.

As with fixed-term employment, temporary agency work has also been increasingly liberalised over the last decades, with the most important deregulatory step being taken in 2003. Here, virtually all restrictions regarding agency work, such as the maximum duration of assignments, the ban on synchronicity between employment contract and individual assignments or the ban on rehiring, were lifted. At the same time, equal pay and equal treatment were stipulated as a general principle. However, deviations were allowed for initial periods of employment after phases of unemployment and, most importantly, by way of collective agreements. This led to virtually full coverage of the agency sector by collective agreements – however, the wages set are now significantly below those of major user sectors such as the metal working sector. Therefore, while the original intention of promoting temporary work agencies was to strengthen the placement capacities for the unemployed, contradictions, largely due to differing wage scales and assignments that can be made for an indeterminate period of time, in labour market reforms in Germany actually led to the creation of a peculiar wage gap between direct employees in manufacturing and temporary agency workers performing similar tasks. Finally, while in the late 1990s ‘bogus’ self-employment was defined more strictly according to specific criteria in order to avoid exit from social insurance and reclassify those workers as dependent employees, policies to promote business creation have eased barriers to own account work since the early 2000s.

Figure 10 shows the asymmetric liberalisation of employment protection with reduced levels of EPL for fixed-term contracts and temporary agency work while maintaining relatively strong dismissal protection for open-ended contracts.

**Fig. 10: OECD Summary indicator on EPL (Version 1)**



Source: OECD. For details on the situation also refer to the OECD country file.

Most important, but outside employment protection legislation, was the change in the regulation of so-called marginal part-time work in 2003. In contrast to earlier, more restrictive regulation of small part-time jobs, the 2003 reform lifted the earnings threshold to 400 EUR per month (450 EUR as of 2013), abolished the weekly working hours ceiling of 15 hours and allowed for marginal part-time work as a second job. What is peculiar about marginal part-time work or Minijobs in Germany is the fact that employment in marginal part-time is not liable for income taxes and employee social insurance contributions while at the same time not providing full social protection. Hence, earnings from Minijobs can be received without a reduction of taxes and social insurance contributions. But when earning more than 450 EUR (or if combining more than one of these jobs), full taxation and a gradual phase-in into social insurance begin. Therefore, the 450 EUR threshold acts as a strong disincentive to earn or work more. This arrangement, however, is quite attractive and popular with secondary earners such as married women, people with a fully socially protected first job and students and pensioners. What has occurred since 2003 is not only the expansion of Minijobs but also the further restructuring of some private services, such as retail trade or hotels and restaurants, where most of these jobs are concentrated. There is some evidence that regular part-time and full-time jobs have been crowded out, and employers have reaped part of the benefits on the employee side by reducing gross hourly wages (Eichhorst et al. 2012; Hohendanner and Stegmaier 2012). In-work benefits also contribute to the more widespread appearance of low pay since the *Hartz IV* reform simplified access to social assistance as a means to top up low

earnings due to earnings disregard clauses. This can induce employers to lower gross wages if there is no binding wage floor. *Hartz IV*, one has to note, was one of the core pillars of activation policies in Germany (Eichhorst et al. 2008; Ebbinghaus and Eichhorst 2009).

With the number of recipients of unemployment benefits and social assistance steeply rising, largely due to a continuous increase in long-term unemployment, reforming these systems became a priority on the agenda of labour market and social policy. The Hartz report formed the base for a package of reforms aiming at activating both the short- and long-term unemployed by reforming the public employment service and the institutional repertoire of active schemes. Finally, with *Hartz IV* coming into force in January 2005, unemployment assistance and social assistance were replaced by a single means-tested replacement scheme for persons in need and able to work who are not entitled to unemployment insurance benefit or after expiry of this contribution-based benefit. *Hartz IV* radically changed the German system of wage-related welfare. The new scheme has a dual aim: on the one hand, it was designed to prevent poverty but not to secure previous living standards. Thus, for those having received social assistance before, the new legislation actually allows them to receive marginally more money and access to job employment services. For former recipients of a substantial amount of unemployment assistance, the level of transfer payment decreased. Apart from its social policy objective, the aim of this reform was to lower unemployment. The major lever to achieve this goal was the shortening of individual unemployment spells through accelerated job placement and more coherent activation of the beneficiaries of unemployment insurance benefits and unemployment or social assistance. Less generous benefits for the long-term unemployed, stricter job suitability criteria and more effective job placement and active labour market schemes were the instruments to achieve this goal. Benefit recipients can be demanded to take up any job and follow obligations stemming from integration agreements. The practical enforcement of “rights and duties”, however, is the core element of the Hartz reforms. This activation strategy is implemented in virtually every element of the labour market policy framework. The Hartz reforms shifts priority towards active measures that require proactive behaviour of the unemployed and promote their direct integration into regular employment. To this end, the reform re-designed integration subsidies, introduced new forms of wage subsidies, start-up subsidies and jobs with reduced social security contributions.

In general, all major steps of deregulation of non-standard work, such as fixed-term employment, agency work, self-employment and marginal part-time work, were intended to

lower barriers for job creation, specifically in the service sector, and ease access to flexible jobs as stepping stones for unemployed or inactive persons, in particular for those with limited skills or work experience. Hence, one can argue that the Hartz reform package established a rather ‘implicit’ linkage between (i) activation-oriented active labour market and social policies aimed at reducing benefit dependency and increasing labour supply and (ii) labour market flexibilisation aiming at more dynamic job creation, in particular in the service sector (Eichhorst et al. 2008; Ebbinghaus and Eichhorst 2009).

The Hartz reforms, initiated by the Social Democratic-Green government after its re-election in 2002, aimed at activating the unemployed (and social assistance claimants), strengthening the reintegration capacities of active labour market policies as well as strengthening the job-creation potential of the economy through a partial deregulation of the labour market. The increase in labour supply (due to activation) was to be absorbed by a more flexible labour market, i.e. in “new” flexible segments such as start-ups, part-time and minor jobs, but also temporary agency work. While the shift towards activation means a break with the past, further steps in partial flexibilisation fit in with the long-standing path of gradual reforms at the margin. Nevertheless, the Hartz reforms are a reform package addressing passive and active labour market policies, employment protection, and an organizational reform of both the employment office and societal responsibility.

While non-standard work also contributed also to the stagnation or decline in unit labor costs for end products (Dustmann et al. 2014; Hassel 2014), there is no clear evidence of strong producer coalitions calling effectively for deregulation of atypical contracts in the German case, rather the labour market reforms of the early 2000s were seen a necessary step to open up the labour market and enhance the job creation potential of the service sector as an entry point for those in unemployment or in inactivity (Eichhorst 2014).

The expectations that of the Hartz reforms, such as significantly reducing unemployment in Germany and overcoming persistently high structural unemployment, have partly been realised as the increase in total employment and the related decline in inactivity and unemployment show. Yet, employers could now shift more and more employment risks onto the flexible part of the labour force and assign more tasks to flexible and low paid workers. The widespread perception is that the German labour market has become more flexible and more conducive to the creation of jobs, but on average this has come at the price of having more heterogeneity between jobs and an increasingly large share of non-standard, i.e. more

fragile, employment and low pay. The growth of the secondary segment has also contributed to fears in the core segment regarding downward mobility of pay and employment stability.

## **5. Outlook and Policy Conclusions**

The German labour market underwent a major transformation over the last 10 to 15 years. New jobs in service occupations have contributed to a significantly higher level of employment compared to earlier phases, and many of these jobs are in non-standard forms of contracts. As a general assessment of labour market segmentation in Germany, one can argue that the variety of employment types and pay dispersion increased significantly since the turn of the century, in particular in response to institutional reforms implemented after 2003. Most of the non-standard jobs, however, can be seen as additional employment opportunities created by institutional liberalisation at the margin of the labour market and the corresponding adaptive behaviours of market actors. Hence, labour market segmentation and dualization have certainly grown in importance over time, moving Germany away from a situation of few, but quite equal jobs to a constellation characterized by more, but also increasingly unequal jobs. However, job quality in terms of pay, employment stability, job security has not declined in general, and some forms of non-standard work provide effective entry points and stepping stones in the German setting. Legislative changes are not the only factor, however. Many other factors such as sectoral change, the further development and relative shrinkage of the scope of collective bargaining and company-level practices all have to be taken into account. Still, one has to note that there is also a high degree of stability in the German labour market with respect to the large segmented of standard contracts, even increasing average tenure and perceived job stability. Despite some areas where we could observe some crowding-out of standard contracts by atypical forms of employment, the growth in the non-standard part of the German labour market can be seen as complementary.

The issue of labour market segmentation has risen in public and political attention in recent years, with a major campaign of the trade unions pushing for minimum wage levels and some re-regulation of the labour market. The major issue here is to reduce the regulatory gap between standard and non-standard types of jobs without making the German labour market overly rigid again, thus paving the way to a smoother transition between jobs and realizing the full potential of flexible jobs as stepping stones to permanent positions (or from low pay to medium pay). All the while, policy must take into account that a labour market dominated by

service sector jobs will tend to have a stronger demand for external flexibility and non-standard types of jobs compared to the decades dominated by manufacturing employment. This is particularly relevant for

- fixed-term contracts (most importantly in the public sector where transition probabilities are low),
- temporary agency work and
- marginal part-time work.

Regarding fixed-term contracts (mainly in the public sector), softening employment protection for permanent staff in public sector jobs to the level of dismissal protection seen in the private sector in exchange for easier access to open-ended contracts in this sector could be one solution. Furthermore, and even more fundamental, a general revision of dismissal protection for permanent workers in exchange for a legal entitlement to severance pay proportional to salaries and tenure combined with some limitations on fixed-term contracts could help ease segmentation along this line. Yet, as many examples from other European countries show, all reforms questioning dismissal protection are difficult in politico-economic terms; therefore, they do not rank high on the policy agenda. German employers have adjusted to the availability of different types of contracts, and trade unions (and works councils) implicitly also accept the segmentation of the labour force rather than challenge the employment protection of permanent staff.

The situation is less deadlocked in the area of temporary agency work. Widespread uneasiness with the current working conditions of agency workers has fuelled a debate about introducing 'real' equal pay and equal treatment through legislative changes. Trade unions in particular have pushed for this; however, the legal situation has not yet been reformed substantially. What we can observe most recently is successful collective bargaining in the metal working sector to move towards stronger co-determination regarding the use of agency work and stronger equal pay in practice. From a trade union perspective, though, this issue can only be addressed via collective agreements in areas where they are strong enough and where employers are willing to compromise on this as part of a larger bargaining deal. Furthermore, the new government coalition formed by Christian Democrats and Social Democrats in 2013 has agreed to re-regulate temporary agency work by introducing equal treatment after nine months of assignment as well as limit the maximum duration of assignments to 18 months. This is currently still a pending issue though.

Marginal part-time could be reformed in order to promote more substantial part-time work – this would imply, however, removing the tax privilege of Minijobs and joint income taxation of married couples (Eichhorst et al. 2012) which tend to benefit middle-class household work arrangements and income situations. Hence, reforms in these areas will most likely be unpopular as they affect core constituencies of major political parties and the trade unions.

Regarding wage dispersion, the weakness of collective bargaining in the private service sector, in particular in medium- and low-skill occupations, has raised attention of the issue of setting binding minimum wages since the mid-2000s. This was virtually a non-issue for many years as trade unions (and employers) always saw wage bargaining as their genuine responsibility, but faced with increasing low pay and limited capacities to establish collective agreements, the trade unions started to push for a general statutory minimum wage, a political project that is also popular with the majority of German voters. Over the last years and in different government constellations, however, collectively agreed minimum wages in an increasing number of sectors have been made generally binding via existing legislation on the posting of workers or, in the case of agency workers, on the regulation of temporary work agencies. The new government is planning to introduce a statutory minimum wage of 8.50 EUR per hour as of January 2015 with a transition period of two years for existing and binding collectively agreed minimum wages. This will establish a binding minimum wage floor for virtually all categories of workers (except for young people and apprentices) and all sectors for the first time in Germany. From a labour market point of view, a national minimum wage at a moderate level would be feasible without major negative effects on job creation, particularly if it set by an independent committee of experts and accompanied by a regular evaluation of its effects. However, the current government has decided on the level of minimum wage *a priori* and handed over further adjustments to a committee formed by employers' and trade union representatives. Along with the expected interventions into agency work, the relatively high statutory minimum wage will probably be the most important reform breaking with the deregulatory approach adopted about ten years ago. While designed to limit the dispersion of wages and working conditions, the re-regulatory approach may also trigger new forms of circumvention, such as a resort to undocumented overtime or more bogus self-employment.

Apart from the current regulatory stance of German politics, in the medium perspective we can certainly expect further creative adjustment of social partners and collective bargaining as well as company-level practices to promote and safeguard employment of permanent skilled

staff. This is particularly true in a situation where skilled labour becomes a scarce resource due to demographic ageing but continues to be essential for the German production model. Social partners continue to be of major importance in the well-established core sectors of the German economy, including manufacturing and some service industries, but the realm of collective bargaining will probably continue to shrink. In many dynamic service sectors market forces are of particular and growing importance within a largely flexible institutional environment. This gives a strong role to employers and employees to negotiate according to their individual market position. For the increasingly large margin of the labour market though, government action is certainly crucial. Where the social partners are unable or unwilling to act and intervene, the state, i.e. through political decisions, will become more important. This holds for institutional arrangements governing non-standard forms of employment and for questions regarding the establishment of minimum pay provisions.



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