The Gradual Transformation of Continental European Labor Markets: France and Germany Compared[1]

FIRST DRAFT

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Abstract

Germany and France are both Continental European welfare states with severe labor market problems such as low employment and high and persistent unemployment which can be explained by labor market institutions that inhibit labor market adaptability. This paper analyzes recent reforms in core areas of the employment system such as active and passive labor market policies, employment protection and the funding of social policies through taxes and social security contributions in both countries and shows if and to what extent more favourable conditions for employment growth could be created. The paper identifies the limits of partial reforms in terms of the creation of more efficient labor market institutions although these reforms are highly plausible in politico-economic terms. However, the cumulative effect of sequences of marginal changes contributes to a gradual medium-term transformation of both Continental European labor markets.

[1] I am grateful to Julia Erkens, Margard Ody and Christoph Braun for invaluable research assistance.

1. INTRODUCTION

Germany and France, the two largest economies in Continental Europe, are often described as countries with severe structural problems on the labor market as institutional arrangements provide only for limited adaptability of the national employment system. Therefore, the need for reform is seen as paramount in these two countries in particular. The paper will first discuss the relation between labor market and welfare state institutions in Continental Europe and the political economy of institutional reforms before analyzing the institutional changes implemented over the last decade and assessing their effects on levels and structures of employment and unemployment. Outcomes of these reforms with respect to overcoming the labor market problems will be analyzed in a European context, i.e. in comparison with both EU-15 average and data on selected European countries such as the United Kingdom, Denmark and the Netherlands. These countries were chosen because, first, they show diverse patterns of labor market institutions and represent different types of welfare states and employment systems, and, second, because of the fact that they are often taken as “model” countries with regard to labor market reforms and employment performance. The paper discusses the political economy of recent labor market reforms in Germany and France and provides an outlook on probable paths of future institutional change.

2. EMPLOYMENT AND THE WELFARE STATE IN CONTINENTAL EUROPE

Welfare state institutions and institutional arrangements of national employment systems in a wider sense influence the functioning of the labor market as they have strong impacts on both the level and the structure of employment as well as on the patterns of labor market dynamics and mobility. Both comparative research in economics (Blanchard 2005) and welfare state analysis (Scharpf 2000) rely on the concept of labor market adaptability to describe the role institutions play in allowing national markets to adjust to business cycle variations, structural shifts and societal or technological change. There may be different viable paths of successful labor market adaptation, but an insufficient capacity to adapt will in any case result in persistent labor market problems such as low utilization of labor or high long-term unemployment. Economic and comparative welfare state research both explain differences in labor market outcomes by referring to core institutional variables such as active and passive labor market policies, taxes and social security contributions, wage setting and employment protection (see also Bassanini/Duval 2006).

With respect to these core elements of national employment systems, Continental European countries share common features such as relatively generous and status-protecting unemployment benefits, a rather passive orientation of labor market policies, high taxes and non-wage labor costs, i.e. social security contributions, corporatist wage setting with high minimum wages set by law of collective agreements and stringent employment protection. Despite some diversity, these elements also characterize both the German and the French labor market. This is why they are usually clustered together in comparative research either as Conservative or Corporatist welfare states

(Esping-Andersen 1990) or corporatist market economies of the Continental European type (Amable 2003, Hall/Soskice 2001, Albert 1991, Erhel/Zaydela 2004).

The institutional arrangements of Continental European labor markets generated favourable labor market outcomes in the post-war period. Unemployment insurance, employment protection and early retirement were well fitted for stabilizing internal skilled labor markets with long tenure in manufacturing (Estevez-Abe/Iversen/Soskice 2001). However, the performance of Continental European labor markets was less impressive over the last decades and points at problematic aspects of the given institutional setting with regard to labor market adaptability. To counter open unemployment, Continental European countries embarked on a strategy of reducing labor supply through various schemes of early retirement, passive labor market policies aimed at "hiding" open unemployment, and a selective approach to labor market inclusion in particular to the detriment of women (in Germany), the young (in France), the low-skilled and older workers. This, however, led to the emergence of "welfare states without work" (Esping-Andersen 1996) suffering from high levels of benefit dependency and an increasing burden of taxes and social security contributions raised in order to finance inactivity. Together with relatively high standards regarding minimum wages and employment protection, this hampers employment growth in private services, the major area of employment expansion in post-industrial economies and the most promising field of reemployment for workers made redundant in manufacturing (Scharpf 1997).

Given the limited potential of labor market adaptability in Continental European institutional arrangements, the need for institutional change is particularly pronounced. Raising employment and furthering labor market inclusion means breaking with the traditional strategy of restricting access to the labor market and reducing labor supply. Adopting more activating labor market policies and making social security more employment-friendly as well as allowing for higher wage flexibility and easing employment protection would help reduce benefit dependency and create more employment in the service sector. Comparative work shows that there are different models of superior labor market performance: a liberal or Anglo-Saxon model (e.g. in the UK or the US) and a Scandinavian one (Denmark and Sweden), but also a "modernized" Continental European model (Austria and the Netherlands) that are equally successful in employment terms but have diverging distributional outcomes due to different models of redistribution through taxes, benefits and active labor market policies (Bassanini/Duval 2006).

3. REFORMING WELFARE STATES: POLICY PACKAGES OR GRADUAL REFORMS?

Given the need for reform in related policy areas of the labor market and the welfare state, the capacity of political systems to implement institutional changes is a crucial factor for raising labor market adaptability. In this respect, actors, preferences and capacities to act are the most relevant explanatory variables. Comparative studies on labor market reforms emphasize the role of governments, political parties and the social partners, i.e. trade unions and employers' associations, which are incorporated into the administration of social policy or have a strong role in collective bargaining as is the case in all Continental European countries.

As furthering labor market adaptability requires changes in more than one policy area, complementary and coordinated reforms affecting all major labor market institutions are the most promising strategy not only in economic terms but also in politico-economic ones as potential opposition against particular reform steps could be neutralized through compensatory measures (Orszag/Snower 1988, Eichhorst/Konle-Seidl 2005). However, realizing ambitious policy packages depends on institutional prerequisites:

a) the government is either unified and strong enough to design such strategies and push them through the policy-making process characterized by few veto points (e.g. the UK),

b) or the government and social partners are able to negotiate and can agree upon a tripartite agreement on coordinated reforms as was the case. This, in turn, is also facilitated by a strong government that is capable of establishing a “shadow of hierarchy” by threatening with unilateral action, a strong institutional infrastructure for tripartite talks and trust relationships between government, trade unions and employers (Ebbinghaus/Hassel 2000). Examples of this setting can be found in Austria, the Netherlands, Ireland and Denmark.

Institutional capabilities of actors, however, cannot be analyzed without taking actors’ preferences into account. Give the institutional legacy of Continental European welfare states with their strong commitment to status-protection and a high level of “solidarity”, implementing more fundamental labor market reforms would question the “low activity, high equality” equilibrium (Streeck 2003) which might be risky in politico-economic terms. This is particularly problematic since the transition to the service economy would either mean higher flexibility and inequality in the labor market through growing employment in low-paid jobs and high taxation for redistribution objectives or continued struggles with mediocre employment performance and high benefit dependency (Iversen/Wren 1998).

To the extent that broad policy packages cannot be negotiated, a strategy of partial labor market reforms is the most plausible alternative in politico-economic terms. Given the strong position of labor market insiders in the electorate and interest associations and a prominent role of Christian Democratic or Conservative parties, policy makers might opt for a liberalization of employment protection and furthering flexibility at the margin of the labor market only while maintaining or even reinforcing job security at the core of the labor market (Saint-Paul 1996, Lindbeck/Snower 1988). This phenomenon has recently been described as the “layering” of institutions through a sequence of gradual reforms (Streeck/Thelen 2005). Establishing a labor market segment with less rigid employment protection and meagre social protection sets strong incentives to circumvent established forms of regular employment and might thus lead to a gradual transformation of the whole institutional arrangement as higher flexibility at the margin facilitates employment growth in this segment. In the long run this can result in crowding out the institutional setting of the core. The more widespread flexible employment becomes, the more viable might deregulatory steps addressing regular employment protection become (Saint-Paul 1996, Dolado et al. 2002). The strategy of partial reforms, however, deepens the segmentation of the labor market to the detriment of outsiders that have limited access to regular employment and who are referred to temporary and/or low-paid jobs (Esping-Andersen 2000). Therefore, avoiding the societal costs of complementary institutional reforms implemented across policy areas might result in higher costs over the protracted transition period.

Hence, what is most promising in economic terms – complementary reforms of different policy areas in order to create a more flexible labor market – is difficult in politico-economic terms if there is no sufficient capacity of government and/or social partners to deliver policy packages. But gradual transformation through sequences of partial reforms might result in similar outcomes. Both strategies can bring about significant and radical institutional change. However, in the case of partial reforms, societal costs associated with long transition will be higher.

4. LABOR MARKET REFORMS IN GERMANY AND FRANCE

The remainder of this paper will analyze changes in institutional settings and employment outcomes over the last decade in order to assess if and to what extent path dependent or path changing reforms have been implemented and in turn improved the functioning of the labor market. The comparative analysis of France (OECD 2005, Beninger 2005, Barbier et al. 2002, Jamet 2006) and Germany (OECD 2006b, Eichhorst/Kaiser 2006) focuses on four core areas of the labor market: a) regulation with regard to employment protection, working, time, minimum wages, b) unemployment benefits, c) active and activating labor market policies and d) reforms in welfare state funding, i.e. taxation and social insurance contributions.

4.1 Increasing Flexibility of the Labor Market? Employment Protection, Working Time and Minimum Wages

Both Germany and France are countries with a high level of employment protection legislation. They are also similar with regard to the path of reforming labor market regulation by way of liberalizing flexible types of employment relationships such as temporary agency work or fixed-term contracts while leaving statutory dismissal protection basically untouched.

Regarding legislated employment protection as measured by OECD indicators and not taking additional provisions through collective agreements into account (Table 1), France scores high not only in comparison with Germany but also with respect to the EU average and the reference countries. France shows a stable level of regulation for open-ended contracts ("Contrats de durée indeterminée") which is largely due to complex and expensive layoff procedures, whereas statutory severance pay is not particularly high. Constraints on dismissals were tightened by new legislation in 2002 but eased again in recent years. However, obligations of employers to find alternative jobs have become stricter as a result of court jurisprudence and legal amendments. Additional employer obligations apply in case of collective dismissals ("plan de sauvegarde de l'emploi") and for large firms that have to offer "reclassification leave" for employees before dismissals become effective (Beninger 2005, Jamet 2006). A special levy, the "Delalande contribution" makes dismissals of older workers particularly expensive. Hence, dismissals for economic reasons have become more difficult over time, which reinforces a trend towards dismissals for personal reasons, termination of contracts through severance payments and a higher reliance on fixed-term contracts (“contrats de durée determine”).

This is true even if the regulation of fixed-term employment is rather strict as well, since it is not allowed for permanent additional employment, but only for replacing employees on leave, for temporary need of labor, seasonal or sectoral reasons. French labor law only allows for one renewal and a maximum duration of 18 months (24 months with specific reason) and entitles fixed-term workers to severance pay if the contract expires. The situation is less restrictive in the public sector. Besides, fixed-term employment, interim work (“travail intérimaire”) organized by special agencies for temporary placement, internships (“stages”) and several forms of subsidized employment within the framework of active labor market policies aiming at “insertion” contribute to a dual structure of employment protection in France (Beninger 2005). In 2005, the ”Contrat Nouvelle Embauche” (CNE) was introduced in small firms up to 20 employees, thus establishing an open-ended contract that can be terminated without justification and severance pay in the first two years after a notice period between two weeks and one month. However, a bill generalizing the CNE for all young people below 26, the “Contrat Première Embauche” (CPE), was withdrawn by government after major unrest in spring 2006.

In Germany, after many steps of deregulation of fixed-term employment between the mid-eighties and the mid-nineties, the most recent reform implemented in 2000 restricted the use of fixed-term contracts without valid reason to newly hired employees, whereas fixed-term employment is still possible if valid reasons are given. At the same time, however, regulation of regular contracts remained basically unchanged, with a sequence of reform steps between the mid-nineties and the “Agenda 2010” package (2003) basically addressing only the establishment size threshold so that firms with fewer employees are exempt from statutory dismissal protection. Nevertheless, as in France, dismissal procedures are lengthy and generate considerable legal uncertainty for employers that often terminate employment relationships through severance payments although there are no legal provisions on their level but stable jurisprudence (Jahn 2005). One element of the Hartz reforms liberalized temporary agency work in order to “neutralize” dismissal protection by lifting the most important restrictions on temporary work agencies while calling for equal treatment of regular staff and agency workers at the same time, a principle that allowed for deviations only in the case of hiring formerly unemployed persons and through collective agreements. This led to the creation of collective agreements in temporary work agencies and a binding minimum wage in this sector. The Grand Coalition announced the complete abolishment of fixed-term contracts without valid reason in exchange for a prolonged probationary period of 24 months in regular contracts similar to CNE or CPE. After this sequence of reforms in both countries, despite some liberalization at the margin, France shows one of the highest levels of labor market regulation not only in overall employment protection but also with regard to flexible forms of employment.

Table 1: Intensity of Employment Protection Legislation (late 1990s - 2003)

	Germany	France	EU-14*	United Kingdom	Denmark	Netherlands
Overall EPL	2.2 (-0.3)	3.0 (+/-0)	2.1 (-0.1)	0.6 (+/-0)	1.4 (+/-0)	2.1 (+/-0)
- regular contracts	2.7 (+/-0.0)	2.5 (+0.2)	2.3 (+/-0)	1.1 (+0.2)	1.5 (+/-0)	3.1 (+/-0)
- fixed-term employment	1.8 (+/-0.0)	4.0 (+/-0)	2.1 (+/-0)	0.3 (+0.3)	2.3 (+/-0)	0.8 (+/-0)
- temporary work agencies	1.8 (-1.0)	3.3 (+/-0)	2.0 (+/-0)	0.5 (+/-0)	0.5 (+/-0)	1.6 (+/-0)

Source: OECD Employment Outlook 2004; *) without Luxembourg.

At first glance, France and Germany differ more clearly regarding the organization of working time. Government influence on working time policies is much stronger in France, and in contrast to Germany, where working time reduction disappeared from the agenda of collective bargaining in the late nineties, redistribution of work through shorter weekly working hours was favoured by French governments through three legislative steps. The “loi de Robien” in 1996 provided for lower social security contributions if firms reduced working time in order to create additional jobs or preserve existing jobs. This approach was reinforced by the two Aubry laws in 1998 and 2002 that introduced statutory working time reduction across the economy. The first law stipulated a general reduction of the working week from 39 to 35 hour, leaving weekly compensation and monthly minimum wages unchanged. It was to be implemented in all firms with more than 20 employees as of 2000 and in smaller firms in 2002. However, lower social charges were available if working time was reduced by at least 10% before the deadline and 6% additional jobs were created. At the same time, overtime work was to become more expensive. In exchange, working time flexibility could be increased via negotiations at firm level. The second Aubry law implemented new cuts in social contributions not depending on the extent of working time reduction or job creation, thus reducing non-wage labor costs at earnings close to the SMIC level and stabilizing employers’ costs at the expense of the public budget (Jamet 2006). The “loi Fillon” of 2003, finally, increased flexibility further by raising maximum overtime from 130 to 180 hours per year, reducing the overtime premium and allowing for branch level derogations. Currently 220 hours of overtime are possible if there is no branch or firm level agreement. Hence, by strengthening the role of negotiated working time arrangements, the recent years increased flexibility at the sectoral or firm level.

In contrast to the French experience with statutory working time restrictions, Germany embarked on a way towards an ever increasing level of working time flexibility through enterprise-level agreements and collective bargaining in exchange for some working time reductions at the sectoral level. However, the most recent developments have been characterized by a growing role of enterprise-level agreements on either shorter working time in order to preserve jobs that would otherwise be at risk in a situation of insufficient demand or on longer weekly working hours without wage compensation which could help restore international competitiveness of German manufacturers that operate in a global environment characterized by stronger price competition and the option of relocating production to countries with lower labor costs. These changes took place without intervention by the state. The only major government initiative was the introduction of the right to switch from full-time to part-time work in 2000.

Regarding minimum wages, France limits wage dispersion by a statutory minimum wage (SMIC) which is applicable to all types of dependent employment except for apprentices with a reduced rate for young workers below 18. Its current level is 1.254 € in the case of 35 hours per week. Compared with statutory minimum wages in other countries, SMIC is relatively high. Relying on data for 2004, the SMIC is set at about 47% of the median wage whereas the Dutch minimum wage is at about 45% and the National Minimum Wage in the UK is around 40% (Funk/Lesch 2005). In addition, collectively agreed wages are regularly extended to firms and employees not organized in either employers' associations or trade unions. Hence, in many sectors higher minimum wages apply. Due to the statutory working time reduction there were different hourly and monthly minimum wages in the transition period that were unified again in 2005. To the extent that the political goal of stabilizing monthly earnings despite shorter hours worked, increases in labor costs of incomes close to SMIC were eased by subsidizing employers' contributions to social insurance. Notwithstanding this reduction of non-wage labor costs, the minimum wage effectively compresses wage dispersion at the lower end of the wage scale. However, wage setting above the level of the statutory minimum wage is relatively decentralized, flexible and was characterized by wage moderation in recent years. This trend was reinforced through the negotiations on the 35 hour week (Jamet 2006).

While the French statutory minimum wage has been in place for many decades, there are no wages fixed by government in Germany as wages are primarily defined through collective agreements and only formally binding for firms and employees which are members of employers organizations or trade unions. Although bargaining coverage declines, a considerable share of firms continue using collective agreements as a guideline even though they are not covered in a legal sense (Schnabel 2005). Only few collective agreements on wages are made generally binding. Since the mid-nineties a generally binding minimum wage has been in place in the construction sector in order to establish a level playing field for both domestic and foreign construction firms. Most recently, the labor market segment covered by generally binding minimum wages was extended to cover cleaning and will probably also include temporary work agencies in the near future. In the context of Eastern enlargement of the EU and the shift towards more activating labor market policies, calls for a general statutory minimum wage or a regular extension of sectoral minimum wages in an increasing number or all industries have become stronger.

But event today Germany does not lack a de facto minimum wage as the level of basic income guaranteed under social assistance or – since the most recent reform in 2005 – "Arbeitslosengeld II" can be seen as an implicit minimum wage. Its level is 345 € net plus housing and heating for a single person. This means a gross minimum wage of about 1.000 €. Compared with wages defined in collective agreements, this implicit minimum wage is higher than earnings gained from full-time employment in some segments of the private service sector (Brenke 2006). This relation is even more problematic for larger households receiving benefits, i.e. married couples with children or single parents. As the option of combining Arbeitslosengeld II with earnings from part-time work or low wages results in some additional net income, incentives to move to full-time work or higher remuneration are weak. At the same time, this might result in wage cuts that are set off by benefit receipt. As this is seen as one the reasons for extra expenditure on Arbeitslosengeld II, introducing a binding minimum wage is discussed in order to limit wage decline and state subsidization of employment in the low-wage sectors.

4.2. Unemployment Benefits: From Insurance to Assistance?

When comparing levels of unemployment benefits, both German and French unemployment insurance and assistance benefits are relatively generous. However, to limit expenditure and to strengthen incentives for individual job search effort, some reforms were implemented over the last decade without questioning the system of unemployment insurance benefits, but focusing on unemployment assistance and social assistance.

Regarding Germany, some clauses on skills protection were abolished and access to unemployment benefits made more restrictive in the nineties. However, the overall level of benefits and their maximum duration was untouched until, in 2005, with Hartz IV, earnings-related means-tested unemployment assistance ("Arbeitslosenhilfe") and means-tested flat-rate social assistance for employable people ("Sozialhilfe") were replaced by a unified benefit that is means-tested and flat-rate ("Arbeitslosengeld II") so that the link between prior earnings and benefits for long-term unemployed was severed. In early 2006 the maximum duration of unemployment insurance benefits ("Arbeitslosengeld I") was cut from 32 to 18 months for older workers. This means that unemployment insurance benefits will lose their function as a pathway to early retirement. At the same time, however, older workers are still exempt from labor market availability. Old-age part-time, in practice one of the most important gateways to early exit from the labor market, will remain accessible until 2009. As benefits from public old-age pension insurance will be lower for younger cohorts - the statutory retirement age is to be raised to 67 and earlier receipt of pensions is gradually being phased out - incentives to continue working beyond the current actual retirement age will become stronger in the foreseeable future. However, this change takes place rather slowly as reforms were not as consistent as in other countries – and the availability of old-age part-time work, the suspension of labor market availability and longer benefit duration for older workers contributed to stronger labor shedding in the recent economic downturn (Eichhorst 2006).

Unemployment insurance provides generous benefits in France as can be seen from relatively high net replacement rates – in particular for low-wage earners – and a very long duration of insurance benefits especially for older workers aged 50 or 57 and older. This is true even after recent cuts from 60 to 42 months in 2002 and to 36 months in early 2006. Maximum duration of unemployment benefits of 23 months for the remaining unemployed is also generous in comparison with other countries. In 2001, however, the degressive element in insurance benefits was removed in exchange for stronger activation. If unemployment insurance benefits expire or if the unemployed are not entitled to them due to a lack of prior employment record, they can rely on unemployment assistance and social assistance. French "Allocation Specifique de Solidarité" is granted for six months with the possibility of renewal. In contrast to former

German “Arbeitslosenhilfe”, however, it is not earnings-related but a flat-rate benefit. Regarding social assistance, the most important innovation is the “Revenu minimum d’insertion” (RMI) establishing a general national minimum income scheme. In contrast to German basic security benefit “Arbeitslosengeld II” which is available for all employable persons aged 15 and older, young people below 25 do not have access to French RMI. It provides basic income security on a national basis with a monthly payment of 433 € per month for a single person (plus housing allowance). From the point of view of labor market integration RMI is problematic with regard to weak work incentives and a lack of a systematic job search requirement (Beninger 2005, Palier 2005, Levy 2005).

In addition to the relatively long duration of unemployment insurance benefits France heavily relied on other early retirement schemes in the past (Ebbinghaus 2001, Levy 2005). Although many of them have been phased out recently as the unemployment benefit duration was shortened, several bridges to early retirement are still available such as regular “préretraite”, “préretraite progressive” (old-age part-time work) or early retirement after dismissal so that some incentives for early exit from the labor market persist, in particular when taking into account firm-level strategies (Beninger 2005, Jamet 2006).

On the other hand, the most recent pension reform implemented in France in 2003 resembles the German one in that will eventually lead to a longer working life, postponed and more flexible retirement, while early retirement becomes less attractive in terms of benefits and due to an additional contribution to be paid by employers. Cuts in pension levels for younger employees will work in the same direction. In both countries the lowering of public old-age pensions for younger cohorts means a departure from status-protecting old-age pensions. This was combined with the creation of a third pillar in the pension system through strong subsidization of private saving schemes via tax incentives: “Riester-Rente” in Germany and “plans d’épargne individuel pour la retraite” (PEIR) in France. Germany introduced an entitlement to occupational pensions, whereas France’s occupational pension scheme governed by the social partners had been made mandatory before.

In both countries, however, there is a gradual shift towards basic social security. This is not only the case with regard to the departure from status-protecting public old-age pensions but also obvious in the growing reliance of the unemployed on means-tested flat-rate benefits – RMI in France and “Arbeitslosengeld II” in Germany – whereas the number of beneficiaries receiving unemployment insurance benefits tends to decline. National data show that the number of RMI recipients grew from 780.000 in 1994 to 1.080.000 in 2004. In Germany, receipt of “Arbeitslosengeld II” by employable persons grew from 3.7 million in late 2004 to 5.2 million in June 2006, whereas unemployment insurance benefit was paid to 1.9 million unemployed in late 2004 and to 1.3 million in mid-2006.

Table 2: Net replacement rates of unemployment benefits in % of prior earnings, 1995 / 2004

	Germany	France	EU-15*	United Kingdom	Denmark	Netherlands
single, 100% of APW, 1st month	61 (-9)	73 (-3)	62 (-3)	45 (-7)	61 (-4)	71 (-4)
married, single earner, 100% of APW, 1st month	60 (-6)	69 (-5)	63 (+1)	45 (-18)	63 (-5)	76 (-5)
Single parent, 67%, 1st month	82 (+2)	90 (+3)	81 (+1)	71 (+8)	90 (-5)	85 (-1)
single, 67% of APW, 1st month	62 (-11)	77 (-8)	71 (-3)	63 (-12)	84 (-6)	81 (-5)
married, single earner, 67% of APW, 1st month	65 (-9)	79 (-6)	73 (-5)	61 (-27)	85 (-9)	87 (-3)
single, 100% of APW, 60th month	60 (-2)	40 (-3)	41- (-2)	45 (-7)	59 +10)	61 +1)
married, single earner, 100% of APW, 60th month	62 (-1)	52 (+9)	51 (-4)	56 (-7)	56 (-21)	73 (-3)
Single parent, 67%, 60th month	92 (+1)	80 (+20)	67 (-3)	71 (-9)	84 (-4)	79 (-15)
single, 67% of APW, 60th month	81 (+5)	55 (-2)	57 (-2)	63 (-12)	81 (+13)	82 (-3)
married, single earner, 67% of APW, 60th month	84 (-3)	75 (+19)	68 (-3)	75 (-13)	76 (-22)	91 (-4)

Note: Changes over time have to be taken with caution. Source: OECD, Tax-Benefit Models; OECD Benefit Systems and Work Incentives *) 1995 without Greece.

4.3. From Active to Activating Labor Market Policies?

Despite the potential of active labor market policies to further reintegration into gainful employment, both Germany and France used to rely on active schemes to “hide” open unemployment and buffer the labor market against structural shifts and business cycle variations. Reintegration into gainful employment was not a major objective. In Germany, not only early retirement and prolonged unemployment insurance benefit receipt by older workers but also active labor market policy schemes were used to compensate for employment decline after reunification, particularly in Eastern Germany, by taking “surplus labor” out of the labor market (Manow/Seils 2000). Direct public job creation and extended training schemes were of major importance in this respect and were partially used to renew entitlements to insurance benefits for unemployment assistance beneficiaries. However, a passive stance of active labor market policies did not contribute to higher labor market adaptability and lower benefit dependency. Along with cuts in benefits and tighter entitlement conditions, making receipt of unemployment insurance benefits or unemployment assistance conditional upon individual job search and acceptance of job offers or participation in active labor market schemes marks a departure from the mainly passive orientation of labor market policies in Germany and France.

Regarding Germany, notwithstanding some minor changes in the nineties, the most significant steps towards activating labor market policy were implemented through the Hartz reform package (Eichhorst/Kaiser 2006, Jacobi/Kluve 2006). The legislation resulting from the proposals of the Hartz Commission not only abolished status-related unemployment assistance and cut benefit duration in unemployment insurance benefits, but also reinforced job search requirements, sanction options and monitoring addressing both short- and long-term unemployment. Despite the fact that job search requirements had been in place for some time under both unemployment insurance and unemployment assistance or social assistance, the Hartz reforms pushed further ahead in sharpening the bite of these provisions and aimed at implementing them in actual practise.

Regarding implementation, however, actual activation of the long-term unemployed is less strict than expected so far. On the one hand, potentially binding reintegration agreements are not implemented in a systematic way. On the other hand, activation focuses on the provision of fixed-term public employment opportunities, so-called “One Euro Jobs”, which provide additional income of 1.00 to 1.50 € per hour to be combined with full benefits. Employment opportunities are hardly used to monitor labor market availability but lead to lower job search efforts during participation in these schemes. Another unexpected consequence is an increasing number of recipients of “Arbeitslosengeld II” who combine benefit receipt with part-time employment at low earnings or working hours, i.e. through “Minijobs”, which is possible due to corresponding earnings disregard clauses (Bundesagentur für Arbeit 2006). The combination of benefit receipt with a “One Euro Job” or earnings from marginal employment can result in higher earnings than in full-time employment in low-wage jobs (Brenke 2006). These implicit in-work benefits set strong incentives in favor of continuous benefit receipt and part-time work only.

The public employment service (“Bundesagentur für Arbeit, BA) and the interface between the local branches of the BA administrating active and passive labor market policies and the municipalities which had been responsible for social assistance were reorganized to establish a more unified system of labor market counselling and job search monitoring as well as to allow for more professional placement services. At the same time, active labor market policies were reoriented towards stricter monitoring regarding reintegration effects which resulted in a more selective funding of training and other active labor market schemes so that the passive “buffering” of unemployment virtually disappeared from the agenda of contribution-based active labor market policy for short-term unemployed but resurfaced in the framework of tax-based benefits. However, different forms of publicly funded training for young people, subsidized employment and small business creation, e.g. the “Me Inc.”, continue to exist in unemployment insurance.

At the same time, France continued on its path of “insertion”, i.e. providing for different models of fixed-term subsidized employment addressing diverse target groups of unemployment (Clasen/Clegg 2003, Clegg/Clasen 2003). In the late nineties the “emploi jeunes” scheme provided for fixed-term employment of young unemployed people in non-profit or public organizations for up to five years. It was replaced by subsidized employment in the private sector through the "contrat jeune en enterprise" implemented in 2002. This contract provides for three years (as of 2006 two years) of employer subsidies in case the unskilled young unemployed are hired on a full-time open-ended contract. This program has recently been expanded after the withdrawal of the CPE proposal. Older unemployed, the long-term unemployed and the disabled are also "inserted" through "contrat initiative-emploi", i.e. subsidized employment on a fixed-term or open-ended basis combined with the obligation to provide some training.

"Insertion" through subsidized contracts has the dual aim of creating employment and providing social inclusion while benefit conditionality is absent or only very weak. Hence, it can be classified as active labor market policy in a more classical sense. This is also true for other forms of subsidized employment such as low-wage jobs exempt from employers' contributions. However, France also embarked on the road towards more activating labor market policies at the turn of the century. In France, the turn towards activation as a major principle of labor market policies is also related to cuts in benefit duration and more restrictive entitlement criteria. The "plan d'aide au retour à l'emploi" (PARE) adopted in 2001 combined unemployment benefits with return to work schemes and brought the public employment service ANPE and unemployment insurance (UNEDIC) closer together. While unemployment benefits no longer decrease with the duration of unemployment, rights and duties are now laid down in a "plan d'action personalisé" (PAP), an individual reintegration agreement to be signed by all newly unemployed persons and monitored regularly (Beninger 2005, Palier 2005). Joint agencies, one-stop shops for the unemployed, are being established within the framework of the recent "plan de cohésion sociale" which also provided for strengthened job search obligations and benefit conditionality. However, PARE and PAP activation only concerns a minority of the French unemployed so far (Jamet 2006). But PARE is not the only attempt at activation in France. RMI recipients also moved into the focus of activation in 2003 as the "revenue minimum d'activité" (RMA) scheme offers a part-time contract remunerated at minimum hourly wages for up to 36 months to selected employable RMI recipients in combination with training. It is also available as fixed-term employment in the public sector for two years ("contrat d'avenir"). RMA participants continue to receive RMI while the employers only pay the difference between part-time SMIC and RMI. Another element of activation is the "prime pour l'emploi", a tax-credit available to low-wage earners introduced in 2001 and expanded in several steps in recent years. However, given the relatively high level of guaranteed minimum income and minimum wages in France, "prime pour l'emploi" can only provide much smaller in-work benefits and work incentives than similar schemes in systems with lower social assistance and minimum wages (Cahuc 2002, Laroque/Salanié 2002, Stancanelli 2004). In addition, "prime pour l'emploi" may have some negative effect on labor supply or hours worked by married women.

Notwithstanding these changes in labor market policies, the institutional setup of French active and activating labor market policies with ANPE, UNEDIC, regional "directions du travail, de l'emploi et de la formation professionnelle" and other more specialized bodies is more fragmented than in Germany. This multitude of actors hampers effective implementation of activation in practice. The same is true for the complexity of the different contract types that are available for different target groups.

However, the current institutional setup in Germany is not conducive to deliver effective activating labor market policies either, as there is a divide between contribution-based benefits and active schemes administered by the BA and tax-funded benefits and activation programs implemented by joint bodies of the BA and the municipalities or – in some districts – by the municipalities alone. This leads to a highly selective investment of BA resources in favour of the short-term unemployed, while the potential long-term unemployed are transferred to the tax-funded system. At the same time, governance problems in the joint bodies of the BA and the municipalities inhibit more coherent activation.

Table 3: Expenditure on active and passive labor market policies in % of GDP in 1993-95 / 2002-2004

	Germany	France	United Kingdom	Denmark	Netherlands
Passive labor market policies	**2.24 (-0.10)**	**1.68 (-0.27)**	**0.32 (-1.19)**	**2.54 (-2.54)**	**2.02 (-1.14)**
Active labor market policies	**1.14 (-0.08)**	**0.97 (-0.05)**	**0.53 (+0.03)**	**1.90 (+0.11)**	**1.48 (+0.31)**
- training	0.36 (-0.09)	0.30 (-0.11)	0.13 (+/-0)	0.62 (-0.09)	0.31 (+0.06)
- Start-up incentives	0.09 (+0.07)	0.01 (-0.02)	n/a	n/a	n/a
- Employment incentives	0.10 (+0.03)	0.10 (-0.02)	0.06	1.24 (+1.19)	0.04 (+0.02)
- Direct job creation	0.15 (-0.19)	0.33 (+0.13)	0.01 (-0,01)	n/a	0.23 (+0.16)

Note: Figures do not include subsidization of social security contributions in France. Source: OECD Employment Outlook 1997, 2006.

4.4. From Contribution-based to Tax-funded Welfare States?

Both Germany and France adhere to the Bismarckian principle of funding social benefits mainly through social security contributions paid by employers and employees as payroll taxes. In Continental European welfare states, high non-wage labor costs are perceived as a major obstacle to employment growth. Hence, stabilizing or reducing social security contributions became a main goal in policy making.

However, in Germany only relative stability of social security contributions could be achieved despite some cuts in benefits in health insurance, old-age pensions and unemployment insurance, some ad hoc measures to broaden the contribution base and a partial shift from contribution funding to taxation and private expenditure. Most significant in this respect were the introduction of eco-taxes in 1999 and both the recent health and pension reforms that resulted in a higher burden on the insured and a more prominent role of private expenditure. In 2007, there will be a slight decline in non-wage labor costs due to a reduction of the contribution rate to unemployment insurance by two percentage points (or even more) whereas the contributions to old-age pension insurance and sickness insurance will be raised by approximately one percentage point. With the Hartz reforms, expenditure on unemployment insurance benefits and contribution-based active labor market policy schemes declined while expenditure on tax-funded “Arbeitslosengeld II” and related labor market programs for the long-term unemployed rose so that labor market policies have become more tax-based in Germany in recent years. In combination with a steep increase in VAT by three percentage points, this will, nevertheless, allow for a reduction of the overall burden of non-wage labor costs. In recent years, German employees also benefited from a reduction of income taxes. The system of joint taxation of married couples, however, remained in place.

While non-wage labor costs were more or less stable over the last years, a selective reduction of contributions for low-wage earners similar to the French approach was discussed in Germany in order to facilitate the creation of low-wage jobs. However, in practice the most important model does not address labor market integration of low-skilled people but second jobs or supplementary employment of spouses through “marginal jobs” (“Minijobs”). This model of tax- and contribution-free employment had been in place for many years, but was expanded in the nineties and the early years of this decade, the last reform stemming from the Hartz package implemented in 2003 allowing for second jobs or supplementary employment exempt from income taxation and employee contributions up to 400 € per month, while employers have to pay a lump-sum tax and partial social insurance contributions. Although other models of lowering non-wage labor costs were considered, they were not implemented as general schemes but as limited regional experiments only. Hence, average tax wedges are still high in Germany, and marginal effective tax rates are particularly high for second earners.

France implemented more general cuts in employers‘ contributions to social insurance in the low-wage sector in order to fuel demand for low-skilled labor and compensate for labor cost increases at SMIC level caused by working time reduction. France embarked on this approach in 1993 in a more consequent way than Germany and raised the threshold for contribution reduction several times until it reached 1.6 SMIC in 2003. At the same time, however, contribution rates for other segments of the labor market were not lowered. To compensate for cuts in social security contributions in the low-wage sector and to fund non-contributory benefits, the “contribution sociale generalisé” (CSG) was introduced in 1990 (Palier 2005). As this special proportional contribution is raised on all types of income including capital revenues and welfare benefits and is earmarked for non-contributory welfare programs, it reinforces the trend towards a more tax-based welfare state. Beginning with a tax rate of 1.1% in 1990, it was increased to 7.5% in 1998. This meant stronger redistribution through the tax/social insurance system as low-wage earners benefit from lower benefits, whereas additional contributions are deducted from higher incomes. Similar to Germany, the combined burden of social security contributions and income taxes remained more or less stable over the last decade. Problematic work incentives are also embodied in French family tax splitting which leads to high marginal tax rates for second earners and reinforces inactivity traps through social benefits (Jamet 2006).

Table 4: Tax wedges in 2005

	Germa-ny	France	EU-15	United King-dom	Den-mark	Nether-lands
single, 100% of APW	51.8	50.1	42.1	33.5	41.4	38.6
Married, two children, 100% of APW	35.7	41.7	31.6	27.1	29.6	29.1
single parent, 67%	33.8	32.4	22.9	9.6	13.8	22.0
single, 67% of APW	46.7	41.5	38.0	29.9	39.3	41.3

Source: OECD Taxing Wages 2004/05.

4.5. Common and Diverging Paths

The general picture for both countries shows basic stability in core areas of labor market institutions, such as employment protection and unemployment insurance for regular employment, as well as is regard of the funding structures of the welfare state. Regular employment gained in flexibility not via deregulation but through increasing wage and working time flexibility induced by concession bargaining in Germany and by bargaining reform and stronger firm level negotiations as an indirect consequence of the attempt at statutory working reduction in France.

However, while income and employment security of labor market insiders are marked by continuity, the most recent reforms contributed to a gradual change of the overall setting of both the French and the German labor market which is characterized by three elements:

1. the partial liberalization of non-standard employment such as fixed-term contracts and agency work while maintaining or introducing binding wage floors in these segments;
2. both countries gradually shift from Bismarckian social policies to universal social security at basic levels not only in pensions, but, more important for the labor market, through the creation of national minimum income schemes for the non- or unemployed without prior employment record or in the case of (shortened) benefit periods of status-protecting unemployment insurance;
3. the shift from passive labor market policies aimed at reducing labor supply towards activation through benefit cuts, integration agreements and more stricter monitoring, i.e. Hartz IV in Germany and PARE as well as RMA in France. However, some routes to early exit continue to exist, and activation of the long-term unemployment was not yet implemented coherently. Hence, the shift towards activation was hesitant and partial so far. At the same time, France, but also Germany, albeit to a smaller extent, still rely on a multitude of selective active labor market schemes providing for employer subsidies.

These broad trends also reflect limited labor market flexibility as core labor market regulation, levels of social protection and minimum wages have not been modified to allow for additional regular jobs being created in the service sector – in contrast, there have been attempts at reinforcing regulation of the labor market. This goes hand in hand with a stable or even increasing burden of taxes and social insurance contributions on regular employment, i.e. labor market insiders. However, both countries implemented selective models of contribution rebates in order to generate employment in services – with France stressing this more strongly - and partially shifted welfare state funding to new forms of taxes such as eco-taxes, tax-funded Hartz IV in Germany or CSG in France. Hence, a dual structure emerges: regular employment benefiting from full social security and employment protection, but with a high tax burden, and several compartments of marginal or precarious employment on the other hand that partially rely on public resources from national basic income schemes and different forms of subsidization.

5. BEYOND WELFARE STATES WITHOUT WORK?

Studying German and French labor market performance over time, but also in comparison with other European countries, data on employment and unemployment rates still show problems with overall labor utilisation and a selective pattern of labor market integration to the detriment of older workers, women and low-skilled people (Table 5). However, with respect to employment growth and raising the employment/population ratio, France experienced significant progress whereas German employment virtually stagnated over the last decade. This can in part be explained by higher GDP growth in France which reached 2.2% on average over the period from 1995 to 2005 compared to 1.4% in Germany. At the same time both countries benefited from medium-term wage moderation and increases in working time flexibility. Real wages in the business sector grew only by 1.2% in Germany and by 2.2% in France. Growth in international competitiveness was most pronounced in Germany where relative unit labor costs declined between 2000 and 2005 by 2.5%, while they increased by 9.9% in France.

Nevertheless both countries still lag behind the three reference countries. Taking a closer look at details, low-skilled employment increased in France and is now slightly above the EU average while the low-skilled have only very limited access to employment in Germany. On the other hand, however, the labor market situation of the youth is unfavourable in France, while Germany still does better despite a sharp drop in youth employment. Inactivity of older workers is high in both countries, and increases in employment of older workers have been weaker than in other countries. Hence, labor market imbalances persist as can be seen from high and even growing shares of long-term unemployment and a level of structural unemployment (NAIRU) above the EU average, although France could achieve some improvement.

Table 5: Employment and unemployment (1993-95/2003-05)

	Germa-ny	France	EU-15	United King-dom	Den-mark	Nether-lands
Average Employment Growth 1995-2005	**0.3**	**1.0**	**1.1**	**1.1**	**0.6**	**1.4**
Employment/ population ratio	**65.0 (+0.3)**	**62.4 (+3.6)**	**64.9 (+4.8)**	**72.6 (+3.9)**	**75.5 (+2.6)**	**72.3 (+8.1)**
- women	59.1 (+4.1)	56.6 (+5.5)	57.1 (+7.6)	66.7 (+4.6)	71.1 (+3.5)	64.9 (+12.1)
*- low skilled **	49.9 (+1.0)	58.8 (+2.3)	57.6 (+2.2)	53.3 (-0.8)	61.2 (+/- 0)	58.9 (+5.2)
- youth	42.3 (-8.7)	26.4 (+3.8)	42.9 (+3.9)	61.0 (+2.2)	60.9 (-1.8)	64.5 (+8.8)
- older workers	42.1 (+5.7)	40.5 (+6.9)	42.7 (+6.4)	56.1 (+9.0)	60.7 (+10.5)	44.1 (+15.3)
Standardized unemploy-ment rate	**9.3 (+1.2)**	**9.5 (-2.4)**	**8.0 (-2.8)**	**4.7 (-4.9)**	**5.2 (-1.9)**	**4.3 (+0.8)**
- women	10.0 (+0.3)	11.0 (-2.8)	9.0 (-3.5)	4.1 (-3.2)	5.6 (-4.0)	3.1 (-5.0)
*- low skilled **	17.9 (+4.3)	12.0 (-2.4)	9.9 (-3.4)	7.3 (-5.3)	7.0 (-9.0)	4.7 (-3.4)
- youth	12.8 (+4.7)	22.3 (-3.7)	15.7 (-4.8)	12.8 (-3.4)	8.5 (-3.0)	8.4 (-2.5)
- older workers	11.6 (+0.3)	7.0 (-0.2)	6.1 (-2.2)	3.0 (-5.9)	4.8 (-2.9)	3.5 (+0.4)
Share of long-term unemployed	51.9 (+7.9)	42.3 (+3.0)	43.3 (+2.3)	22.2 (-21.6)	22.8 (-5.5)	33.9 (-10.1)
NAIRU	**7.4 (+1.4)**	**9.0 (-1.3)**	**6.5 (-0.9)**	**5.3 (-2.1)**	**4.8 (-1.8)**	**3.3 (-2.5)**

Sources: OECD Employment Outlook and Economic Outlook, OECD Education at a Glance. *) 1995-98 /2002-04; **) without Luxembourg.

The structures of the French and German labor markets also differ with regard to the use of non-standard forms of employment (Table 6). On the one hand, (voluntary) part-time employment is a prominent feature of female employment in Germany and to a certain extent mirrors an adaptation of labor supply of women to limited child-care infrastructure and high marginal taxation. On the other hand, involuntary part-time work, which reflects a strong tendency towards female full-time employment, is more frequent in France (Beninger 2005). However, taking into account the fact that about half of all fixed-term contracts are apprenticeships in Germany, “genuine” fixed-term contracts are more frequently used in France and their numbers have grown over the last decade.

Table 6: Regular and flexible employment 1993-95 / 2003-2005

	Germany	France	EU-15	United Kingdom	Denmark	Netherlands
Part-time employment	20.5 (+7.0)	13.3 (-0.4)	17.4 (+2.9)	23.9 (+1.7)	17.1 (-0.6)	35.1 (+6.4)
Involuntary part-time employment	12.2 (+5.5)	22.4 (-7.9)	n.a.	6.6 (-5.2)	13.1 (-2.0)	3.3 (-1.9)
Fixed-term employment	13.0 (+2.7)	12.9 (+1.6)	13.5	5.9 (-0.5)	9.5 (-2.1)	14.9 (+4.3)

Source: Eurostat.

At the same time, individual panel data show different patterns of mobility on the labor market (Table 7). Both Germany and France have strongly segmented labor markets with relatively long tenure (Auer/Cazes 2002). However, France shows a particularly low mobility rate from fixed-term employment to regular employment. Hence, there is not only a divide between fixed-term and open-ended contracts, but also little mobility between the two segments. This is confirmed by national empirical evidence. In France, fixed-term contracts play a major role in external labor market flexibility that is restricted in regular employment. Fixed-term employment is used to circumvent dismissal protection although regulation of fixed-term contracts is also rather strict - but the relative gap in rigidity between fixed-term and open-ended employment explains the strong growth of temporary employment in France over the last decade. In this setting, liberalization at the margin through fixed-term employments or the longer probationary period under CNE has positive effects on employment and increases labor market flexibility by lowering hiring thresholds. At the same time, due to very short average durations, turnover in fixed-term contracts is high, in particular among young workers, but transitions to open-ended contracts remain difficult (Blanchard/Landier 2001). Therefore, fixed-term employment induces additional external labor market flexibility, but deepens labor market segmentation and increases employment insecurity of employees in precarious jobs at the margin (Cahuc/Postel-Vinay 2002, Cahuc/Carcillo 2006). This not only holds for fixed-term jobs, but also for different subsidized contracts that have been designed in the framework of “reinsertion” policies but often lead to repeated unemployment spells (Jamet 2006).

The situation is different in Germany where, first, a major part of all fixed-term contracts are apprenticeships and, second, fixed-term employment is mainly used as a prolonged probationary period that frequently paves the way to regular employment (Boockmann/Hagen 2005). Hence, fixed-term jobs are on average more qualified in Germany than they are in France. In Germany, the flexible element of the labor market is not fixed-term employment, but part-time work, marginal jobs and the combination of benefits and work. Both provide additional external flexibility and allow for a swift adjustment of labor demand in particular in the service sectors. However, mobility between low-wage jobs and higher earnings is weaker in Germany than in France.

Table 7: Labor mobility 1994/95-2001

	Germany	France	EU-15	United Kingdom	Denmark	Netherlands
Move into employment	13.9	14.1	13.0	18.4	21.1	15.5
Stay in employment	91.5	92.4	92.3	92.3	92.6	93.7
Temporary to permanent	37.2	20.7	31.4	44.5	36.3	44.9
Low pay to higher pay	25.4	34.5	30.7	28.0	36.2	29.4

Source: European Commission 2004 based on pooled data from the European Community Household Panel UDB version from December 2003.

Despite the relatively high SMIC, France has been more successful in stabilizing employment of the low-skilled. This is mainly due to the subsidization of employers' contributions to social insurance in the low-wage sector. This has set off adverse effects of minimum wage increases and statutory working time reduction that would otherwise have resulted in higher labor cost at the minimum wage level and endangered jobs for low-wage earners. Available evidence shows that the demand for low-skilled labor could be stabilized or even increased although the evaluation results differ for methodological reasons (Abowd et al. 1999, Audric/Givord/Prost 2000, Kramarz/Philipppon 2001, Laroque/Salanié 2000, Crépon/Desplatz 2001). However, this could only be achieved at the expense of additional public expenditure that was necessary to compensate for potential negative effects of higher labor costs. It seems fair to argue that low-skilled employment could be stabilized through broad subsidization (Jamet 2006, OECD 2005). While the employment effect of statutory working time reduction was unclear or even negative (Beninger 2005), the joint effect of working time reduction, higher working time flexibility, medium-term wage moderation and subsidization of low-wage employment seems positive at least in the short run. In contrast, longer-term effects are uncertain in particular when taking potential negative effects of funding into account (Jamet 2006).

Data on income inequality and poverty show that income distribution in Germany and France is broadly in line with the EU average and more unequal than in Denmark or the Netherlands, but less polarized than in the UK. As poverty is mainly due to non-employment or marginal labor market integration of benefit recipients (OECD 2006b), activating labor market policies on employment may reduce poverty. However, due to the lack of evaluation, activation strategies in France and Germany cannot be assessed so far. But recipient figures and expenditure data show no significant effects. This can be explained by the inconsistent implementation of activation in both countries and persistent inactivity or poverty traps built in the benefit systems for the long-term unemployed.

Table 8: Inequality and poverty 1995 / 2003-2004

	Germany	France	EU-15	United Kingdom	Denmark	Netherlands
Inequality of disposable income D8/D2	4.4 (-0.2)	4.2 (-0.3)	4.8 (-0.3)	5.3 (+0.1)	3.4 (+0.5)	4.0 (-0.2)
Poverty rate before social transfers [%]	24 (+2)	26 (+/-0)	26 (+/-0)	29 (-3)	31 (+2)	23 (-1)
Poverty rate after social transfers [%]	16 (+1)	14 (-1)	17 (+/-0)	18 (-2)	11 (+1)	12 (+1)

Source: Eurostat Structural Indicators.

Both countries still have problems with low utilisation of labor and high benefit dependency which can be explained by reluctant activation and only partial flexibilization of the labor market so that employment is still lower than in EU average. There is a rather strong divide between the core and the margin of the labor market. The core of the labor market remained stable in institutional terms and benefited from increasing wage and working time flexibility, but its share in employment declined. The margin of the labor market is characterized by "precarious", i.e. instable, part-time or fixed-term jobs with less favourable conditions regarding job security and remuneration. However, patterns of labor market segmentation differ between France and Germany. Regarding levels of labor market integration, the major weakness in France is employment of young and older workers, whereas not only older workers, but women and the low-skilled are negatively affected by the institutional arrangement in Germany. While mobility from fixed-term to regular contracts is problematic in France which is particularly harmful to the young, moving from low to medium wages and from part-time to full-time is more difficult in Germany. Over all, low employment in both Germany and France means continuously high levels of benefit dependency as the non-employed or workers in instable or low-paid jobs rely on additional public spending. Hence, it comes as no surprise that net social expenditure in France and Germany rank at the top of the OECD world (Adema/Ladaique 2005). In 2001, net social spending reached 31.2% of GDP in France and 30.8% in Germany compared to 26.4% in Denmark, 27.1% in the UK and 25.0% in the Netherlands.

6. THE POLITICAL LOGIC OF LABOR MARKET REFORMS IN GERMANY AND FRANCE

The review of labor market reforms in Germany and France shows that both countries maintained strong employment protection for regular jobs and unemployment insurance for the short-term unemployed despite some changes in benefit duration and entitlement criteria and a gradual removal of early retirement options. At the same time, some deregulation took place at the margin of the labor market, while basic income protection combined with stronger, albeit reluctant, activation of the long-term unemployed became more prominent. However, while France implemented more coherent strategies to further demand for low-skilled labor, Germany advanced more strongly in setting up an activation scheme for all the long-term unemployed. While keeping the core of the labor market stable, both France and Germany facilitated the emergence of “precarious” jobs through lower non-wage labor costs or lower levels of regulation – but labor market “permeability” remained weak. A more in-depth analysis of the political economy of labor market reforms in France and Germany helps explain why there were such sequences of gradual reforms.

Considering France first, government is strong in institutional terms (Levy 2000, 2005) but it stands alone with regard to labor market reforms as state-society relations are tense and prone to conflict. Hence, there is no basis for broader package deals to be negotiated between the government and the social partners (see e.g. the experience with negotiations on the 35 hour week in 1997/98). However, even attempts at increasing labor market flexibility through marginal modifications have proven to generate considerable conflict. The most prominent of major public unrest refer to the “SMIC jeunes” proposal in 1994, the Juppé pension reform in 1995 or the CPE project in spring 2006. In all cases, government had to enter “negotiations with the streets” that eventually resulted in government withdrawing or watering down its initiatives. As incumbent governments are highly vulnerable in electoral terms in France, reluctance with regard to more far-reaching reforms is a plausible strategy aimed at avoiding electoral defeat. In addition, center-right parties (the Gaullists) and left parties are not advocates of “neo-liberal” reforms, but support the principle of “traitement social du chômage”. Hence, establishing a single type of employment relationship with lower dismissal protection for regular employment in exchange for severance pay (as proposed by Cahuc and Kramarz in 2004) might be an efficient strategy in economic terms, but it is not feasible in politico-economic terms as the French public does not accept significant increases in labor market flexibility. Neither does it support growing inequality in the labor market, i.e. through lower minimum wages and social benefits, although gradual reforms imply at least implicit acceptance of precarious employment.

This constellation makes it plausible for French policy makers to rely on cautious and partial reforms on the one hand and on state-administered “insertion” policies on the other hand although this strategy requires significant public resources. However, “social anesthesia” (Levy 2005) trough “insertion” and passive income support is only one element of the French reform path as some elements of activation could nevertheless be implemented (e.g. PARE and RMI/RMI). Despite the fact that this approach is different from strict activation inspired by the Anglo-Saxon or the Nordic model, it is a major institutional innovation in the French context. This is particularly true given the fact that activation also brings ANPE and UNEDIC closer together. Since institutional reorganization is essential, but difficult due to the strong role of social partners in the administration of unemployment insurance (UNEDIC), PARE could only be achieved through an agreement by the social partners and the government (Palier 2005, Clegg/Clasen 2003, Clasen/Clegg 2003). However, given the fact that “selective occupational solidarity” is a major principle of unemployment insurance, activation, but also different forms of “insertion”, are easier in areas that are not related to unemployment insurance but address the unemployed without entitlements to unemployment insurance benefits. While PARE and RMA advanced activation in France, these schemes did not question the established level of social benefits or minimum wages or the overall level of labor market regulation. The same is true for the broad subsidization of low-wage employment and the partial shift to quasi-taxes such as the CSG. In France, low-wage employment at SMIC level seems less problematic than in Germany. This difference might be explained by the existence of a binding minimum wage that provides an effective wage floor and neutralizes some fears of the “working poor”.

Compared to France, German government is weaker in institutional terms due to the division of power between often diverging majorities in both chambers of parliament, and only very limited influence of the state in the arena of collective bargaining. At the same time, however, the social partners are strong at the sectoral level, but have much smaller administrative capacities in social policies. Partial labor market reforms not questioning the labor market position of insiders are a plausible outcome of a political system characterized by weak government and a strong role of Social Democrats and Christian Democrats with neither of the two major parties advocating more radical reforms, although such reform initiatives are advocated by economic advisors. This virtually excludes more far-reaching reform proposals from the political agenda, as they would provoke blockage by opposition parties and electoral defeat. Similar to France, some rather marginal reforms announced and implemented by the Kohl government in the mid-nineties triggered the successful electoral campaign of the Social Democratic Party in 1998, which accused the Christian Democratic/Liberal coalition of neglecting “social justice”. However, at the same time, strategies aimed at limiting the use of flexible employment through stronger restrictions on fixed-term jobs, self-employment or “Minijobs” could not be sustained either.

As in France, there was no viable option of negotiating a broader policy package between the state and the social partners due to the institutional weakness of government and the lack of an effective institutional infrastructure for tripartite negotiations. The “Alliance for Jobs, Vocational Training and Competitiveness” initiated by the Red-Green Coalition in the late nineties did not result in significant policy initiatives but was hampered by bilateral concessions granted by government in favour of trade unions and employers. Hence, a “shadow of hierarchy” could not be established. However, the negative experience with the Alliance for Jobs paved the way for the Hartz reforms and the subsequent “Agenda 2010” package benefiting from stronger government initiative supported by, first, the Hartz Commission, a pluralist expert committee presenting a carefully balanced set of proposals addressing active and passive labor market policies and a partial deregulation of the labor market, and second, an implicit “Grand Coalition” of Social Democrats and Christian Democrats that was capable of implementing the abolition of earnings-related social assistance and the institutional framework for activating labor market policy focusing on inactive persons and the long-term unemployed. However, compromise on “Hartz IV” also resulted in the creation of a rather ineffective implementation structure. The Hartz reforms terminated active labor market policies as a tool for “hiding” open unemployment and curtailed social partner influence on labor market policies considerably (Streeck/Hassel 2003). But the experience with “Hartz IV” also points to the limits of more coherent reforms in Germany as the shift from status-related unemployment assistance to flat-rate “Arbeitslosengeld II”, subject to stricter means-testing, provoked considerable opposition against this alleged social “cruelty” that was supposed to bring about significant benefit cuts and increase low-wage employment. Public unrest triggered by the “Hartz IV” issue contributed to a significant loss of electoral support for the Red-Green Coalition and to electoral defeat in fall 2005.

The Grand Coalition, in power since late 2005, is more cautious with respect to labor market reforms and tends to raise labor market regulation through the probable introduction of binding minimum wages and a more restrictive treatment of fixed-term contracts. Continuously high levels of inactivity or partial attachment to the labor market generate persistent fiscal problems in welfare state funding that are dealt with by ad hoc stabilization measures and attempts at redistributing deficits across different branches of social policy (Streeck/Trampusch 2005).

Comparing German and French labor market reforms shows that what is plausible in politico-economic terms is less efficient in economic terms, but reforms advancing more efficient institutions are hardly feasible in political terms. Partial reforms and institutional layering are highly plausible from the point of view of policy makers, but result in deep labor market segmentation and a certain extent of “Americanization” through the backdoor as the flexible segment of less heavily regulated and subsidized jobs grows without facilitating transition to higher remuneration or to jobs with stronger employment stability. Hence, advocating a “social” approach to the labor market in political discourse goes along with tacit and implicit acceptance of deepened segmentation between the core and the margin, precarious labor market situations and continuously high benefit dependency.

7. CONCLUSION AND OUTLOOK: TRANSFORMATION THROUGH GRADUAL REFORMS

Both Germany and France opted for the path of partial reforms establishing more flexible but marginal labor market segments characterized either by lower levels of employment protection and reduced non-wage labor cost or by other forms of subsidized employment within the framework of active labor market policies. At the same time, the provision of basic income security has become a more prominent feature of the French and German labor markets in combination with a partial and hesitant shift towards more activating labor market policies. However, although these reforms contributed to some increase in labor market adaptability through stronger employment dynamics at the margin, they have not been sufficient to overcome high benefit dependency and deep labor market segmentation, as institutional arrangements of the core labor market have not been changed significantly even though increases in wage and working time flexibility contribute to the relative stability of regular employment in a more competitive economic environment. However, despite a partial shift to tax-funding, the burden of non-wage labor costs remains high and reduces the potential for job creation in regular employment. Hence, the strategy of gradual reforms involves considerable societal costs in terms of persistent benefit dependency, precarious employment and selective access to regular employment.

The comparative analysis of institutional reforms in both Germany and France, however, shows that more systematic reforms are hardly feasible so that more effective institutional adjustment seems blocked. This precludes the adoption of either the Nordic model or the Anglo-Saxon road to higher employment. Moving from a Continental European labor market regime to an institutional arrangement inspired by the Danish “golden triangle” of flexible employment protection, generous unemployment benefits and reintegration oriented labor market policies would mean easing dismissal protection and raising taxation while reinforcing the activation element in labor market policies (Madsen 2002). All three elements are contentious issues in a Continental European setting. The same is true for the Anglo-Saxon model of high labor market flexibility, lower unemployment benefits and stronger in-work benefits. Both strategies are problematic in politico-economic terms as they would imply lower employment stability for the core of the labor market and – in the Anglo-Saxon model – acceptance of a higher degree of wage inequality or, as in the Danish case, tolerance of higher taxation. At the same time, renegotiating a new balance between flexibility and social security similar to Dutch legislation on "flexicurity", narrowing the gap between regular and flexible employment, that was implemented in the late nineties is hardly feasible in Germany or France due to the institutional weaknesses of state/social partner relations at the national level.

Ironically, despite the rejection of more stringent reforms in Germany and France, the creation of diverse forms of flexible or marginal employment led to the emergence of an "Americanized" segment of precarious employment relationships in exchange for continued job stability in the core labor market. Given the risk of "asphyxiation" of regular employment due to high non-wage labor costs and strict employment protection that limit labor demand in this segment, the continuous expansion of flexible jobs might change the overall functioning of the labor market. In this sense, the process of institutional "layering" might lead to a gradual crowding out of regular employment in the traditional sense and may make a general revision of the institutional arrangement a viable alternative in the long run. This could result in a unified, but more flexible labor law, a stronger reliance on basic social security funded through taxes and stricter activation, which would be conducive to the creation of a more inclusive and "permeable" labor market. However, the transition will most probably be a protracted one generating considerable economic and societal costs.

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