

# Germany's Employment Problem in Comparative Perspective

*Lane Kenworthy*

Several of Wolfgang Streeck's recent writings have focused on what is widely perceived to be Germany's principal economic problem: an inadequate and stagnant rate of employment (Streeck 2001; Kitschelt/Streeck 2004; Streeck/Trampusch 2005). This is a critical issue. Given population ageing and the difficulty of raising tax rates in an environment of extensive capital mobility, the financing of high-quality public services and a generous welfare state will increasingly depend on a high employment rate.

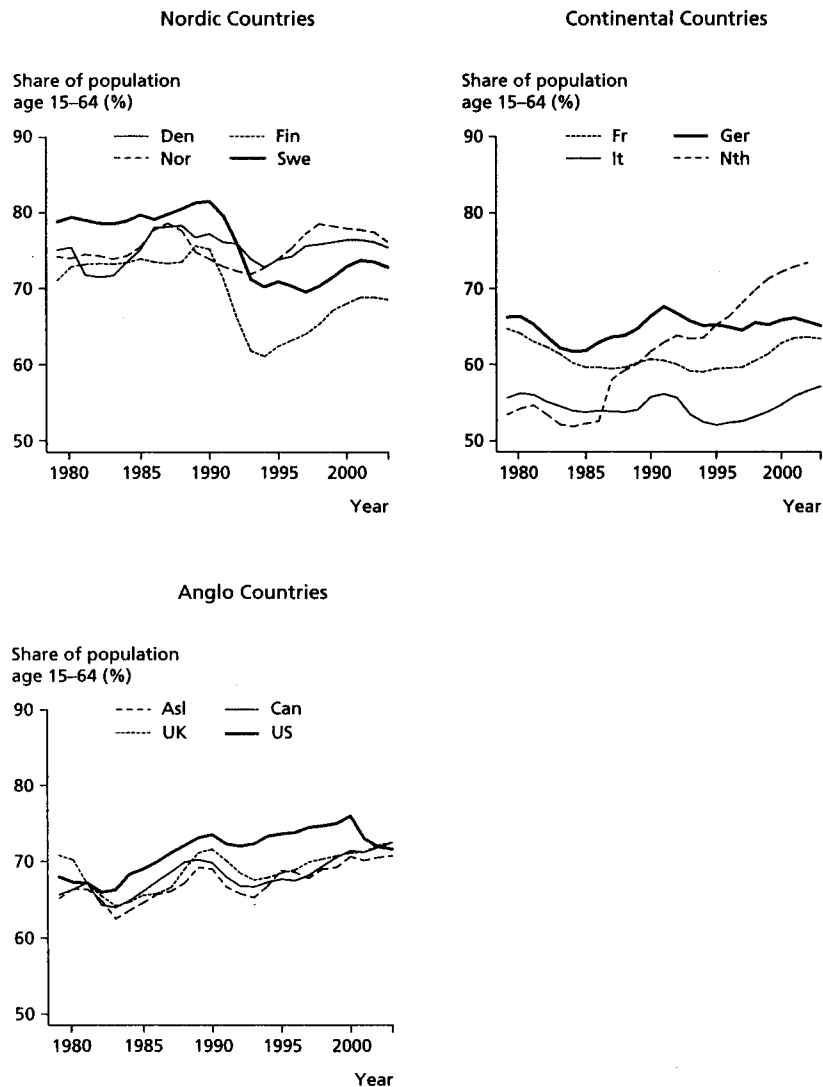
I consider three questions here: Does Germany in fact have an employment problem? If so, what are the causes? And what can be done to remedy it?

## 1 Is There a Problem?

Figure 1 shows employment rates – employed persons as a share of the working-age population (persons age 15 to 64) – in twelve countries since 1979. For most of these countries 1979 was the peak year of the late 1970s business cycle, so it is a useful starting point. I include four “Nordic” countries (Denmark, Finland, Norway and Sweden), four “Continental” countries (France, Germany, Italy and the Netherlands), and four “Anglo” nations (Australia, Canada, the United Kingdom and the United States).

Germany entered the 1980s with a comparatively high employment rate, at 66 percent. This was below the rates for the four Nordic countries but similar to those of France and the four Anglo nations. And it was considerably higher than the rates in Italy and the Netherlands. Like most of the twelve countries, Germany experienced a decline in its employment rate during and after the early 1980s recession, followed by an increase in the second half of the eighties. But in contrast to most other countries, the employment rate in Germany barely changed over the decade as a whole, as the increase from 1985 to 1990 merely offset the decline of the previous five years.

Figure 1 Employment Rates, 1979–2003



Note: Vertical axes are truncated (do not begin at zero). Country abbreviations for this and subsequent figures: Asl – Australia, Can – Canada, Den – Denmark, Fin – Finland, Fr – France, Ger – Germany, It – Italy, Nth – Netherlands, Nor – Norway, Swe – Sweden, UK – United Kingdom, US – United States. For variable definitions and data sources, see the appendix.

In the first half of the 1990s the employment rate again dropped, as it did in all countries other than the Netherlands. In 1995 Germany's employment rate was similar to that in three of the four Anglo countries and the Netherlands, and higher than in Finland, France and Italy. Only Norway, Denmark, Sweden and the United States had rates substantially higher. But in the second half of the 1990s Germany was the only country among the twelve with no growth in its employment rate. By 2003, eight of the countries had employment rates more than five percentage points higher than Germany's. One of the other three, Finland, had a rate three percentage points higher. France's rate was marginally lower than Germany's. Only Italy trailed by a significant margin.

Thus, Germany moved from being toward the high end among these nations coming into the 1980s to being at the low end at the turn of the century. It achieved no increase in its employment rate over the 1980s and 1990s. In 2001, its peak year in the 1990s business cycle, Germany's employment rate was 66 percent, the same as in 1979.

The easy story to tell about what caused this disappointing performance focuses on unification. The country absorbed a relatively poor nation (the GDR) with little sustainable employment base. In some respects the fact that Germany's employment rate is not now substantially lower than before unification is a significant achievement. Yet (West) Germany's employment performance in the 1980s was comparatively weak as well, so unification cannot be the entire story. Perhaps more important, while unification clearly imposed additional costs and strains on the country's economy, the relevant question is how its institutions and policies have dealt with those costs and strains.

Germany has powerful unions concentrated in manufacturing. Large manufacturing firms must also negotiate work conditions and hiring and firing procedures with firm-level works councils. In addition, codetermination laws stipulate that employees elect half of the board of directors in incorporated firms with more than 2,000 employees and one third in firms with between 500 and 2,000. Perhaps these institutional "rigidities" have burdened manufacturing firms with excessively high labor costs and reduced their ability to respond quickly to changes in the competitive environment (Siebert 1997, 2004).

Figure 2 shows employment rate trends in four key economic sectors. The first is manufacturing (ISIC 3). The second is "high-end" services, consisting of finance, insurance, real estate and other business services (ISIC 8). The third and fourth are two groups of relatively "low-end" services: wholesale and retail trade, restaurants and hotels (ISIC 6) and community, social and personal services (ISIC 9). Each chart shows employment rates in 1979, 1989, and 2000 – all peak business cycle years for most of the twelve countries.

Figure 2 Employment Rates by Sector, 1979, 1989 and 2000

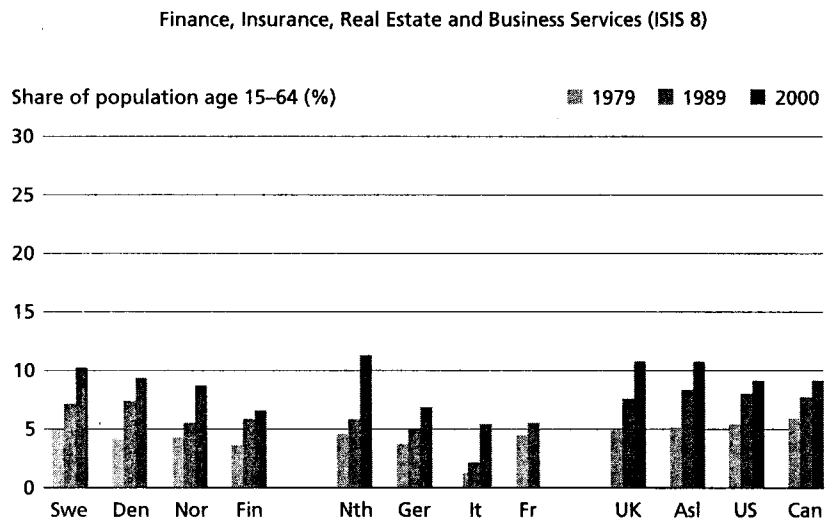
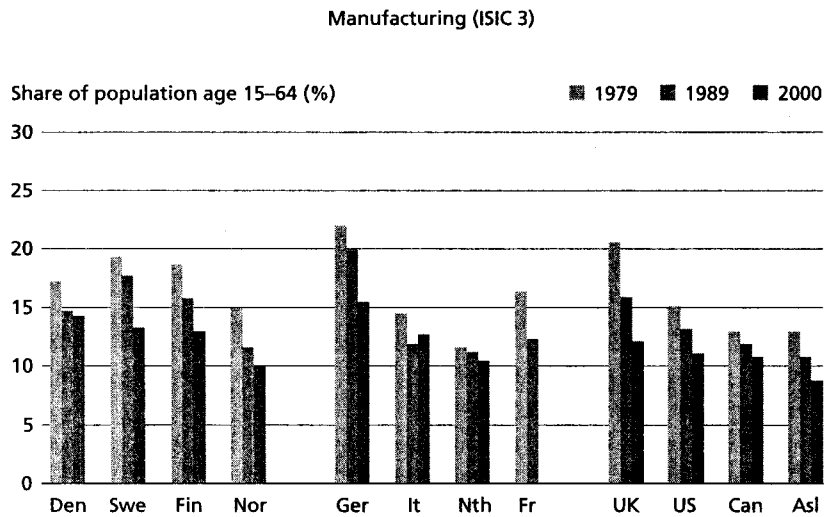
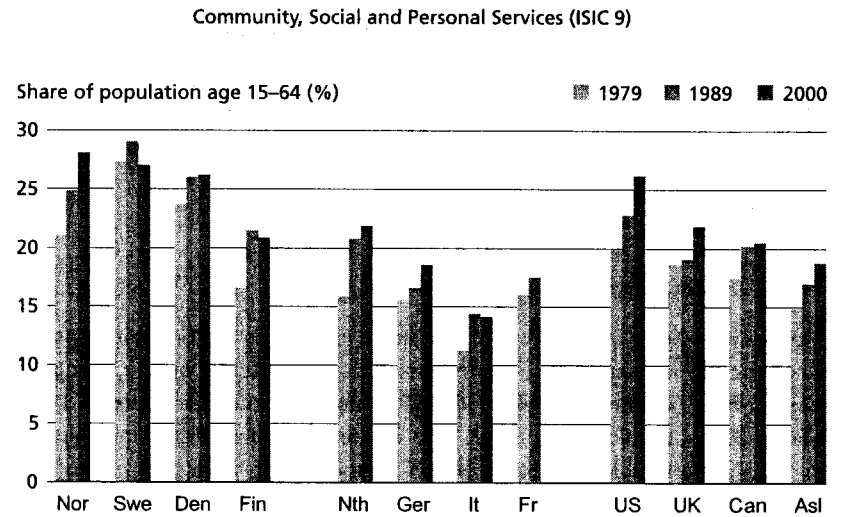
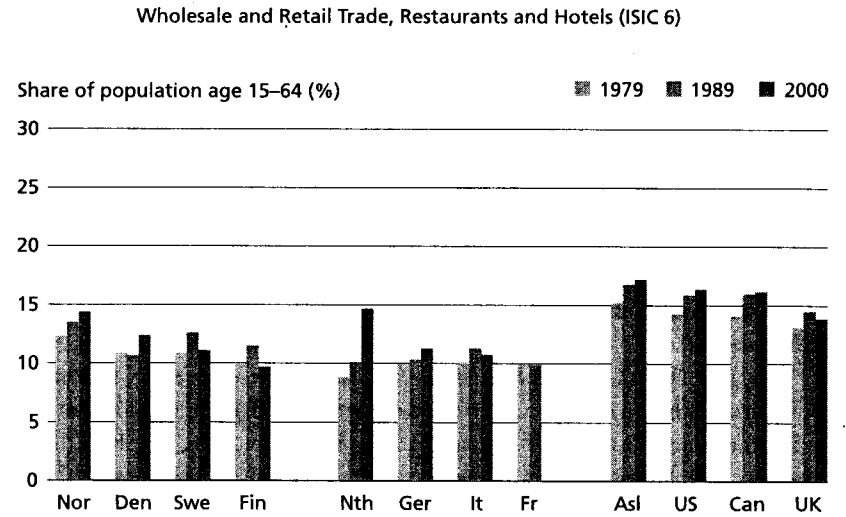


Figure 2 continued



Note: These are four of the nine ISIC sectors. The others are agriculture, mining/quarrying, electricity/gas/water, construction, and transportation/storage/communication. Sector-specific employment data are not available for France after 1990. For variable definitions and data sources, see the appendix.

Employment has declined in German manufacturing. But this has been true everywhere. Across these twelve countries, trends in manufacturing employment in the 1980s and 1990s followed straightforwardly from starting levels: countries beginning with the highest rates experienced the sharpest declines. Manufacturing employment in Germany began the 1980s at a higher level than in any of the other eleven countries. Given this high starting level, its rate of decline has not been especially rapid. As of 2000, Germany continued to have the highest manufacturing employment rate among the twelve nations, at approximately 15 percent.

The other three charts in Figure 2 indicate that Germany's employment deficit is mainly in services. Its employment rate trails that of most of the Nordic and Anglo countries in both high-end services (ISIC 8) and low-end services (ISIC 6 and 9).

Employment in Germany has increased in each of these three service sectors. But Germany began at low levels in the three sectors and, given that low starting point, the increase has not been particularly rapid. For instance, in ISIC 8 (business services), Germany's employment rate increased from 4 percent in 1979 to 7 percent in 2000. In the United States it rose from 6 to 9 percent. In ISIC 6 (trade, restaurants, hotels), the employment rate rose from 10 to 11 percent in Germany and from 14 to 15 percent in the United States. In ISIC 9 (community, social and personal services), Germany's employment rate grew from 16 to 19 percent, while the rate in the United States jumped from 20 to 26 percent.

Mediocre employment growth in these three service sectors is thus key to understanding Germany's employment woes. What has caused it?

## 2 What Are the Causes?

### *Tight Monetary Policy?*

One view is that Germany has suffered from excessively tight monetary policy since the 1970s, first by the Bundesbank and more recently by the European Central Bank (Dornbusch 1986; Ball 1999; Galbraith/Conceição/Ferreira 1999; Martin 2004; Schettkat 2004, 2005). This squares with conventional understanding of the Bundesbank as the most anti-inflationary of the affluent countries' central banks in recent decades.

Yet this view overlooks the fact that several countries tied their monetary policy to Germany's and others tended to follow the Bundesbank's lead more informally. This suggests that Germany's monetary policy may not in fact have been more restrictive than that of many other European nations.

Figure 3 Employment Change in Three Service Sectors, 1979 to 2000, by Various Potential Determinants

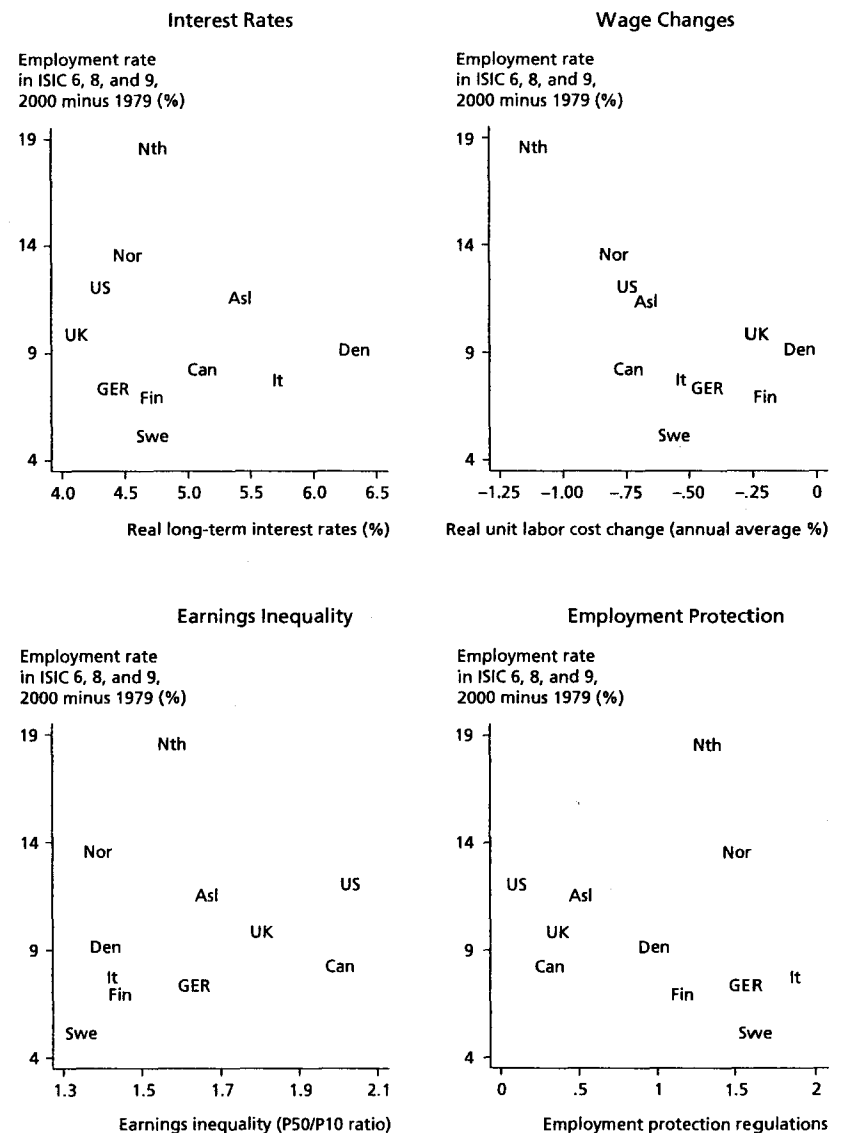
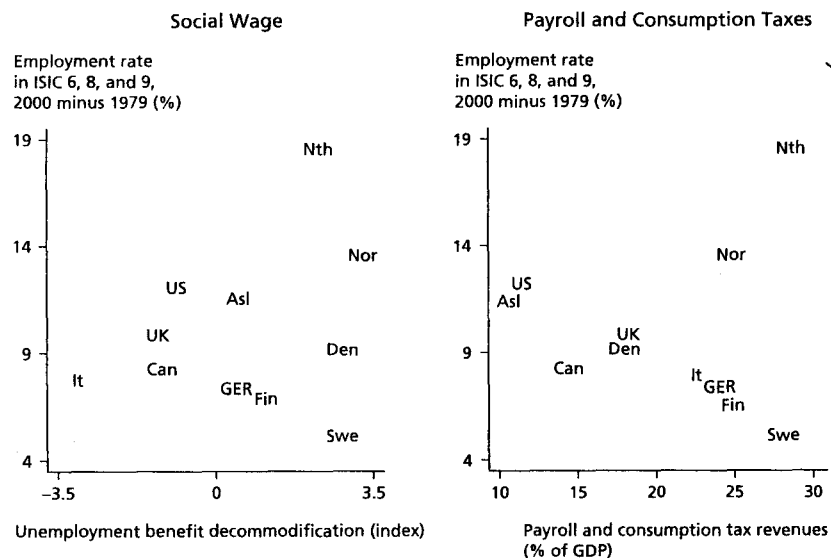


Figure 3 continued



Note: Figures for interest rates, earnings inequality, employment protection, the social wage, and payroll and consumption tax revenues are averages over the period 1980–2000. Service-sector-specific data are not available for France after 1990. For variable definitions and data sources, see the appendix.

The best available indicator of the restrictiveness of monetary policy is real long-term interest rates. The first (top left) chart in Figure 3 shows change in employment in the three service sectors highlighted in Figure 2 (ISIC 6, 8 and 9) by average real long-term interest rates. The employment change measure is calculated as the employment rate in these three sectors in 2000 minus the rate in 1979. The interest rate figure is an average over the period 1980 to 2000. The data suggest that, although the Bundesbank may indeed have pursued a comparatively restrictive approach over the 1980s and 1990s, real interest rates in Germany tended to be *lower* than in many of the other countries. Furthermore, there is no apparent association across the group of countries as a whole between interest rates and employment growth in services.

#### Lack of Wage Restraint?

As noted earlier, Germany's unions are comparatively strong. Moreover, although they represent only about one third of the work force directly, extension practices mean that collectively bargained wages cover 70 to 85 percent of workers (depending on the estimate). Perhaps, then, rapid wage increases in

manufacturing, themselves justified by rapid productivity growth, have pulled up economy-wide wages too quickly, deterring employment growth (OECD 1994, 2004d; Siebert 1997, 2004, chap. 4; Hemerijck/Schludi 2000).

The second (top right) chart in Figure 3 suggests that "insufficient" wage restraint may indeed have contributed to the shortage of service-sector employment growth in Germany in the eighties and nineties. The measure shown in the chart is average annual change in real unit labor costs, which represents total compensation adjusted for inflation and productivity. Real unit labor costs declined in all of the countries over the two decades. But those in which they declined least tended to experience the least increase in service employment. Germany is located in the lower-right portion of the chart. Its decline in real unit labor costs was less rapid than in most of the other countries, and it was on the low end in service employment growth.

#### High Low-End Wages?

Another common hypothesis is that high wage levels at the low end of the earnings distribution reduce employment growth in low-end services (OECD 1994, 2004d; Siebert 1997, 2004, chap. 4; Iversen/Wren 1998; Esping-Andersen 2000a; Blau/Kahn 2002). Productivity in these jobs tends to be relatively low and difficult to increase. If wages are too high, employers will not be able to hire as many people as the level of consumer demand would otherwise permit.

The third (middle left) chart in Figure 3 shows employment change in the three service sectors by the ratio of earnings at the fiftieth percentile of the earnings distribution to those at the tenth percentile. The figures are for the full-time employed only. The P50/P10 earnings ratio is thought to be a more relevant indicator than the absolute level of earnings at the low end because most of these jobs are in non-tradable services. Hence the relevant benchmark for employers is more likely to be the median wage within the domestic economy rather than, say, the tenth-percentile wage in other nations.

If we discount the Netherlands and Norway, we observe the expected pattern: countries with higher levels of earnings inequality tended to have greater employment growth in the three service sectors than did those with less earnings inequality. Should we discount the Netherlands and Norway? I think there is good reason to do so. The Netherlands is a peculiar case in many respects, and there has been considerable debate over the past decade about the nature and causes of the Dutch employment "miracle" and Dutch exceptionalism (Visser/Hemerijck 1997; Hartog 1999; Gorter 2000; Becker 2001; Visser 2002). Norway deserves to be treated separately because of the importance of oil revenues for its economic performance since the mid-1970s (Jackman 1987; Kenworthy 2004).

However, despite the cross-country association between earnings inequality and service employment growth, this factor does not appear to help much in accounting for Germany's employment difficulties. Although Germany's manufacturing wages are comparatively high in an absolute sense, its P50/P10 earnings ratio is in the middle of the pack among affluent nations.

More evidence on the employment impact of wages in low-end services comes from a study of Germany and the United States by Richard Freeman and Ronald Schettkat (2000). Freeman and Schettkat found that low-wage services – eating, drinking, care facilities, retail trade and so on – account for a large portion of the difference in aggregate employment rates between these two countries. Yet they also found that, although Germany's overall pay structure is more egalitarian than that of the United States, the ratio of wages in the lowest-paying service sectors to average wages is approximately the same in the two countries. Because Germany does not have a statutory minimum wage and many of these jobs are outside of the collective bargaining system, German employers in low-end services do not have to pay higher relative wages than American employers. This suggests reason for skepticism about the role of wage levels in contributing to the two countries' different employment performance.

More recently, Andrew Glyn and colleagues (2005) performed the same exercise for wages and employment in retail trade. They examined not only Germany and the United States but also France, the Netherlands and the United Kingdom. They reached a similar conclusion: relative to average wage levels, wages for the lowest paid in this industry are approximately the same in each of these countries. Glyn et al. also found that productivity levels are similar across the countries; if anything, they are higher in the European countries. This suggests that wage levels probably have not been the main impediment to employment in retail trade in Germany.

#### *Stiff Employment Protection Regulations?*

If employers' freedom to fire workers during a downturn is restricted, they may be more reluctant to hire when times are good. Over the long run, therefore, employment protection regulations, whether imposed by government or negotiated collectively between unions and employers, may reduce employment growth (OECD 1994, 2004a; Siebert 1997, 2004, chap. 4; Esping-Andersen 2000b).

The fourth (middle right) chart in Figure 3 shows employment change in the three services sectors by a measure of the stiffness of employment protection regulations. Germany is among the countries with the strongest regulations. In firms with more than ten employees (more than four between 1998 and 2004), layoffs not prompted by individual misbehavior must be justified by a firm's

economic situation. Disputes frequently are settled in labor courts, which means firms risk having layoff decisions reversed. Severance pay of a year's salary is typically required for those laid off. Also, German firms traditionally have been limited in their ability to hire workers on fixed-term contracts. Such hires must be justified as part of a project with limited duration and generally must be limited to two years (four years beginning in 2004).

The comparatively high degree of employment protection in Germany is consistent with the country's comparatively poor employment performance. And as with earnings inequality, if we discount the Netherlands and Norway, we observe a fairly strong association, in the predicted direction, across the twelve nations.

#### *Generous Social Wage?*

The "social wage" refers to the level of government (and other) benefits available to persons who are not employed. Unemployment benefits, sickness benefits, disability benefits, social assistance, early retirement packages, pensions, health care provision and various other programs contribute to the generosity of the social wage. In principle, the higher the social wage, the higher the employment wage ("reservation wage") must be for a person outside the labor market to accept a job. A higher social wage may therefore reduce employment growth (OECD 1994; Siebert 1997, 2004, chap. 4; Nickell/Layard 1999; Esping-Andersen 2000b; Peter 2004).

Though the unemployment insurance system has been substantially altered in the past few years, Germany's social wage was comparatively generous throughout the 1980s and 1990s. Unemployment insurance paid around two thirds of prior earnings and was available for more than two years. After that, a person could receive unemployment assistance for an indefinite duration and often at more than 50 percent of former earnings. Sickness, disability and social assistance benefits were comparatively high. These programs were complemented by housing assistance and full health care coverage. Workers over age 50 were often encouraged to take generous early retirement packages, partially subsidized by government (Ebbinghaus 2000).

The fifth (bottom left) chart in Figure 3 shows employment change in the three service sectors by a measure of the social wage: unemployment benefit decommodification. This is a composite measure that takes into account eligibility rules, replacement rates, and duration of benefits. It is at best a partial measure, but it is a fairly comprehensive one for perhaps the most important of the programs that influence the social wage. Germany is in the middle of the pack on this measure. Moreover, there is less indication of a relationship across

the countries between this policy measure and employment growth in the three service sectors. Thus, although the social wage has been the focus of recent Germany policy reforms, the comparative evidence suggests that it may not have been of primary importance.

#### *Heavy Payroll and Consumption Tax Burden?*

Taxes may reduce employment for a variety of reasons. On the demand side, taxes on income and corporate profits may diminish job creation by reducing incentives to save, invest, expand output or start new businesses. Taxes on payroll paid by employers increase non-wage labor costs. Taxes on consumption are likely to raise the price of goods and services, potentially reducing consumer demand and therefore lowering employer revenues. Taxes on income and taxes on payroll paid by employees may lead to employee (or union) demands for higher wages to compensate for the tax payments, thereby increasing labor costs for employers. On the supply side, income taxes and employee-contributed payroll taxes lessen the financial gain from employment, reducing the incentive to work. A number of recent studies have found empirical support for the notion that high taxes are bad for employment (OECD 1994; Nickell 1997; Scharpf 1997, 2000; Manow/Seils 2000; Esping-Andersen 2000b; Daveri/Tabellini 2002; Kenworthy 2004, chap. 5; Kemmerling 2005).

Some analysts suggest that adverse employment effects are generated by particular types of taxes rather than by the overall level of taxation (Scharpf 1997, 2000; Kemmerling 2005). In this view, payroll and consumption taxes are especially detrimental to employment in low-productivity services. Fritz Scharpf (1997) has put the argument as follows:

The negative impact on service employment is particularly acute in those countries which, like Germany and France, rely to a large extent on payroll taxes for the financing of the welfare state. In Germany, for instance, 74% of total social expenditures were financed through workers' and employers' contributions to social insurance systems in 1991, and in France that was true of 82%. In Germany, these contributions presently amount to about 42% of the total wage paid by the employer ... If the net wage of the worker cannot fall below a guaranteed minimum [the level of unemployment benefits and social assistance], the consequence is that any social insurance contributions, payroll taxes, and wage taxes that are levied on jobs at the lower end of the pay scale cannot be absorbed by the employee but must be added to the total labor cost borne by the employer. Assuming that additional overhead costs are proportional to total labor cost, the implication is that the minimum productivity that a job must reach in order to be viable in the market is raised by more than 50% above the level of productivity required to pay the worker's net wage. As a consequence, a wide range of perfectly decent jobs, which in the absence of payroll taxes would be commercially viable, are eliminated from the private labor market.

This argument is echoed in a recent paper by Streeck and Christine Trampusch (2005).

The sixth (bottom right) chart in Figure 3 shows service employment growth by the sum of payroll and consumption taxes as a share of GDP. Apart from the Netherlands and Norway, we see a clear and fairly strong association between the two variables. Consistent with the argument of Scharpf and others, countries with high payroll and/or consumption taxes, including Germany, have tended to achieve less employment growth in the three service sectors.

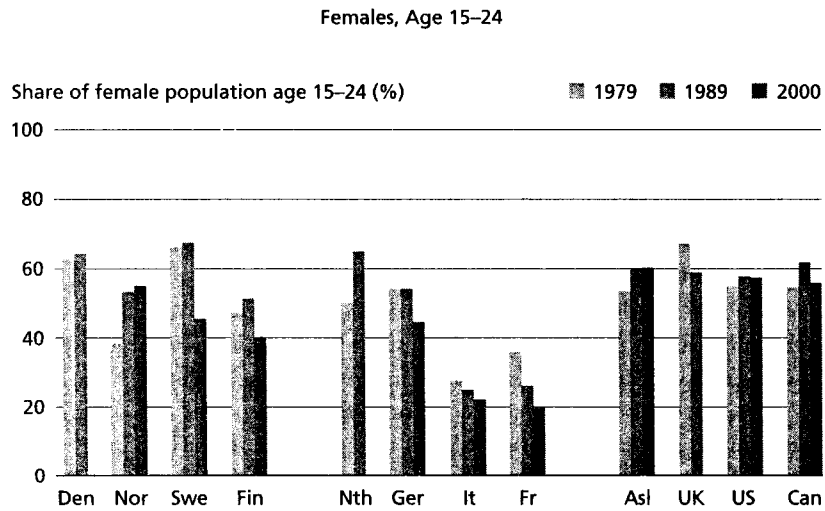
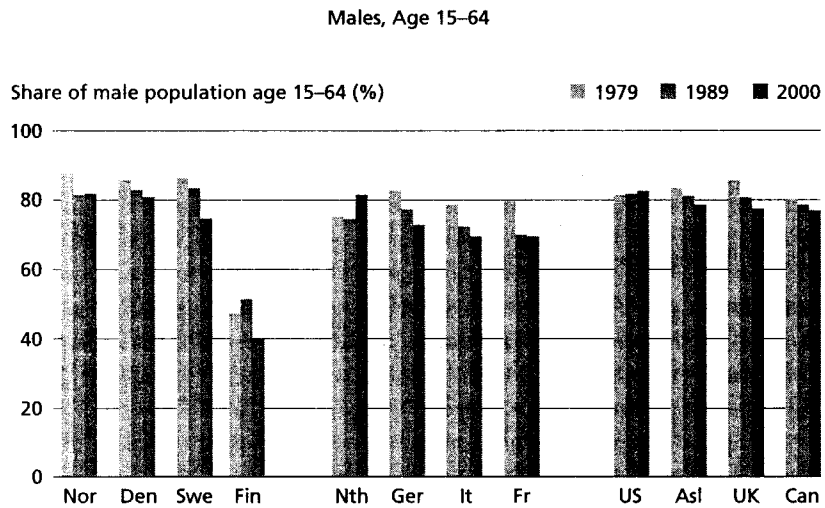
#### *Lack of Women-Friendly Policies?*

Across affluent countries the chief source of variation in employment rates is variation in employment rates for *women*. This suggests that policies and institutions that specifically affect women's employment may be a key cause of differing overall employment performance.

Compared to many other affluent countries, policies and institutions in Germany are not particularly conducive to female employment (Ondrich et al. 1999; Gottschall/Bird 2003; Spiess/Wagner 2003; Kenworthy 2007). Childcare for children under three is undersupplied. Public preschool is available for children age three to six, and approximately 80 percent of such children attend. But this schooling is half-day, which poses a problem for parents in full-time jobs. Half-day schooling for six to nine-year-olds forces many couples with even school-age children to keep one parent home during the heart of the working day. There is government-subsidized maternity/care leave, but it is too long; it encourages mothers to take a three-year break from employment, which increases the number who never return or who return only part-time. Moreover, eligibility for leave is not conditional on prior employment, so there is no incentive for women who wish to make use of the leave to enter the labor market beforehand. The tax system imposes a comparatively stiff penalty on households with two earners. The German pension system further reinforces the male breadwinner model: if a husband qualifies for a pension, the wife automatically does too. In addition, survey data suggest that German women are less favorably disposed toward employment than their counterparts in most other affluent nations.

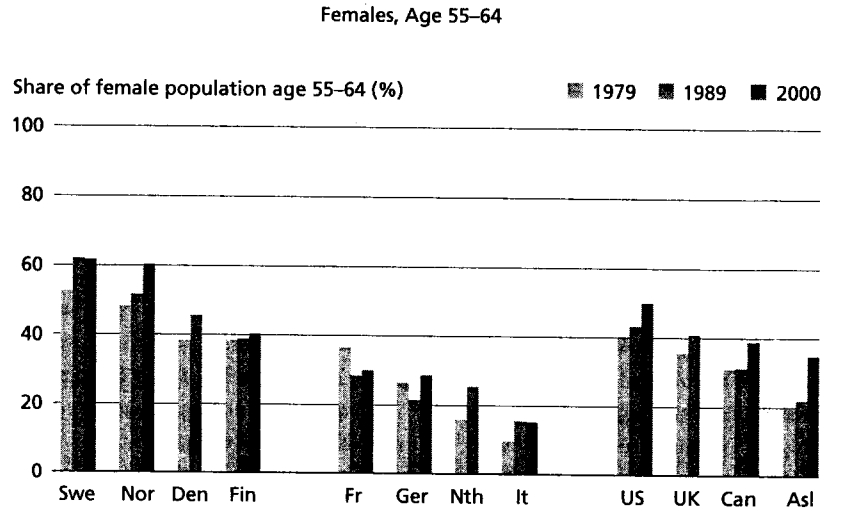
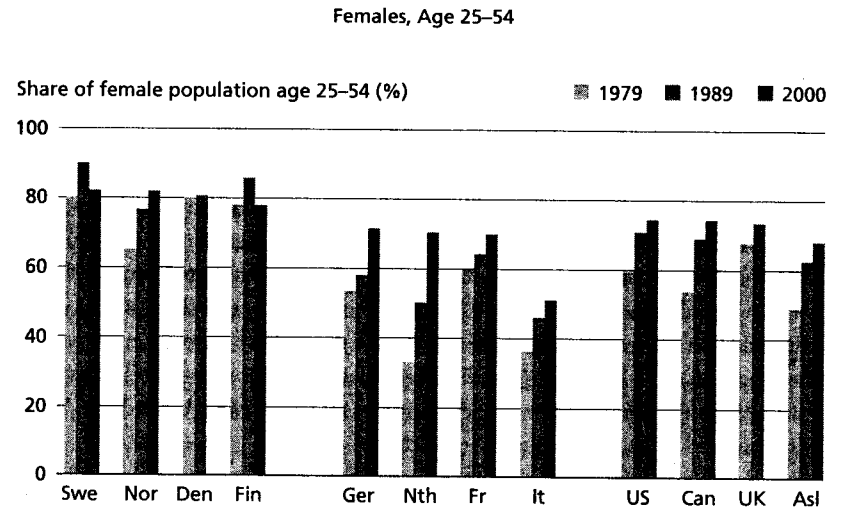
Given this array of obstacles to women's employment, the rate of employment among prime working-age women is higher than might be expected. As the third (lower left) chart in Figure 4 indicates, employment among German women age 25–54 is nearly as high as in the Netherlands and in the Anglo countries. However, this is somewhat artificial – inflated by unification with the east. Employment rates among women in the former East Germany tended to be much higher than in the west. The employment rate for women age 25–54

Figure 4 Employment Rates by Sex and Age, 1979, 1989 and 2000



Note: Age-group-specific employment data are not available for Denmark, the Netherlands, and the United Kingdom prior to the mid-1980s. For variable definitions and data sources, see the appendix.

Figure 4 continued



jumped by seven percentage points between 1990 and 1991, when unification occurred.

Then again, after a temporary dip in the early 1990s, the employment rate for prime working-age women in unified Germany has increased steadily. This is not a product of women-friendly policies. Instead, it seems to be the result of a combination of other factors: improvements in women's educational attainment, increases in pay, changes in attitudes toward work among German women, and higher unemployment among men.

As the fourth chart in Figure 4 indicates, German women's employment is lowest among those age 55–64. However, the rate for German men in this age group is also comparatively low (not shown). This suggests problems in the labor market that are not necessarily gender-specific. The same thing is suggested by the data in the first (top left) chart in Figure 4, which is for male employment rates (age 15–64). Although the differences across countries are far less pronounced than those for women, Germany does lag noticeably behind the Anglo countries and most of the Nordic countries.

#### *Which Explanation Is Correct?*

Ordinarily we look to comparative analysis for help in sorting through competing explanations of a phenomenon such as employment performance. Unfortunately, cross-country comparison is of only limited utility here: there is a relatively small number of countries, the list of potential causes is long, and a number of the countries share more than a few of the relevant institutions and policies. Furthermore, several of the countries are exceptional in ways that cast suspicion on their usefulness for making comparative judgments. I have already noted this with respect to Germany (unification), the Netherlands (an assortment of factors), and Norway (oil). Sweden and Finland could certainly be added to this list, as the employment records of these two countries during this period is dominated by the deep economic crises of the early 1990s, which arguably were products of exogenous factors – a series of policy mistakes for Sweden and the collapse of the Soviet market for Finland.

I therefore hesitate to render a judgment about which of the factors discussed in this section have been most important, either across the countries or for the German case in particular. The most likely culprits would appear to be wage changes, employment protection regulations, and payroll and consumption taxes. But it is difficult to be confident about such a conclusion.

### 3 What To Do?

One proposed solution to Germany's employment problem is to radically alter the entire institutional and policy configuration – union and works council influence, codetermination, employment protection, the welfare state, and the tax system (Siebert 2004; *The Economist* 2006). But given the continued healthy performance of manufacturing firms, this seems unduly radical. A more sensible approach, at least for the medium term, might be to focus on introducing changes to the institutional and policy structure that would have little impact on arrangements in manufacturing.

This suggests that perhaps the wage determination system should be left more or less intact. In a sector such as manufacturing, where there is considerable potential for productivity increases, high and rising wages can function as a “beneficial constraint” on employers, forcing them to constantly search for new and better techniques and strategies (Streeck 1997a). Moreover, because a number of low-end service-sector jobs are outside the collective bargaining system, their wages are already at about the same point relative to the median as in the United States and a few other European economies (Freeman/Schettkat 2000; Glyn et al. 2005).

What should be changed, then? There are several potential candidates. One is to reduce the social wage. The series of reforms introduced by the Schroeder government, culminating in the Hartz IV reforms, which took effect in 2005, have done so for unemployment benefits.

A second is to reduce employment protection regulations, making it easier for employers to dismiss workers. This, it is argued, will render employers less hesitant to hire when economic conditions are good. The comparative pattern suggests some support for the view that limited employment protection is conducive to rapid employment growth in services. Denmark in particular is sometimes pointed to as an example of a country that has benefited from limited employment protection combined with otherwise labor-friendly institutions and policies (Campbell/Pedersen 2005). I suspect that moving in this direction would be beneficial for service-sector employment in Germany, but it would represent a major curtailment of the rights and powers of works councils, which are a key component of the still relatively successful institutional configuration in German manufacturing.

I agree with Scharpf (1997, 2000), Streeck and Trampusch (2005) and others that the most employment-friendly alteration of the German institutional and policy structure probably would be a revision of the tax system to shift more of the burden from payroll taxes to general taxation. The comparative evidence suggests some likely payoff, and this change seems likely to least disturb existing

institutional arrangements. That is not, of course, to say that it is an easy thing to do politically (Streeck/Hassel 2004).

Germany has an egalitarian culture (Streeck 1997b, 2001; Siebert 2004). Most of the potential reforms I have discussed are aimed at promoting employment in low-productivity, low-pay service jobs. Is that a good thing from an egalitarian point of view? That depends on which level of inequality is prioritized. More Germans would be working in jobs at the low end of the pay scale, which presumably would increase earnings inequality among employed individuals. (Then again, this may have happened already, even though the official figures for earnings inequality do not show it. Because of high payroll taxes and perhaps other factors, a range of “off the books” jobs in consumer services have developed in recent years, usually at low pay levels and without unemployment insurance or pension entitlement [Streeck 2001]).

What effect would an expansion of low-wage jobs have on earnings inequality among households? On the one hand, with more individuals earning low wages, we would expect a widening of household earnings inequality. On the other hand, to the extent that some (many?) of those who move into such jobs come from zero- or single-earner households at the low end of the distribution, the new earnings, even though relatively low, should help to pull up the earnings of the household. This would have the effect of reducing earnings inequality across households.

The inequality that egalitarians should care most about, in my view, is inequality of disposable (posttax-posttransfer) income across households. Here, I think, there is good reason for optimism. If policy reforms succeed in generating a growing number of low-end service jobs (or bringing them out of the black market into the formal sector), there will be many individuals and households with low earnings. But this can be remedied with an employment-conditional earnings subsidy – something along the lines of the Earned Income Tax Credit in the United States or the Working Tax Credit in the United Kingdom. These programs provide a tax refund to households with low earnings. If (as is often the case) the refund is greater than the amount the household owes in income taxes, the household receives the difference as a cash benefit. In order to encourage labor force participation, the amount of the tax credit increases with earnings up to a point, and then begins to decrease. The credit in the United States has existed since the mid-1970s, and most studies have concluded that it heightens labor force participation, effectively targets transfers to households most in need (more so than a subsidy to low-earning individuals, since some such individuals may be in higher-earning households), creates minimal stigma, and has low administrative costs (Hoffman/Seidman 2003; Hotz/Scholz 2004). If shifting the tax burden away from payroll taxes, reducing employment protec-

tion or some other policy reforms succeed in stimulating a large number of relatively low-paying jobs, something along the lines of an employment-conditional earnings subsidy can ensure that Germany not only achieves high employment but also maintains low inequality.

## Appendix: Variable Definitions and Data Sources

*Earnings inequality.* Ratio of pre-tax earnings of a person at the fiftieth percentile of the earnings distribution among the full-time employed to a person at the tenth percentile. Annual earnings for Canada, Finland, France (post-tax), the Netherlands and Sweden. Monthly earnings for Germany and Italy. Weekly earnings for Australia, the United Kingdom and the United States. Hourly earnings for Denmark and Norway. Source: Author's calculations from data in OECD (2005a).

*Employment.* Employed persons as a share of the population age 15–64. Source: Author's calculations from data in OECD (2005b).

*Employment: manufacturing.* Employment in manufacturing (ISIC 3) as a share of the population age 15 to 64. Source: Author's calculations from data in OECD (2005b).

*Employment: finance, insurance, real estate, and business services.* Employment in finance, insurance, real estate and business services (ISIC 8) as a share of the population age 15–64. Source: Author's calculations from data in OECD (2005b).

*Employment: wholesale and retail trade, restaurants, hotels.* Employment in wholesale and retail trade, restaurants and hotels (ISIC 6) as a share of the population age 15–64. Source: Author's calculations from data in OECD (2005b).

*Employment: community, social and personal services.* Employment in community, social and personal services (ISIC 9) as a share of the population age 15 to 64. Source: Author's calculations from data in OECD (2005b).

*Employment: men's.* Employed men as a share of the male population age 15–64 (or other age groups). Source: Author's calculations from data in OECD (2005b).

*Employment: women's.* Employed women as a share of the female population age 15–24, 25–54, and 55–64. Source: Author's calculations from data in OECD (2005b).

*Employment protection.* Index capturing the strictness of employment protection rules and regulations. Range is 0 to 2, with higher scores indicating greater strictness. Source: Baker et al. (2004) update of data in Nickell et al. (2003). Originally created by Olivier Blanchard.

*Interest rates.* Real long-term interest rates: long-term nominal interest rates minus the rate of inflation. Source: Author's calculations from data in OECD (2004b).

*Social wage.* Decommodification index for unemployment insurance, based on a scoring procedure similar to that in Esping-Andersen (1990) but substantially revised. Six aspects of unemployment insurance policy are used: net replacement rate for a single person, net replacement rate for a family of four, qualifying condition, waiting period, benefit duration, and coverage rate. The first five are standardized (using data for 18 countries). Values of less than -2 or greater than 2 are recoded as -2 and 2, respectively. The five standardized scores are then summed, and the resulting sum is multiplied by the coverage rate. Source: Scruggs (n.d.). For discussion see Scruggs and Allan (2005).

*Tax revenues: payroll and consumption.* Government revenues from social security contributions, payroll taxes, and taxes on goods and services as a share of GDP. Source: OECD (2004c: 74, 77, 79).

*Wage changes.* Change in real unit labor costs: year-to-year percentage change in employee compensation, adjusted for changes in productivity and for inflation. Source: Author's calculations from data in OECD (2004b).

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Jens Beckert, Bernhard Ebbinghaus,  
Anke Hassel, Philip Manow (Hg.)

# Transformationen des Kapitalismus

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zum sechzigsten Geburtstag

*Jens Beckert* ist Professor für Soziologie und Direktor am Max-Planck-Institut für Gesellschaftsforschung, Köln. *Bernhard Ebbinghaus* ist Professor für Soziologie und Leiter des Arbeitsbereichs A »Die europäischen Gesellschaften und ihre Integration«, Mannheimer Zentrum für Europäische Sozialforschung, Universität Mannheim. *Anke Hassel* ist Professor of Public Policy an der Hertie School of Governance, Berlin. *Philip Manow* ist Forschungsgruppenleiter am Max-Planck-Institut für Gesellschaftsforschung, Köln.

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