

## **Germany response to the crisis**

Germany as the world's biggest exporter is severely hit by the fall in global demand. Exports revenues have been declining by 20 per cent in the first quarter of 2009 on a year-over-year basis. Recovery might be on its way, in August 2009 for the first time since mid 2008 output was growing again. Nevertheless, at a far lower level than the previous year.

The sectors hardest hit were the manufacturing industries such as automobile and machinery. Although public attention focuses on major companies such as Opel (a General Motors daughter), also small and medium enterprises that supply the big trusts are threatened by bankruptcy.

To counter the crisis, the German government has tied two major stimulus packages and a law to stabilise the financial and banking sector has passed the parliament. The stimulus packages tied to counter the crisis aim at shoring up domestic demand to make up for the loss in external demand.

The major measures to counter the crisis in the field of social security are partial unemployment benefits or reduced working hour compensation. This instrument has so far been successful in avoiding full unemployment on a large scale, and has in international comparison received good feedback (see the bruegel article on "The good and the bad flexibility

## ***Impact of the crisis and challenges to social security systems***

Germany has been hit hard by the crisis and suffers its first economic contraction since 2002. GDP in 2009 is expected to fall by about 5.6 per cent. The main mode of transmission is its high reliance on exports.

Negative economic trends of this scale, obviously also have an affect on the social security systems. Generally speaking, Germany has a fairly comprehensive social security systems based on five main pillars:

- Unemployment insurance and unemployment/social assistance; managed by the public employment agency (Bundesanstalt für Arbeit, BA) contributions are shared on an equal basis between employers and employees. Insurance is compulsory for all employees above a threshold of €800. While unemployment insurance benefit is earnings related, the unemployment/ social assistance is a means-tested flat benefit.
- Health insurance; in most cases insurance is compulsory. Citizens can choose from a large pool of public and private providers, about 85 per cent of the population are insured in one of the public schemes.
- Pension system; next to the state pension system which covers about 80 per cent of the population, occupational pension plans and private capitalized pension schemes and life insurances exist.
- Accident insurance; the statutory accident insurance is solely financed by employers and covers risks related to occupational accidents.
- Care insurance; the youngest pillar of the social system was established in 1995 and covers the costs for long-term care.

The branch of social security which is traditionally most effected by economic crisis is the unemployment insurance scheme. This is also the case in Germany. Due to the raising number of beneficiaries the reserves of the scheme are declining (see figure below).

Unemployment and health insurance schemes are furthermore affected by lowered contribution rates. The contribution to the unemployment insurance scheme is down to 2.8 per cent (gradually decreased from 6.5 per cent in 2006). The contribution to the health insurance was decreased by 0.6 per cent and now stands at 14.9 per cent since June 2009. To cover the losses for the schemes, the state support to the general health fund was increased by €3 billion in 2009 and €6 billion in 2010.

The reduction of the contribution rate to the unemployment insurance scheme was planned to be implemented in 2009 already before the onset of the crisis. Over the past years the BA had accumulated reserves worth €18 billion, according to actual estimated they will depleted by the end of 2009.

Only insufficient information is available on the affects of the crisis on the other branches of social security. Occupational pension funds partly seem to have encountered quite big losses,<sup>1</sup> also the value of the assets of some of the private

---

<sup>1</sup> One example for the latter is the case of Siemens. The coverage gap of its pension plan „Siemens Pension Trust e.V.“ increased from €1bn in 2007 to €2,5bn in 2008 (fiscal year October-September). <http://www.handelsblatt.com/unternehmen/industrie/renten-belasten-konzerne;2096291;0>. Another

pension funds have declined. But the statutory German pension system fares quite well in the crisis says a recent OECD report). Please see the section pensions in the crisis.

### *The German crisis responses in general*

To counter the crisis, the government has tied two major stimulus packages so far, and realized a major effort to stabilize the tumbling banking sector. The grand coalition currently in power had no trouble securing a majority in the two chambers (the parliament and the house of states) in favour of the packages. While the first stimulus pack<sup>2</sup> and the law on stabilization of the banking sector are important pillars of the crisis reactions, the second stimulus was by far the most important with regards to social security.

The second stimulus package has the title “Law for the securitization of employment and stability in Germany” and passed the parliament on March 2<sup>nd</sup> 2009. Additional expenditure on social security and infrastructure measures, as well as a reduction of taxes and social security contributions in a number of areas worth €50bn is foreseen.<sup>3</sup> To secure this amount Germany has taken up additional national debt worth €21 billion.

The biggest investments are foreseen for infrastructural measures to be taken on local and state level (€10bn). This is followed by federal investment in traffic infrastructure and energy efficiency (€2bn and €0.75bn respectively). Originally, €1.5bn were foreseen for a so called environmental benefit of €2,500, to be paid to car-owners that trade in their at least 9 year-old car for a new one with better environmental standards. Due to the high number of applicants, the funds foreseen turned out to be insufficient; costs are currently estimated at €5bn.<sup>4</sup> Other measures foreseen include credit facilities for small and medium enterprises (€0.9bn), renewal of public buildings (€0.5bn), and last but not least a contribution of €0.1bn to the Rapid Social Response Fund of the World Bank.

According to the ministry of economy the total macro-economic impulse of all stimulus measures in 2008-2010 (including multiplier effects) amount to 3,5% of GDP, including the expenditure on social security it even equals 4,5 to 5% of GDP.<sup>5</sup> The total arithmetical fiscal stimulus as percentage of GDP is said to be 1.3% in 2009 and 1.8% in 2010.<sup>6</sup>

---

article mentions losses of roughly 9% or €12,8bn of the externally managed pension funds of the 30 companies listed in the German stock market index DAX. In 2007 they reported gains.  
<http://www.handelsblatt.com/finanzen/vorsorge/pensionsvermoegen-von-dax-unternehmen-sinken-deutlich;2220177;0>.

<sup>2</sup> The first stimulus package included only two social security measures. Firstly, 1000 new placement officers were to be employed by the public employment agency. Secondly, a training programme for low-skilled and elderly workers has been extended.

<sup>3</sup> <http://www.bmwi.de/BMWi/Navigation/Wirtschaft/konjunktur.html>

<sup>4</sup> Despite of the great success of the benefit in terms of demand, its effect on the German automobile industries is debated. On the one hand many of the new cars sold were not of German origin, and on the other hand used car sellers and mechanics have suffered sharp declines in turnover.

<sup>5</sup> <http://www.bmwi.de/BMWi/Navigation/Wirtschaft/Konjunktur/historischer-vergleich,did=298740.html>

<sup>6</sup> [http://www.ifw-kiel.de/wirtschaftspolitik/konjunkturprognosen/konjunkt/2009/gd\\_2009-1.pdf](http://www.ifw-kiel.de/wirtschaftspolitik/konjunkturprognosen/konjunkt/2009/gd_2009-1.pdf)

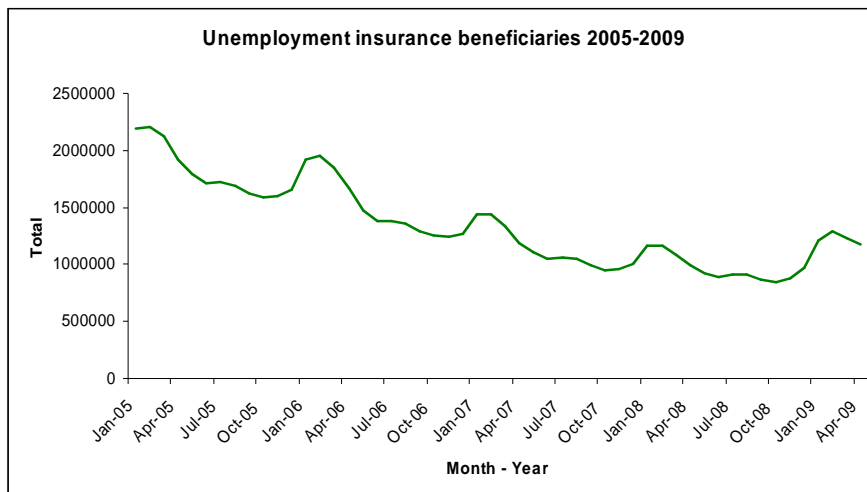
## ***Social security responses***

As outlined above, the German social security system is fairly comprehensive. As a reaction to the crisis no new instruments have been developed. All measures concern either the increase of benefits (e.g. child benefits for social assistance beneficiaries), the prolongation of the maximum duration (e.g. shortened working hours compensation), and the extension of benefits to groups that have hitherto been excluded (also compensation for shortened working hours). Moreover, as means to stimulate domestic aggregate demand and trigger competitiveness, the contributions to the public health insurance and the unemployment insurance have been decreased.

### **Unemployment and partial unemployment benefits**

Different from unemployment insurance schemes in other countries, the German scheme did not yet suffer a decrease in the number of contributors. Before the crisis started to have an impact on the labour market, in September 2008 the highest number of socially insured employees, and thus contributors to the social security schemes, since 2001 was registered. The stable growth of contributors of the past years has slowed down, but it did not yet come to halt.

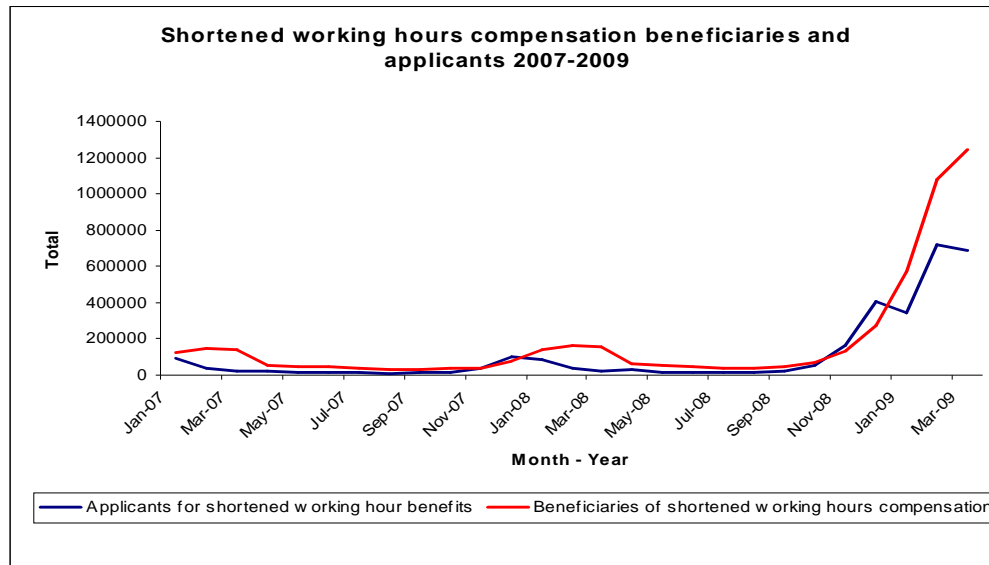
At the same time, the number of recipients of (full) unemployment benefits rose only moderately.



Source: Bundesagentur für Arbeit. Data for March and April 2009 are estimates

As one can see in the graph above, the rise of the number of unemployment insurance beneficiaries is not as steep as in other European countries such as Spain. Nevertheless, the number of beneficiaries climbed more steeply during the winter months of 2008/2009 than in the previous years.

This relatively moderate rise may at least partly be attributed to the much higher number of employees receiving compensation for shortened working hours/partial unemployment benefits. This labour market policy tool allows employers to shorten the working hours of their employees in times of economic difficulties, and the loss of net income will partly be reimbursed to the employee by the state employment agency (BA). As reaction to the crisis the maximum duration of benefits was successively prolonged from 6 months to 24 months. The number of beneficiaries of this major tool to counter the crisis in Germany has skyrocketed since November 2008.



Source: Bundesagentur für Arbeit

At the same time funds have been made available for training for workers that are receiving the compensation. Training is furthermore encouraged by an exemption from social insurance contributions for employers who send their employees on training.

### Financial implications

As mentioned earlier, the biggest bulk of the social security measures will have to be borne by the schemes themselves. The measures listed above will be financed by the the public employment agency, BA.

On February 2<sup>nd</sup> 2009, the BA agreed on a revised budget for 2009. The revision became necessary to adapt to the changed forecasts and the additional measures in 2009. Following the adjustment in the forecasts on the number of contributors in 2009 (now -0.8 per cent, earlier -0.1 per cent) the public employment scheme (BA) expects revenues to fall by €186mn and amount to €22.45bn in total. The expenditure on unemployment benefits on the other hand is said to rise by €1.8bn to €17.18b, because the average number of unemployed over the year will mount by 253.000 to 3.518.000. Training measures have been extended and will receive additional €810mn in 2009. For the shortened working hours compensation additional €1.8bn have been made available, to adapt to the expected growth in beneficiaries. Furthermore, 2500 additional employees will be hired by the public employment scheme to weather the economic crisis. The total revenues for 2009 are thus expected to fall to €34.7bn while the expenditure is expected to raise to €45,6bn. The deficit will be covered by the reserves of the public employment scheme, which will be down to €5.8bn at the end of 2009.<sup>7</sup>

### Pensions

<sup>7</sup> [http://www.arbeitsagentur.de/nn\\_27008/zentraler-Content/Pressemeldungen/2009/Presse-09-014.html](http://www.arbeitsagentur.de/nn_27008/zentraler-Content/Pressemeldungen/2009/Presse-09-014.html)

The German state pension scheme is a pay-as-you-go (PAYG) system that covers around 80% of all employees. Pensioners have profited from a steeper rise of their pensions in 2008 and 2009 than originally foreseen, and this was to be compensated by lower increases in pensions in 2011 and 2012.

The formula for pension adjustments was changed again in summer 2009, when the government followed an initiative of the Minister of Labour and Social Affairs and enacted a “pension guarantee”. In Germany pensions are indexed to real wage developments. As there are fears that due to the crisis real wages might decline, also pensions would need to decline. In order to avoid this hardship for pensioners, the pension guarantee was enacted, which foresees stable or growing pension benefits even in times of falling wage income. This is to be compensated by lower pension rises in the years with growing wage incomes, when pensions would rise more moderately than wages.

#### Other social security measures

Other measures in the field of social security include increased benefits for children of recipients of social assistance benefits, and increased housing benefits for low-income earners and social assistance recipients.

### ***Conclusions***

The clear focus of the German stimulus package in the field of social security is to maintain jobs, invest into training and increase the services of the employment exchange. Thereby, the strategy aims at the avoidance of full-unemployment and the related loss of skills and motivation, which is usually associated with (especially longer term) unemployment. So far the strategy seems successful and is also lauded for its fairer distribution of the social costs of the crisis. The major question remaining is whether all employees who are currently on partial unemployment will be able to return to full employment within the 24 months maximum duration of the benefit. Whether the strategy has been really successful thus remains to be seen in late 2010 and 2011 when the last crisis related partial unemployment benefits are paid.

Additionally, the evaporated reserves of the public employment agency might become a problem in the years to come. In order to make up for its losses the contribution rate might have to be increased again in the medium term, otherwise the scheme might not be able to fulfil its legal obligations.

With a view to pensions, the OECD study mentioned earlier highlights the fact that public PAYG schemes are by far not as bad as their reputation. The crisis might thus also serve as an incentive to rethink the privatization tendencies of the past decade and invest in a supporting public pension system for the future.

Generally, attention should be paid to the sustainability of social security financing in the aftermath of the crisis. This crisis proved the advantage of comprehensive social security, which can be flexibly extended according to the needs. Therefore, the cuts in the contribution rates should not be used as a pretext for cuts in benefits. Instead, this experience may also inform future debates on the German welfare state and the social market economy with a view to desirable structures and benefits rather than the mere expenses.

