

# free enterprise group

*making the case for free enterprise*



## **A decade of gains - Learning lessons from Germany**

by Elizabeth Truss, Member of Parliament for South West Norfolk

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# Executive summary

## Lessons from Germany

- Britain has much to learn from Germany, especially on jobs and skills. Germany now has the lowest rate of unemployment in Europe with youth unemployment at 8 per cent, down from 16 per cent in 2005.

## Labour market regulation

- In 1997, Britain's labour market was considerably less regulated than Germany's and unemployment was lower. Now Germany is catching up and in some cases (exemptions for small businesses) has overtaken Britain.

## Flexible workforce

- Germany's flexible workforce has increased with the advent of "mini" and "midi" jobs for low-waged work, with tax paid at a fixed rate outside of the normally onerous social security system. Workers on any income can take on one of these jobs paying a low flat rate of tax. Temporary work now accounts for two thirds of new hires.

## Small business exemptions

- German small businesses are exempt from various regulations including unfair dismissal. The UK Government should implement similar proposals.

## Parental leave and childcare

- Parental leave in Germany has been made more flexible and is paid to the employee directly by the Government. Childcare is more affordable costing parents 11 per cent of their income compared to 27 per cent in the UK. Female participation rose by 10 per cent in the last decade.

## Education

- German education reforms are now delivering real skills improvements. In 2000 the UK was ranked 12 places ahead of Germany in mathematics. By 2009 the UK was 12 places behind. Germany's reforms have focused on strong accountability, core academic subjects and a longer school day.

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# Workplace reforms

Germany's recent economic performance has been impressive. Everyone from Brendan Barber, leader of the TUC, who said that "the UK has much to learn from Germany - it is the powerhouse of the European economy", to Sir John Rose believes Britain should learn the lessons. Of course there have been many factors in Germany's relative success, including strong exports, which now amount to nearly half of GDP and the effective devaluation of the German currency through the eurozone (although this policy has other negative consequences).

A critical factor in Germany's performance has been the approach to jobs and skills. Germany's labour market outperformed the rest of Europe after the crisis and the country now has the lowest rate of unemployment in Europe. Germany's youth unemployment is 8 per cent, down from 16 per cent in 2005. Germany's improved employment, which has risen from 66 per cent in 2001 to 71 per cent in 2010, has been achieved through increasing the supply of informal and flexible work, reducing the regulatory burden on small business and transforming educational performance.

During the same period from 1997, the Labour Government in Britain increased regulation and decreased flexibility. The signing of the Social Chapter in 1997 ushered in EU Directives on equal opportunities, employment protection, working conditions, health and safety and data protection which, coupled with domestic measures like the Employment Relations Act 1999 and the Employment Act 2002, have cost businesses an estimated £90 billion. Over this period the UK's total employment rate has fallen behind Germany's.

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# Flexible jobs

New and more flexible contracts called “minijobs” and “midijobs” were introduced in Germany in 2003. Minijob-holders are paid a maximum of €400 a month. Instead of cumbersome tax and social security contributions, employers pay a flat rate of 30 per cent tax to a single body. For private households this is 12 per cent. Meanwhile midijobs give a flexible salary of between €400 and €800 with varying levels of contribution. Because there is no limit on the number of hours a minijobber can work, a single point of contact and a single flat-rate payment, employers find it easy to administer.

Combined with tighter rules on unemployment benefit, the fact that workers’ wages are “gross for net” attracts workers who might otherwise have no financial or time incentive to work: the long-term unemployed, women, young and older workers. 30 per cent of all minijobs have gone to those aged either under-20 or over-60. The proportion of inactive women, young and older workers has fallen in Germany. The proportion of employees doing shift work, working on Sundays and working at night has risen in Germany over the last decade but has flat-lined or fallen slightly in the UK.

There is no legal limit as to how many hours a month people may be employed, though most jobs tend to be part-time, widespread in private households and in service industries such as hotels and catering. A minijob may be a person’s sole employment or a side job alongside something else. The waiving of social security contributions on minijobs caused huge expansion in employment in this income range: up by 1.8 million, around 850,000 of whom held minijobs in addition to regular employment. Midijobs witnessed an extra 125,000 employees in this income range. The introduction of minijobs led to a decrease in undeclared work worth about €9 billion.

The results have been lower youth unemployment and high turnover in the jobs market. Two-thirds of new jobs are now on a temporary basis. By 2010 temporary workers made up 15 per cent of the German workforce (up from 13 per cent in 2000), compared to 6 per cent in the UK (down from 7 per cent over the same period). Between 2003 and 2007, overall employment levels rose from 39 million to 40 million, largely through the expansion of part-time work.

Other innovations have helped older workers. Partial early retirement schemes, widely used across the manufacturing and engineering sectors, give workers over 55 pensions and salary incentives to choose to go part-time or reduce their hours up to retirement age. The company is then able to take on an apprentice or unemployed young person

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to work the extra hours. Since 2000, employment amongst the over 55s has gone from being massively below Britain's to level pegging.

The UK's employment taxes are lower than Germany's and under the Coalition's policy, low earning workers are being taken out of tax altogether. The German reforms suggest that this will have a very positive economic effect. Britain should consider the creation of a new category of capped rate "flexi-jobs" to get young people and those returning to work a foothold in the jobs market, with much easier administration for the employer and reduced dismissal terms.

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# Micro business exemptions

Businesses with fewer than 10 employees in Germany were made exempt in 2004 from the need to provide cause when dismissing an employee – previously the limit had been five. This makes it more attractive for small businesses and start-ups to take on new workers. In the UK there is no such exemption for small businesses. After one year's service (rising to two for those starting after April 2012), employees have a right not to be unfairly dismissed. If an employee chooses to bring a claim, the business must demonstrate that the dismissal was for a fair reason, and that statutory procedures were followed. The cost of defending a claim, regardless of whether it is won or lost, is an average of £8,500 per case, at a cost of £1.6 billion to all UK businesses in 2010. The fear factor is probably even greater. The Government should follow Germany's example by exempting small businesses from dismissal regulation, which would encourage them to take on more staff.

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# Flexible parental arrangements

Germany has also improved the flexibility of parental leave arrangements for business and parents which has driven up female participation. Since 2000, female participation has risen by nearly 10 per cent in Germany; in the UK it has stayed the same. Parents can work whilst they are on parental leave for up to 30 hours a week for either their own or another employer. There is also greater flexibility between parents. Instead of being claimed back from the Government parental pay is funded directly by the federal government for up to 12 months and capped at a maximum of €1,800 a month, compared to unlimited reimbursement and employer administration in the UK system. Exemptions exist for small businesses (fewer than 15 employees), with consent required from the employer for employees to work part-time.

Parental costs are also eased by more affordable childcare. German parents pay 11 per cent of their income on childcare compared to 27 per cent in the UK. Small-scale childminders caring for children for fewer than 15 hours a week are unregulated. In the UK, this limit is two hours per day. Germany has a decentralised system of funding and regulation through municipalities, which set fees, ratios and opening hours according to local demand. Although individual States have learning plans, there is no federal curriculum for all providers as in the UK.

The Coalition's policy for shared parental leave could be implemented in a way that is flexible for parents and businesses, by direct payment of a flat rate to working couples. If this was paid decoupled from leave there would be more room for parents to work part-time or occasionally during this period.

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# Education reform

In 2000, Germany performed poorly in the international OECD PISA tests in mathematics reading and science. These results were bad news for the economy as cognitive skills and economic growth are intrinsically linked. With a quarter of German 15-year-olds unable to read fluently, the “PISA shock” prompted a radical shake-up of the German education system, bringing in tougher standards for both teachers and students.

The result of these reforms was a radical improvement in the performance of German schools. In 2000 the UK was ranked 12 places ahead of Germany in mathematics; by 2009 the UK was 12 places behind. In 2000 the UK was 16 places above Germany in science, now it is three below; in reading it was 14 places above Germany, now it is five below.

National standards were introduced for the first time at high school in all core subjects – German, foreign languages, mathematics and science – prescribing more rigorous content, reinforced by international benchmarking. German students are expected to study mathematics, German, science, the social sciences, a foreign language, music, art and sport until the age of 16. In 2000, German students spent less time in the classroom than students in many other countries, below the OECD average. Following the PISA shock, the German school day was significantly increased, with many students starting at 7.20am and working until 4pm. School heads were given greater autonomy and accountability for their students’ results and there was an influx of highly qualified teachers. Germany’s apprenticeship approach also allows the development of academic subjects with practical skills, an approach which is also being developed in England.

Britain is now engaged in an education reform programme through measures including the English Baccalaureate, Curriculum Reform and Free Schools and Academies. The German experience bears out Michael Gove’s claim that “it will take about 10 years before we can begin to see the fruits of all the reforms”.

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# Conclusion

There has been a general assumption that Britain has the most flexible major economy in Europe. Yet looking at some of our neighbours it is clear that this is changing. Germany has shown the strides that can be made in the area. Britain must learn from their experience if we are to compete. It is only through increasing labour market flexibility and boosting skills that we will be able to make our way in the modern world.

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# About the Free Enterprise Group

## Objectives

- Encourage a competitive and free economic environment
- Raise the global economic standing of the United Kingdom
- Challenge monopolies and oligopolies
- Free individuals to create, innovate and take risks

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Contact:

Elizabeth Truss MP on 020 7219 7151 or [elizabeth.truss.mp@parliament.uk](mailto:elizabeth.truss.mp@parliament.uk)

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