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The Hartz reforms, the German Miracle, and labor reallocation

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ABSTRACT

We analyse the recent history of unemployment and labor reallocation in the German economy using a variant of Lucas and Prescott's (1974) reallocation model, modified to include unemployment benefits, rest unemployment, and aggregate shocks. We focus on the implied effects of the Hartz reforms and the Great Recession in the model, and compare them with the corresponding movements in German data. We find that the model's qualitative predictions for reallocation and unemployment correspond well with the observations. When we calibrate the model to assess its quantitative performance, however, we find that it significantly overestimates the changes of both reallocation and unemployment since the introduction of the Hartz reforms.

1. Introduction

Since the turn of the millennium, the German economy has experienced a remarkable sequence of events that have had a significant impact on the structure of its labor market, and which have led to some outcomes that have puzzled some observers. Facing a high and rising unemployment rate (persistently above 10%) the German government instituted a series of labor market reforms, known as the Hartz reforms, phased in over the period of 2003–2005. These reforms were aimed at improving the flexibility of the market, the mobility of workers, and incentivizing workers to seek work more actively (Jacobi and Kluve, 2007).[1] As shown in Fig. 1, starting in 2005, the unemployment rate declined significantly, dipping below 10% for the first time in 2007.

In 2008, like most other economies in the world, Germany was hit hard by the Global Financial Crisis and the Great Recession (GFC, for short). German GDP fell by 6.6% (Q1/2008 to Q1/2009) – a drop even more significant than the one experienced by the US at the time (Burda and Hunt, 2011). Productivity fell by a similar percentage – 6.3%, as shown in Fig. 2.

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[1] In their classic study, Jacobi and Kluve (2007) identified three "cornerstones" of the Hartz reforms: "increasing effectiveness and efficiency of labor market services and policy measures", "activating the unemployed" and "fostering employment demand by labor market deregulation".

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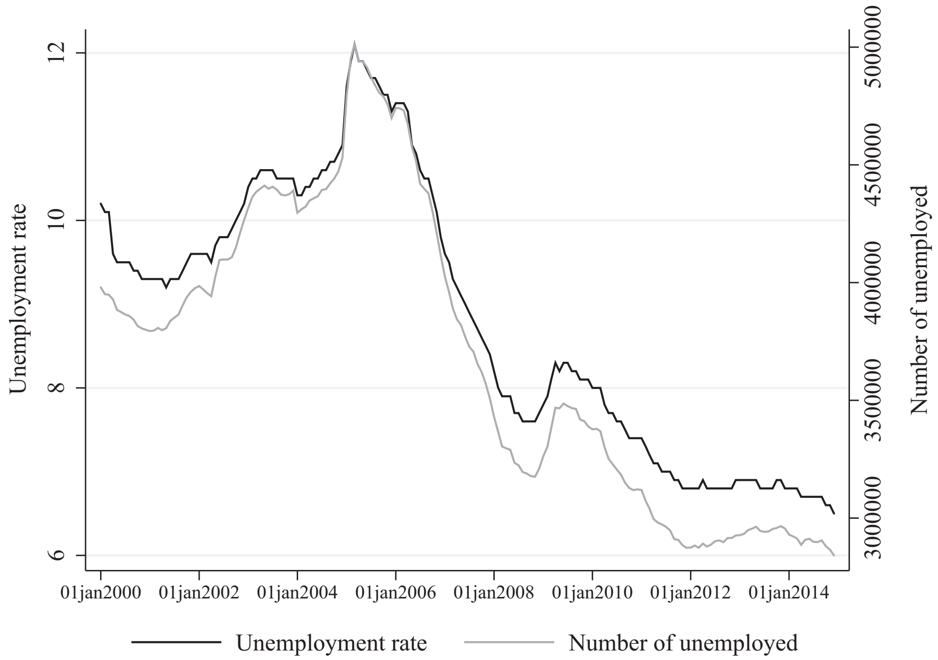

Fig. 1. German unemployment rate from 2000–2014, seasonally adjusted.
Source: Federal Employment Agency, Statistics Office, "Arbeitsmarkt in Zahlen".

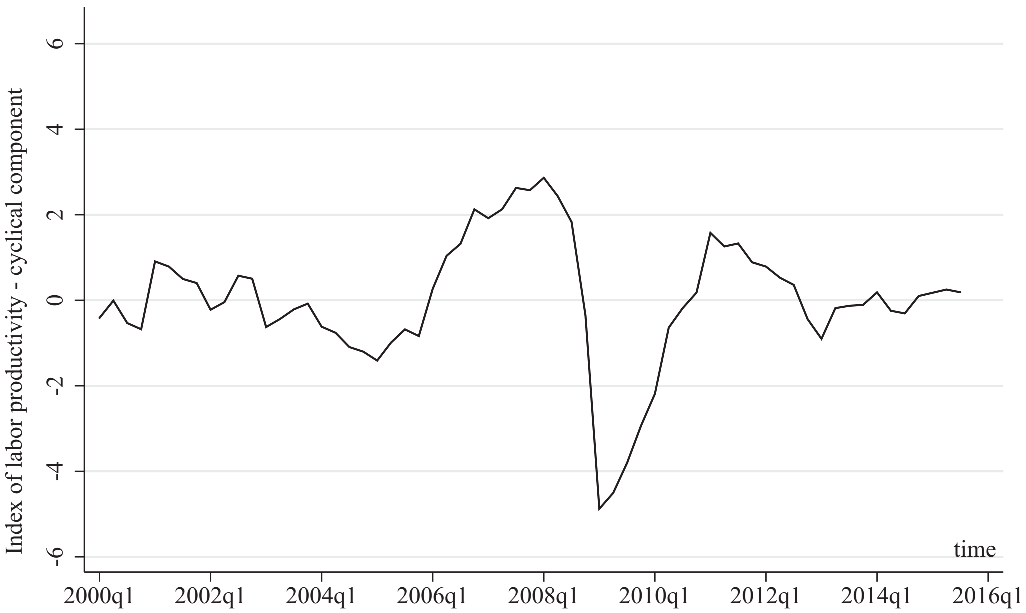

Fig. 2. Labor Productivity per employed, chain-index, base year 2010, seasonally adjusted, cyclical component of Hodrick-Prescott filter ($\lambda = 1600$).
Source: Destatis, Genesis Online Database, "VGR des Bundes".

However, unlike most countries (including the US) the German unemployment rate did not rise significantly at that time. As shown, once again, in Fig. 1 it remained remarkably stable – leading some to call this "Germany's jobs miracle" (see, for example, Krugman (2009)). Viewing Fig. 1, and considering the fall in unemployment since that time, it appears that the German unemployment rate was in a dramatic secular decline when the GFC hit, and this decline was temporarily suspended – leading to a relatively stable unemployment over the 2008–2010 period.

Interestingly, also, although the Hartz reforms were implemented to improve labor market outcomes through more flexibility and mobility, reallocation rates across occupations in Germany have been rather stable over the period (Bauer, 2013; Jung and Kuhn, 2014). Fig. 3 presents data on the proportion of job findings that involved an occupational switch, from