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Employment policies in Germany and the UK: The impact of Europeanisation

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**Anglo-German Foundation
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EMPLOYMENT POLICIES IN GERMANY AND THE UNITED KINGDOM

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Executive summary

Introduction

The need to respond to a persistently high level of unemployment in an increasingly integrated Internal Market led the EU to develop the European Employment Strategy (EES). Given the wide variation in employment performance, and in labour market policies, of the EU member states, the traditional Community method of harmonised policy did not seem feasible in the employment field. So a new mode of EU governance, the Open Method of Co-ordination (OMC), was pioneered by the EES in 1997. This involved a system of guidelines, annual reports, assessment and recommendations. Co-ordination was to be achieved by benchmarking, policy learning and peer review as well as peer and public pressure, which would lead to a movement of policies towards best practice. The OMC is hence seen as one answer to policy development as the EU enlarges and as policy extends into ever more sensitive areas. This makes it particularly important to understand the way in which the OMC operates.

This study considers the operation of the EES in Germany and the UK, which are particularly good exemplars for analysing the impact of the EES because of the large differences in their political and economic systems. The analysis sought to answer four broad research questions. First, would the EES have an impact on national institutions and the networks of actors involved in employment policy? Second, have media and public coverage of the EES led to a Europeanisation of public deliberation and opinion on employment issues? Third, has there been convergence of national employment policies due to the EES? Fourth, has the UK's employment performance been superior to Germany's as a result of its more flexible labour market? This would also provide support for the flexible labour market policies contained within the EES.

The EES and the policy-making process

- The EES did not lead to the establishment of entirely new institutions and policy-making systems; existing ones were utilised, although existing institutional and procedural aspects were further developed to meet the requirements of the EES.
- The national EES-related decision-making systems are characterised by complex interactions between the ministries and *Länder* and between them and the social partners in Germany. The UK by contrast has a centralised structure, with fewer actors involved and with the consultation of the social partners channelled via one ministry.
- Social partner consultation at an early stage of the policy process was new in both Germany and the UK. The extent of this involvement was limited by the demands of the annual cycle and the time pressures involved, together with the limited resources of the social partners.

- The policy networks are generally characterised by the complexity and large number of interactions, but overall the EES is a rather closed process, with relatively few experts involved. The 2003 reform of the EES could enable the social partners to become engaged in a more meaningful way in the multi-annual policy reviews.

The public and media debate on the EES

- There has been very little attention given to the EES in the media and, if anything, interest is diminishing over time.
- It is national problems and policy that predominate; between 1997 and 2002 only about 3% of the 206 employment-related articles in the 12 newspapers under scrutiny referred to the EES.
- National parliamentary debates on the EES were limited and were not discussed to any extent in the media.
- The lack of public attention given to the EES limits the effectiveness of recommendations in affecting national employment policy.
- It is notable that the EES was not used as a justification by Germany in support of its recent Agenda 2010 reforms.

The EES and national employment policies

- Even though German employment policy was largely in line with the Employment Guidelines (EGs), policy change was only marginal until 2003. Fundamental reform then came with Agenda 2010, but this was motivated primarily by budgetary problems and rising unemployment.
- UK employment has generally been more congruent with the EES, but it was already aligned with the Strategy at its commencement. New measures which the UK has introduced have been the result of domestic pressures and preferences.
- The EES may affect policy more subtly by influencing the views of the circle of policy experts involved. Such an effect would only have a gradual impact on policy, and would be difficult to separate from more general processes affecting expert opinion.

The EES and national employment performance

- The EES has operated for only just over six years and its effects on employment policies are even more recent. Given the lag in the effect of policies and the influence of more general macroeconomic factors, it is difficult to isolate the independent effect of the EES.

- Generally the EES supports more flexible labour market policies. The UK has the most flexible labour market in the EU, and Germany one of the more inflexible ones. So a comparison of labour market performance between these two countries provides an assessment of the potential benefits of pursuing EES policies.
- On most criteria the UK is performing better than Germany:
 - The UK's overall employment, female and older workers' employment rates are higher than Germany's.
 - Unemployment and long-term unemployment are lower in the UK.
 - Structural unemployment has fallen more in the UK than in Germany.
- Deeper analysis suggests the UK's relative performance is less satisfactory:
 - Unification has undermined overall German performance: directly as a result of the inclusion of East Germany (but the effect is small), and by depressing the overall growth of the economy.
 - Some differences such as those relating to female employment are long-standing and will only change slowly.
 - UK unemployment has been underestimated because of the existence of a significant amount of hidden unemployment – people of working age who are no longer part of the measured labour force.
 - Some aspects of German employment performance are good, e.g. the low unemployment ratio of young people, and a smaller variation in regional employment rates.

Conclusions

- The impact of the EES on national decision-making processes has been rather low.
- The EES has had no real impact on the media debate or national political deliberation.
- The EES has not led to a sea-change in national employment policies, even though agenda-setting in this area has been in line with the overall targets of the EES.
- The UK with its greater conformity to the EES has enjoyed better employment performance than Germany, but the outcomes are not as good as headline figures suggest, and the problems of unification are still having an impact.
- The EES is relatively new and its impact could grow with time, but so far it has had a regrettably small visible impact on employment policy making, policy and performance.

1 Why co-operate on employment policy?

The overall situation of low employment and high unemployment masks an enormous variation in national performance within the EU, both in terms of the levels and the changes in employment. There is also a very wide range of employment policies and industrial relations systems, which have their origins in national histories and ideologies and are therefore rooted to the societies in which they exist. Moreover, evident national sensitivities over employment policies effectively rule out harmonised Community policy in this area. The heterogeneity of policy and outcomes does, however, suggest that co-operation in the employment field could be productive. The experience of other member states is a potential source of new policy initiatives, provides evidence of their effects and offers benchmarks by which to compare performance. The immersion of national officials and politicians in this experience could be a powerful mechanism for moulding a consensus on appropriate policies and encouraging their implementation. The successes in other countries and the advocacy of the European institutions could also be useful in encouraging the acceptance of difficult changes in employment policy.

In this context the European Employment Strategy (EES), a new EU framework for promoting employment, was created and has developed since the signing of the Amsterdam Treaty. The EES is implemented through what is known as the 'Luxembourg process'; using the so-called 'Open Method of Co-ordination' (OMC), it pioneered 'soft' policy co-ordination. This enabled the Luxembourg process to provide an opportunity structure for reconciling national 'ownership' of the policy area with supranational co-ordination.

A comparison of the UK and Germany is of particular interest with regard to the EES, because it sheds light on how two countries with very different institutional settings are adapting to common European guidelines. Would convergence occur or would national traditions and solutions prevail in policy making and implementation? To investigate these issues, the development of the UK and German employment policies from 1998 until 2002 was scrutinised to identify the impact of the EES on national policies and on the structure of the networks involved in drawing up the National Action Plans (NAPs). The wider impact of the EES was examined by analysing the public debate on the EES. Finally, the impact of EES policies on employment was assessed by examining the differences between German and UK performance and their causes.

The analysis sought to answer four broad research questions. The first concerned the impact of European institutional and procedural provisions on national institutions and their procedural interaction in the EU's 'living constitution' (Olson, 2000: 6). The hypothesis was that the EES would have an impact on national institutions and the networks of actors involved. The second question focused on the media and public discourse in the two member states, and explored whether the EES would lead to a Europeanisation of public opinion by drawing attention to European-level activities creating a common perception of joint European labour market problems and employment policy solutions. The third touched upon the two domestic levels, and

started from the proposition that the Luxembourg process has had an impact on the instruments applied by the two countries. The contention was that the employment policies of both countries would show signs of convergence. A significant impact of the EES would be indicated by the full implementation of the NAPs, and a convergence of instruments triggered by European co-ordination. Finally, the fourth question related to the fact that the UK's labour market is more flexible than Germany's, in line with the general thrust of the EES. The UK should, therefore, have much better employment performance, and this would provide support for the flexible labour market policies contained within the EES.

2 Europeanisation of policy making and policy co-ordination

The political system of the EU is multilevel, with political actors at the European, national and sub-national levels involved in policy making and implementation. Within this European multilevel system, a transfer of problem-solving and policy-making competencies and resources has occurred, from the national and sub-national levels to the European level, constantly strengthening the decision-making powers of the EU (Wessels and Rometsch, 1996). These processes have led to an increasing Europeanisation of political processes as well as of policies and actors' relations, with the European level increasing in importance relative to the domestic levels (Börzel, 2001; Börzel and Risse, 2000; Héritier, 2001; Knodt 1998; Risse et al, 2001). With this growing Europeanisation of interactions (Kohler-Koch, 2002; Olsen, 2002) and the expansion of functional political relations across national borders (Jachtenfuchs and Kohler-Koch, 1996: 16), the co-operation between member states within the EU has become one of the central aspects of the European problem-solving process (Mayntz, 1995). This trend towards the integration of EU member states with a clear tendency in the direction of the fusion of national instruments (Wessels, 1992, 2000) is, therefore, becoming increasingly important when it comes to the analysis of the EU.

In this context the OMC provides for a flexible, de-centralised instrument of policy co-ordination leaving the implementation of measures defined by the EU to the member states (European Commission, 2002a). Steering by the OMC is characterised by the abstraction of concrete programmatic requirements, which are transformed into and regularly presented as European guidelines for the development of national policies, without preconditioning the means or the instruments. It is accompanied by the merger of the policy-making and implementation processes because of the decentralisation of decision making to the level of policy implementation. The main aspects of the OMC are the setting of EU-wide objectives, regular policy cycles, national action plans and the obligatory consultation of social partners. The concrete decision on measures and means is delegated to the lower levels and actors of the political system of the EU, including non-state actors in the political process (Huget, 2002:12ff.). Thus, hierarchical steering is replaced by delegated policy decisions and actions in the soft co-ordination process.

Consequently, the OMC is a new form of soft co-ordination within the framework of EU decision making, an intergovernmental co-operation procedure incorporating supranational elements (European Council 1998; Hodson and Maher, 2001; Wallace, 2000; Wessels and Linsenmann, 2002). 'By issuing guidelines, it de facto develops relatively clearly defined EU policy in areas which have traditionally been out of the EU remit' (Bertozzi and Bonoli, 2002: 5). Thus, despite the lack of legally binding instruments, the OMC contributes to the development of common views and ideas in the EU. Peer review and pressure, as well as best practice, are important means to support the evolution of these common approaches.

As national employment policies are one of the policy areas directly impacting on the competitiveness of the EU member states, it is one of the areas in which member states

are strongly reluctant to cede national sovereignty to the European level (Bertozzi and Bonoli 2002: 2). The OMC was integrated into the European armoury of Community-level employment policy as part of the 'transnational public policy processes embedded in political institutions that are less clearly defined, and much less authoritative, than those of a traditional state' (Wallace 2000). This provided European institutions with the means to foster the development and convergence of national employment policies, as well as to support the enhancement of national policy approaches, without directly harmonising policy at the EU level.

3 The European Employment Strategy (EES)

3.1 The EES process 1997–2002

Under the Luxembourg process the EES fixes guidelines for the EU member states, specifies timetables for the achievement of the set goals and provides general and specific quantitative and qualitative indicators, as well as benchmarks. Additionally, it requires the translation of the European Employment Guidelines (EGs) (established under the co-decision procedure) into national and regional policies, as well as periodically monitoring, evaluating and peer reviewing the success of the implementation.

At the centre of the Luxembourg process stands the establishment of EGs at the European level. The EGs are the 'central EU policy document that deals on a regular basis specifically with labour market issues' (European Commission, 2002b), which shall be consistent with the Broad Economic Policy Guidelines (BEPGs) adopted according to Article 99(2) Treaty Establishing the European Community (TEC). The main function of the EGs is to set out orientations for policy actors in EU member states by providing measures for the assessment of policies in the context of continuous monitoring by the Commission and the Council and incentives for compliance. Since 1999 there has been provision for addressing recommendations to the EU member states (Council of the EU, 1999a) and with this mechanism peer pressure and multilateral surveillance have been strengthened, even if non-compliance involves no (pecuniary) sanctions. Nevertheless, multilateral surveillance, calibration and the setting of common comparable targets put potentially strong political pressure on the member states.

From 1997 until 2002 the European Council annually considered the employment situation in the EU and adopted conclusions on the EGs on the basis of the joint annual employment report of the European Commission and the Council. Based on this European Council conclusion, the Council, acting by a qualified majority, took into account the EU member states' employment policies and, based on a Commission proposal, drew up EGs and non-binding recommendations for the member states, after consultations with the European Parliament, the Economic and Social Committee, the Committee of the Regions and the Employment Committee. The member states mapped out how they would attempt to fulfil the guidelines in National Action Plans (NAPs) on employment policy. The Council, based on these reports and after receiving the opinion of the Employment Committee, carried out an annual examination of the implementation of the employment policies of the member states. There followed an appraisal by the Commission, both of the plans and their outcomes, as well as the amendment of the guidelines followed (Maurer, 2000; Mosley and Mayer, 1999; Sciarra, 1999; Tidow, 1999). Based on the outcome of the assessment, the Council of Ministers and the European Commission established a Joint Employment Report (JER), commenting on the situation in the EU and on the implementation of the EGs by the member states. The annual cycle could be characterised as a permanent monitoring and review process through the JER, recommendations to the member states and peer review of policies. This cycle was

accompanied by a multi-annual (medium-term/5-year) evaluation of the defined common objectives.

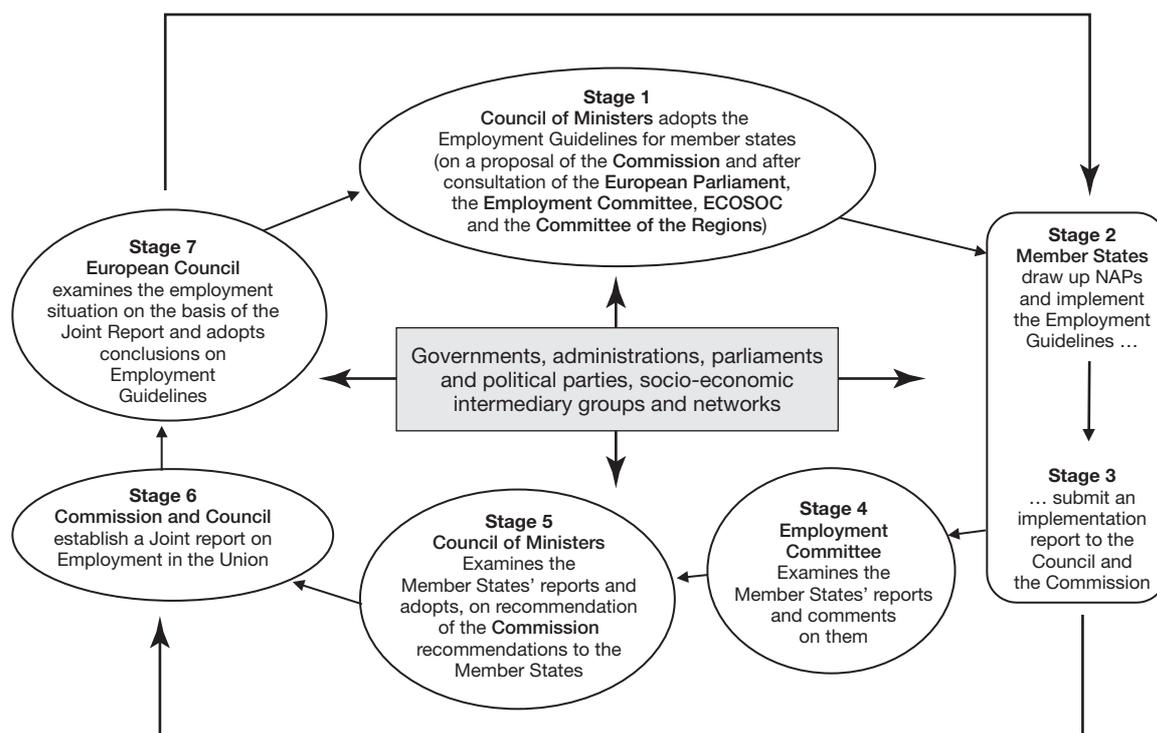


Figure 1
The European Union's co-ordination and monitoring cycle in employment policy (Article 128 TEC)

Source: Wessels and Linsenmann, 2002: 8

3.2 The EES process from 2003 onwards

After the interim evaluation the EES and the EGs were revised for a new term from 2003 to 2010. To structure the revision, the Commission in 2002 identified:

'...four major issues for the EES reform: (a) the need to set clear objectives in response to the policy challenges, (b) the need to simplify the policy guidelines without undermining their effectiveness, (c) the need to improve governance and partnership in the execution of the strategy and (d) the need to ensure greater consistency and complementarity with respect to other relevant EU processes, notably the Broad Economic Policy Guidelines.' (European Commission 2002d:3)

According to the Commission, the EES and the Ministers employment package was expected to:

'... benefit from being more directly related to the overall policy approach ... [and from improving] the complementarity and mutually supportive character of the two sets of instruments.' (European Commission 2002j: 3)

Based on these priorities and the decision of the 2002 Barcelona European Council, the synchronisation of the Luxembourg process with the BEPGs and the Internal Market Strategy (IMS) was proposed by the Commission in September 2002 in order to reinforce the implementation of the Lisbon targets and to put more emphasis on the medium-term aspect of the EES (European Commission, 2002j, 2002e, 2003b). According to the Commission:

'the Employment package will thus benefit from being more directly related to the overall policy approach ... [and from improving] the complementarity and mutually supportive character of the two sets of instruments.' (European Commission, 2002j: 21)

Under the new arrangements that apply from 2003 onwards, the Commission presents the implementation evaluation of the BEPGs, the EES and the IMS at the same time each year in January. In April, after the Spring European Council, the Commission then presents the guidelines on economic and employment policy. This synchronisation should strengthen policy co-ordination in the socio-economic area. Within the Council, the delegations '...emphasised the importance of maintaining the autonomy of both processes, in particular the leading role of the Employment, Social Policy, Health and Consumer Affairs Council in deciding on the employment guidelines' (Council of the EU, 2002c: 49).

The new EES splits the Employment Package. The first part (the JER), is presented by the Commission together with the implementation reports on the BEPG, the EES and the IMS as part of the *implementation package* in January each year before the Spring European Summit. The second part (the Commission proposals for EGs and the recommendations) is then submitted after the Spring Council as part of the *guidelines package* together with the BEPGs in April. The Council adopts the guidelines in June after the European Council meeting and the NAPs are then submitted in October, followed by the Commission's JER in mid-January (European Commission, 2002e: 10; 2002e).

The increased complexity of the EGs over the years has led to a situation where '...the hierarchy of priorities in the Employment Guidelines has become blurred, and the pillars have lost part of their intrinsic coherence' (European Commission, 2002j: 19). Thus the new guidelines are to be simplified, and in principle are to remain in place until the next mid-term review in 2006. This is to shift attention from the annual preparation of guidelines to the monitoring of implementation to enhance the application of the EES.

The objectives of the new guidelines are to be consistent with and complementary to the BEPGs, in order to respond better to the demands of an enlarged EU. Instead of the rather vague pillars of the old policy, there are now three clearer overarching objectives and 10 policy areas (see Section 3.4). This greater clarity within the new EES was welcomed by all the actors involved, like the European Parliament (2002). The EGs and the BEPGs will only be fully reviewed and amended every three years and, therefore, the 2003 guidelines cover the period until 2006 (European Commission, 2002k: 2). In the intervening years they will only be changed if necessary (European Commission, 2002e: 4). Nevertheless, annual proposals for guidelines will be kept as required by the Amsterdam Treaty (*ibid.*: 6). The 2003 EGs concentrated on anchoring the key aspects of the Lisbon strategy (full employment, quality and productivity of work; cohesion and an inclusive labour market) into the EES, on the adoption of the medium-term targets for 2010 and a new mid-term review in 2006, as well as on the clarification and simplification of the policy objectives and priorities and a stronger result orientation.

The annual reports of the member states on employment policy (NAPs) will be submitted jointly with the national reports concerning the BEPGs and the IMS in October each year. A full report is required only every three years. The intermediate reports will concentrate on new policy developments and focus on the implementation aspect. Thus, the next full NAPs are due in 2006 (European Commission, 2002e: 5ff.). It is arguable how much of a change this represents in practice, since the EGs have not changed very much from year to year (see Section 3.4). In addition, the NAPs already concentrate on new policy developments and implementation.

3.3 The structure of European employment policy making

The EES provides for a common procedure and institutional framework to put forward guidelines for member states to report and to evaluate employment policy. The commonality of the process and the policies might lead to the convergence of structures of policy making across the member states. There are two extreme trajectories which could emerge as a result:

1. The adaptation of employment policy networks with domestic actors involved in common participation and interaction patterns. The adaptation of the processes at the national level to the EES would thus lead to similarities and Europeanisation of national policy making and implementation.
2. No impact of the EES, with the new requirements met by the utilisation of existing networks and systems, with continuing differences in national policy making in this domain. Under this trajectory the main obstacles to Europeanisation, the diversity in the structures of representative groups and divergent positions on the relevance and the substance of common European guidelines, would predominate. This outcome is made likelier because of the absence of financial penalties/incentives for domestic actors, with the implication that adaptation pressures be too moderate to challenge the core of national traditions in policy making.

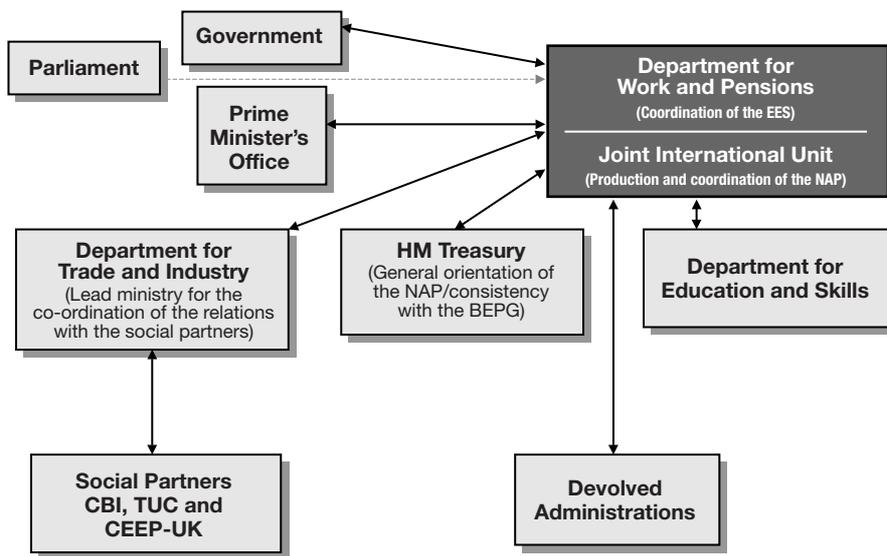
Our results suggest an outcome closer to the latter of these two trajectories:

- Existing lines of co-ordination, interactions, communication and contacts were used, intensified and became more institutionalised under the EES, as they proved to be efficient. No entirely new system was created and no new institutions and modes of procedures have been created at the national level to deal exclusively with the EES and the NAPs. Therefore, even though the EES was innovative as far as it offered new institutional opportunity structures to the national actors, it did not prove to be highly innovative as far as national co-ordination procedures were concerned. Moreover, no strong adaptation processes of national policy-making structures and procedures to the EES were observed, even though functional equivalence of the two institutional setups within the UK and Germany is apparent.
- Both in the UK and in Germany, national institutional logic and traditions dominate the structures developed to deal with the EES. National traditions such as the German corporatist and the UK centralist co-ordination of decision making prevail. Even though the form of social partner consultation under the EES, at a very early

stage of the political process, was new to Germany as well as to the UK, the institutionalisation of social partner contact witnessed under the EES has remained distinctly national in character. The EES did not lead to fundamental institutional or procedural change and did not have the power to ‘transplant’ a corporatist or continental model of social dialogue into the British policy-making process.

- The EES processes are in line with national policy-making systems. A rather complex set of consultations between the ministries and *Länder* and between them and the social partners has been established in Germany. The UK adopted a centralised structure, with fewer actors involved, and in which the consultation of the social partners is channelled via only one ministry.

(a) Structural aspects – UK policy network with a view to the EES



(b) Structural aspects – German policy network with a view to the EES (since 2002/3)

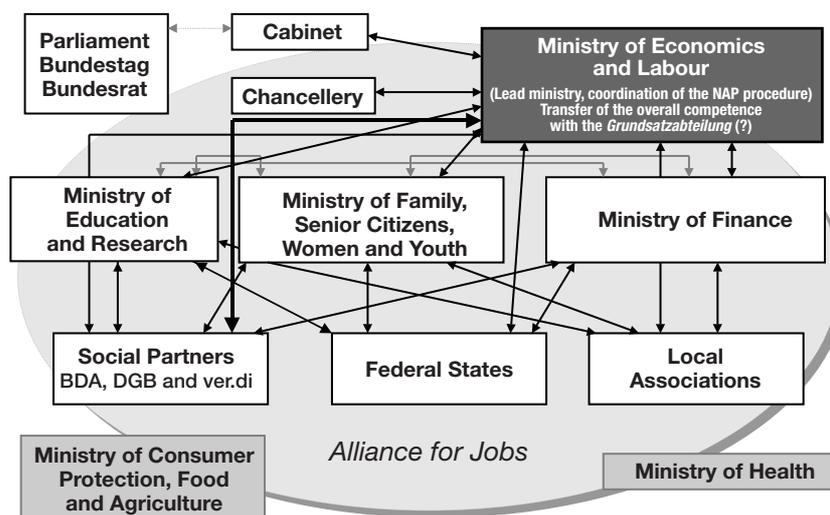


Figure 2
Structural aspects – UK and German policy networks

Source: own compilation

- Regarding the overall NAP process, a high level of co-ordination is necessary in both countries in order to guarantee the integration of the relevant actors. Both policy networks are characterised by the complexity and multitude of interactions, even if the overall circle of relevant actors remains quite limited. In practice, the EES is a rather closed process with only relatively few experts involved.

Thus the EES did not lead to substantial procedural or institutional changes in employment policy making at the national level – the network of actors involved and the procedures employed retained distinct national characteristics. Nevertheless, functional equivalence of the different national procedures is apparent.

3.4 The public and media debate on the EES

Public debate is increasingly perceived as a relevant variable to explain the adaptation of national policies, institutions and procedures to European integration (Meyer, 2002). Public debates, media as well as parliamentary, play an important role in national opinion formation, which could lead to a Europeanisation of national policies. Favourable perceptions of European policies could provide a suitable environment for Europeanisation in addition to encouraging political actors to change policy, because political change also depends on media support.

The assumption tested was that there would be an observable impact of the EES on the debate, public and media as well as parliamentary, in the two member states, leading to a Europeanisation of the public discourse and political deliberation. This national debate among political actors involved, and in the public and media discourse, would highlight the deficiencies of national policy in contrast to the success of EES policies, encouraging the Europeanisation of national policy.

Contrary to this initial assumption of an observable impact of the EES on the national public debate, there was little evidence of any effect. Quantitative newspaper content analysis and qualitative parliamentary debate analysis both demonstrated this to be the case. The earlier observation from the structural analysis, that the EES is rather an 'expert circle process', was confirmed.

Generally the following results should be highlighted:

- The EES has had a low profile in the public and media debate in both countries with very limited attention given to the EES and the NAPs. Five years of the EES do not seem to have created a wider public interested in or informed about activities at the European level and their impact on national policy.
- National problems and aspects of employment policy making and reforms prevail within the public debate. The Europeanisation of political deliberation and the involvement of national actors in the European process did not lead to a strong integration of the EES into the national public debate.
- Generally, the number of articles on the subject has declined over the years. The peak occurred in late 1997 and early 1998 when the EES was introduced. Reporting on the EES is mainly event-driven, such as when a European Council Summit draws attention to the subject.

Table 1
The number of articles on the EES appearing in selected German and UK papers and news journals 1997–2002

	1997		1998		1999		2000		2001		2002	
	D	UK										
January	0	0	1	0	1	0	3	1	0	0	3	0
February	1	2	2	0	2	1	1	2	0	1	1	3
March	0	0	4	2	3	0	2	4	3	0	2	0
April	0	0	10	2	3	2	0	0	2	0	1	0
May	1	0	3	5	4	1	0	0	2	0	0	0
June	4	1	1	3	4	3	1	0	1	0	0	0
July	0	0	1	0	1	1	0	0	0	0	1	0
August	0	0	1	0	0	0	0	0	0	0	1	0
September	2	0	0	0	5	1	3	2	2	1	1	0
October	5	1	7	2	2	0	1	0	2	0	0	0
November	25	7	5	2	3	5	2	0	0	0	0	1
December	1	0	12	1	0	0	0	0	0	0	0	0
	39	11	47	17	28	14	13	9	12	2	10	4

Source: own research

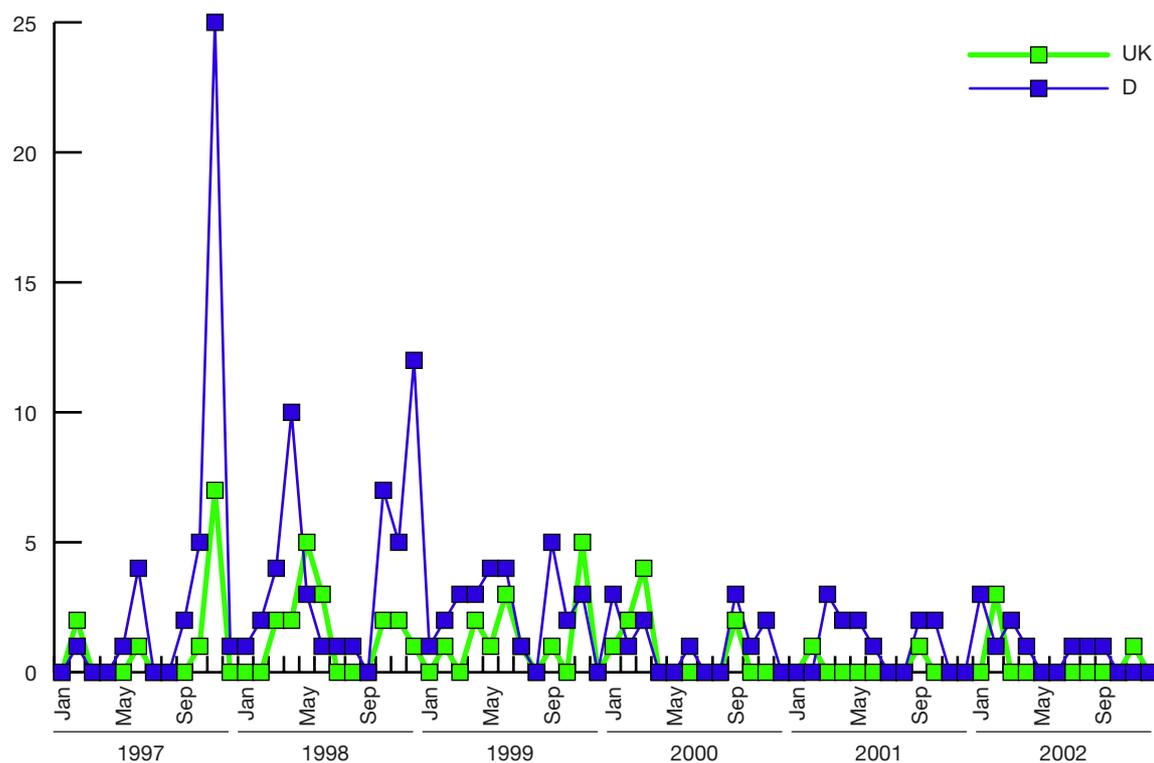


Figure 3
Total number of articles on the EES 1997–2002

Source: own compilation

- Altogether there were 206 articles in the 12 newspapers analysed that mentioned the European dimension of employment policy, an average of 34.3 articles per year (Table 1). This means there were about 2.9 articles per newspaper per year on the subject. This is only a small fraction of the number of articles on employment and labour market policy that appeared during this period: in German newspapers there were about 3,500 articles in total (an average of 700 per year) and in the UK about 1,500 (average of 300 per year).
- The overall thematic focus of media coverage did not differ significantly between the UK and Germany. In the beginning it concentrated on the EES and its possible influence on the national employment policies. Later on the NAPs, the guidelines and the recommendations came to the fore. Nevertheless, the attention of those articles was mainly focused on the reactions of the Commission and the Council to the NAPs, commenting on the European level evaluations, guidelines and recommendations, rather than on the impact of the EES on national policies or on the NAP procedure.
- Similarly, national parliamentary debates on the EES were limited and focused on the response of the parliaments to ongoing European events. Topics included the annual briefing on the NAP's, the employment packages and the JERs, the guidelines and recommendations, but also the local dimension of the EES such as the Territorial Employment Pacts. The German parliamentary debates in the *Bundesrat* were, however, slightly more controversial, because critical aspects of the NAP were tabled by opposition parties and discussed in this forum. Nevertheless, these parliamentary debates were not reflected or taken up in the public and media discourse.

3.5 EES policies

EES policies have shown considerable stability; until the 2003 reform they were grouped around four pillars: employability, entrepreneurship, adaptability and equal opportunities.¹ The employability and equal opportunities pillars contained specific employment objectives. The entrepreneurship and adaptability pillars were concerned with improving employment performance by enhancing the business environment and the operation of businesses.

Under the employability pillar five objectives have been promoted since 1998 (Council of the EU, 1998), the 1999 EGs (Council of the EU, 1999b) added one and the 2001 guidelines (Council of the EU, 2001) another two. This means that in 2002 (Council of the EU, 2002a) there were eight aims under the employability pillar:

1. Reducing youth unemployment.
2. Prevention of long-term unemployment.
3. More employment-friendly tax and benefit systems: to reduce poverty traps and provide incentives for the unemployed/inactive to seek employment.

¹ Agreed at Cardiff, 1998 (European Council, 1998) and mainly promoted by the Nordic countries (Steinle, 2001; p. 160).

4. Developing skills in the context of lifelong learning: the education and training system is to equip individuals to enter employment and to be adaptable to changes in the employment needs of the economy.
5. Combating discrimination and promoting social inclusion by access to employment: this reflects the growing interest in social inclusion and relates to disadvantaged groups generally, particularly disabled people and ethnic minorities.
6. Developing policies for active ageing: this relates both to the need to raise the employment rate of older workers, as well as the encouragement of more active retirement, with fewer demands on health and social welfare services among the elderly.
7. Active policies to develop job matching: some unemployment is the result not of a lack of jobs, but of the inability to match the unemployed with the available jobs (vacancies). Thus employment rates can be raised and unemployment rates reduced if the matching efficiency of the labour market is improved.
8. To prevent and to combat emerging bottlenecks: with structural change a fact of life in production and employment, it is important that the labour force has the skills, training and mobility required for the jobs which are available.

The second pillar, entrepreneurship and job creation, aims to create and support new businesses, new sources of employment and certain sectors of the economy, particularly private services. These aims relate to the general improvement of the economic and, therefore, employment performance of the economy.

The third pillar is adaptability: modernising work organisation is concerned with the reconciliation of contractual/working arrangements with the needs of a more competitive and knowledge intensive economy, or in other words flexibility with job security. Although there are minimum standards of employment protection, employment security is seen more in terms of functional flexibility, achieved through high quality training and lifelong learning. Thus this pillar is concerned with improving employment performance and the quality of work.

The fourth pillar, equal opportunities between men and women, is related directly to the Lisbon target of a 60% employment rate for women. Although the target is set in terms of the employment rate, it can also be seen as a means of reducing female unemployment or inactivity. The increased employment also implies increased female participation which is to be raised by policies to reconcile work and family life, such as childcare and parental leave. The quality of female employment is also important and this is to be assessed primarily in terms of the pay gap between men and women.

This somewhat complex approach has been simplified with the 2003 reform of the EES and the guidelines (European Commission, 2003b: 9ff.) with three overarching and interrelated objectives of the new EES:

1. Full employment.
2. Improving quality and productivity at work.
3. Strengthening social cohesion and inclusion.

These are to be achieved by policies in 10 areas:

1. help unemployed and inactive to find a job, prevent long-term unemployment
2. encourage entrepreneurship and improve climate for business start-ups
3. promote adaptability of workers and firms to change
4. provide more and better investment in human capital
5. increase labour supply and promote active ageing
6. promote gender equality in employment and pay
7. combat discrimination against disadvantaged groups
8. improve financial incentives to make work pay
9. reduce undeclared work substantially
10. promote occupational and geographical mobility'

(European Commission, 2003b)

This revised approach of the new EES has greater clarity, with three clear objectives for policy, rather than the somewhat obscure pillars previously used. Similarly the policy areas are more transparently delineated. Whether the policy itself has been simplified is questionable, as it is still characterised by a multiplicity of targets and indicators.

3.6 The EES and national employment policy

Economic theory suggests that the level of unemployment in an economy will tend² towards a long-term equilibrium determined by institutional features of the economy. Once such an equilibrium is established, workers and employers have no incentive to change real wages. Institutional features of the system discourage or prevent the unemployed from reducing this real wage and the long-term equilibrium will occur with some unemployment, with the extent of this structural unemployment determined by the institutional factors. Similarly, changes in unemployment are the result of the limited adjustment ability in the face of shocks (Cassino and Thornton, 2002; Layard *et al.*, 1991; Morgan and Mourougane, 2001). The principal institutional features singled out by economists (Blanchard and Wolfers, 2000; Nickell, 1997) as affecting unemployment are:

1. Social security benefits.
2. Taxation, particularly of labour.
3. Employment protection.
4. Wage bargaining/trade union strength.
5. Occupational and geographical mobility.
6. Labour force education, training and skills/active labour market policies.
7. Job matching.

How do EES policies correspond to these requirements? To what extent have the UK and Germany changed their policies in line with these requirements, to achieve the flexible markets deemed necessary by economists to achieve high employment? This section

² There are disagreements as to the speed at which this equilibrium is approached and thus the importance of dynamics in the process (Karanassou *et al.*, 2002).

considers the situation in Germany and the UK in relation to these institutional features, and looks at how they have changed over the lifetime of the EES.

Social security benefits: The EES has put increasing emphasis on making benefit and tax systems more employment-friendly. Making work pay has become a specific objective of the new EES guidelines. The UK's system, with not very generous fixed benefits, encourages the unemployed to seek work. Recent reforms have reinforced this tendency by seeking to eliminate poverty and unemployment traps, as well as making the receipt of benefits dependent upon job search. Germany's social security system, with unemployment benefits related to previous earnings, is much more generous than the UK's, but not especially generous by EU standards. Where Germany is unusual is in having open-ended earnings related-unemployment assistance (unemployment benefit and welfare payments are earnings-related); there are also limited requirements for job search. Until Agenda 2010 in 2003 (Section 3.7) reforms of the German social security system had been marginal (European Commission, 2002f: 11–12).³

Labour taxation: The EGs have consistently argued for a reduction of the tax burden on labour,⁴ despite ambiguous theoretical and empirical assessment of its effects. The UK has made significant reductions to its already low level of taxation.⁵ Germany's taxation of labour, particularly via social security contributions, remains high. Levels of taxation have been reduced in Germany but less on average than in the UK and in other EU countries (European Commission, 2002f).

Employment protection legislation (EPL): The EES guidelines reflect the ambiguous attitudes of member states on this issue, advocating more flexible contracts but with adequate security. This to a degree reflects the evidence, since EPL's effects on employment are not entirely clear-cut. Germany's traditionally high level of employment protection has remained largely intact, flexibility has been introduced within rather than between jobs, and adjustment occurs by varying the hours of the work, rather than the size of the workforce. Institutional features and attitudes have limited the use of fixed term contracts in Germany. The UK has maintained its low level of employment protection, the lowest in the EU (IMF, 2002: 44).

Wage bargaining: The guidelines do not consider wage-bargaining co-ordination or trade union strength.⁶ Germany and the UK lie close to the EU average in terms of union membership, but the number of workers covered by collective agreements is much higher in Germany (EIRO, 2002b), because of agreement extension (European Commission, 2002g: 39–47). In Germany there is also a high level of co-ordination as a result of pattern bargaining,⁷ and tripartite discussions between trade unions, employers' associations and the Federal Government.⁸ In the UK, with bargaining predominantly at the company level, extension tends not to take place. While both these systems have achieved wage

³ Agenda 2010 reforms have tightened the link between the receipt of benefits and job search.

⁴ This is another aspect of making work pay under the new guidelines.

⁵ The rise in National Insurance contributions in 2003 goes against this trend.

⁶ Except in terms of employment quality, where worker participation is seen as a good thing.

⁷ Where particular influential wage settlements set the norm for subsequent agreements.

⁸ Currently suspended.

moderation, there does seem to be some compression in the German wage structure, particularly at the lower end of the scale (European Commission, 2002d: 86–7).

Geographical mobility: The EES requires the promotion of occupational and geographical mobility within each member state and within the EU. Geographical mobility has been falling within Europe in general, and Germany in particular. For example, migration from the new *Länder* to West Germany has been very small at only 0.35% of the population in 2000 (European Commission, 2002c: 21). Thus the potential for migration as an adjustment mechanism in Germany is extremely limited. The UK's gross migration level seems on a par with the USA and levels of commuting are very high (OECD, 2000). Net migration is however much lower, so that for the UK migration provides only limited adjustment potential. Survey data does, however, suggest higher geographical mobility in the UK (EORG, 2001).

Education, training and skills are stressed in the guidelines, with the objective of providing the population with the basic skills required for employment and lifelong learning. The unemployed should also have access to training and other help in their job search. Public expenditure on education in Germany (4.7% of GDP) and the UK (4.6%), both in 1999, have been stable as a percentage of GDP,⁹ a little below the EU 15 average of 5.1%. Participation rates and educational attainment are rising, with 76.7% of German and 70.7% UK students completing upper secondary education in 2000, comfortably above the EU average of 60.3% (European Commission, 2002h). According to the OECD, educational attainment of 15 year olds in the UK is much higher than in Germany, which performs comparatively poorly (OECD, 2002b). On other measures, however, the German education system performs well compared with the UK, with high staying-on rates (DFES, 2002; European Commission, 2002h: 30) and low levels of youth unemployment. German education policy is far more successful in terms of the objectives of the EES than that of the UK.

Job matching seeks to ensure that the unemployed are paired with vacancies as rapidly as possible. The guidelines call for the modernisation of public employment services to develop their job matching capacities and the use of databases/information technology. Problems with the German Federal Employment Service indicate that the efficiency of this service has been low (EIRO, 2002a), and the German government is now rather belatedly reforming the system (Bosch, 2003). In the UK, reform of the employment service has been ongoing and has been combined with measures to link the receipt of benefits to job search.

From the above it can be seen that in the policies identified by economists as affecting economic performance and targeted by the EES, the UK is more compliant with the Strategy than Germany. These areas include social security benefits, employment protection, taxation and job matching. The limited movement of employment policies in general in Germany and in sensitive areas in the UK¹⁰ indicates the comparatively meagre impact of the EES upon national policy.

⁹ UK expenditure on education is planned to rise.

¹⁰ Involvement of the social partners and reduction in male-female pay gaps.

3.7 German labour market reform 2002/03

In 2002/03 Germany began to seriously tackle some of the rigidities of its labour market with the Hartz and Agenda 2010 reforms. In March 2002 the German government established the Committee 'Modern Services on the Labour Market' (*'Moderne Dienstleistungen am Arbeitsmarkt'*, the so-called 'Hartz Commission' named after its chairman Peter Hartz), to reform the German employment policy and the Federal Employment Service (FES). The German FES became the focus of public attention in February 2002 with the revelation of over-inflated job placement figures and considerable mismanagement (Thiel, 2002: 14). The Hartz Commission presented its report (the so-called 'Hartz Concept'), which can be regarded as the core of the reform of the German employment policy, on 16 August 2002.

The concept aims to reduce the number of unemployed from nearly 4 million to 2 million by 2006, to diminish the period of job placement from 33 weeks to 22 weeks and to decrease spending on earnings-related benefit and unemployment benefit from €40 billion to €13 billion. The instruments to achieve these aims are (1) stronger incentives for quick job placement, (2) targeted support for self-employment, and (3) more effective use of temporary employment.

There are seven key areas of reform:

1. Restructuring the FES.
2. Tightening-up of social security for the unemployed.
3. Encouraging additional employment by lower tax and social contributions.
4. Improvements in education and training.
5. Stimulating the establishment and expansion of new businesses.
6. Control of expenditure on health and pensions, to reduce the current and future level of contributions necessary to fund the system.
7. A reduction of income tax.

Furthermore the concept proposes *13 modules of innovation* to decrease unemployment and reform the FES (Report of the commission *'Moderne Dienstleistungen am Arbeitsmarkt'*, [Bundesregierung 2002; Schmitthenner, 2002]).

The first two of the Hartz I to IV 'Laws for modern services in the labour market' came into effect on 1 January 2003 and in April 2003, and the remaining Hartz proposals, along with the bulk of Agenda 2010, were agreed on 14 December 2003 (European Commission, 2002d: 16).

The FES in Germany has traditionally been concerned with the administration of benefits, but the reforms switch the emphasis to helping and encouraging the unemployed to find jobs. The new structure of the FES and its job centres with a privatised management structure should support a stronger service and customer orientation including closer relationships with companies. The new employment offices in Germany, like Jobcentre Plus in the UK, merge employment services with social security offices, youth welfare departments, housing offices and addiction and debt counsellors. New public sector 'personnel service agencies' (*'PersonalServiceAgentur'*) have been formed to employ the jobless and hire them out to private firms. Concentrating especially on temporary

employment, these 'personnel service agencies' are attached to each of the 181 job centres. These agencies will hire out unemployed people to companies for a restricted period. Unemployed people not willing to work for these agencies will suffer cutbacks in their unemployment benefit after a period of 6 months' unemployment. By introducing temporary employment, unemployment should decrease by 780,000. The initial numbers involved are small but the schemes can grow (*Economist*, 2003a). One factor in their favour is that they are able to pay considerably below trade union agreed rates.

Procedures relating to job placement and entitlement to benefit have been tightened up in various ways. In the future, when an employed person receives notice to leave their current job, they will be required to notify the FES of their potential future unemployment ('Quick job placement'). Failure to notify will lead to cuts in unemployment benefit. Companies who avoid dismissals will get discounts on their contributions to unemployment insurance. The principle under which it is deemed reasonable to refuse a job offer will be changed. The unemployed will have to demonstrate that the job is unreasonable for them, rather than the FES having to prove that it is reasonable. In addition, young single people can be obliged to move to other cities to find jobs and they will also have to accept lower wages. These revised eligibility criteria seem to have had an impact with the number of unemployed stabilising in 2003 despite falling employment (European Commission, 2003b: 16, graph 3.1).¹¹ Older people can be removed from job placement at their own request. Instead of unemployment benefit, they would then receive a payment which would take into consideration their social security contributions.

The reforms of the unemployment insurance/assistance system with stricter eligibility requirements are reinforced by reductions in the length and generosity of benefits. The immediate changes in effect until 2006 are a reduction in the period of earnings-related unemployment benefit to the first 6 months of unemployment ('Unemployment benefit I').¹² After this period only the newly defined welfare benefit ('Unemployment benefit II') will be paid,¹³ which will be less than the current unemployment assistance, but more than the current welfare benefit. Changes that come into effect in 2006 include restriction of unemployment benefit (*Arbeitslosengeld*) to 12 months¹⁴ and, once entitlement to unemployment benefit is exhausted, a new benefit will replace unemployment assistance (*Arbeitslosenhilfe*). This new benefit will be flat rate and means-tested; part of this benefit will continue for a period if the individual enters employment. Additionally, unemployment benefit and income support will be merged in order to remove disincentives to work.

As to low wages, the current €325 'mini-jobs' will be restructured. Employees earning no more than €500 will get state subsidies to their health and pensions insurance. Compulsory contributions to social security and will start with an income of €200. In the future only one of these 'mini-jobs' will be allowed per person. In addition, workers can earn up to €400 a month without having to pay welfare contributions or tax. This has resulted in legalisation of informal economy jobs and some new jobs being created.

¹¹ This implies that inactivity is rising but, if these individuals were not really actively engaged in the labour market, it is not really additional hidden unemployment

¹² This period can be extended to 32 months for older workers.

¹³ Financed by general taxation.

¹⁴ 18 months for people aged 55 years and over, down from 32 months.

Little change has been made to the wage-bargaining system. The *Günstigkeitsprinzip* remains in place – this is the legal restriction that allows enterprise-level deviations from industry-wide wage agreements only if they are no less favourable than the collective agreement. In practice some employers, particularly in East Germany, are paying below the industry norm. Private sector agencies have reached agreement with the unions to pay 10–15% below collective agreement norms. So some de facto wage flexibility is emerging.

The quality of schooling is to be addressed by a boost to all-day schools in the federal programme between 2004 and 2007. An independent Agency for Standards and Evaluation is to develop national educational standards, and a committee of experts is to report on education. Steps are to be taken to improve the quality of teaching. Some initiatives are to be introduced to raise the quality of vocational education. Improvements in education are dependent upon *Länder* for the implementation of reform measures, because education remains primarily a *Länder* responsibility.

Health care reforms aim to shift costs from the state to patients rather than to reduce costs. For example, patients will pay more for dental care and receive less sickness benefit. These changes are estimated to reduce the joint employee/employer health contributions by 0.7% in 2004, rising to 1.3% in 2007.

Short-term provisions to reduce the burden on the state of the pension system are a postponement of the 2004 pension adjustment, and higher pension contributions. Further steps have been taken to reduce the future burden of pensions. An increase in the mandatory pension age is to be phased in by one month a year from 2010, so that by 2034 the pension age will have risen from 65 to 67. A 'sustainability factor' is to be introduced into the calculation of pensions and this will reduce future increases in pensions. This change, together with simplified supervision, should provide some encouragement to the development of private pensions. As with most other pension reforms in Europe, this short-term fix does not resolve the long-term sustainability problem.

Tax cuts will interact with reductions in social security contributions¹⁵ and changes in the benefit system to improve incentives for workers at all income levels. Tax reform has not, however, begun to unravel the complexity of the system. In addition to €6.5 billion tax cuts already approved for 2004, another €16.5 billion were approved in December but, as a result of negotiations with the opposition, they will be phased in over two years from 2004 to 2005. Given the high level of German taxation, these should be at least partially self-funding through supply-side effects. Other funding comes from increased debt, and the privatisation of *Deutsche Telekom* and *Deutsche Post* should raise €5.3 billion; however, reconciling these measures with Germany's Stability and Growth Pact commitments will be difficult.

The excessive regulation of German business is one factor limiting the establishment of new businesses and the further development of the service sector. Various measures aim to improve this situation by the easing of employment regulations for small firms, introducing special arrangements for one-person businesses, liberalising the regulations

¹⁵ The significance is another matter: 'This may not do much more than prevent a rise in non-wage labour costs for the moment and perhaps reduce them by 1 to 2% ...and even then only from 2006 or 2007.' (Schröder and Walter, 2003).

of craft businesses and extending shop opening hours. The protection against dismissal has been reduced, but only for small firms employing up to ten workers.

Service sector activity has been encouraged by reductions in taxation and red tape. The self-employed now benefit from a scheme that cuts tax and administrative requirements for one-person businesses earning less than €25,000 with, for example, a tax levied at a flat rate of 10%. It is hoped that unemployment will decrease by 500,000 through the development of these '*Ich-AG*' ('I-Inc.') and '*Familien-AG*' ('Family-Inc.') companies; moonlighting should also become less attractive. By the middle of 2003, 33,000 of these businesses had been registered, some no doubt switching from previous undeclared activity, but still a positive development (*Economist*, 2003a). Under previous legislation, 94 crafts required a master craftsman certificate (*Meisterbrief*) to establish a business. Since these certificates are time-consuming and expensive¹⁶ to obtain, this regulation represented a considerable restriction on enterprise. The certificate will no longer be required in 53 of the 94 recognised crafts; however, 90% of craft-based companies are in the remaining 41 trades (Williamson, 2004). Trained staff without the *Meisterbrief* can, however, establish a business if they have six years' experience including 4 in a senior capacity.¹⁷ Restrictions on shop opening were one of the regulatory factors limiting the creation of employment in the service sector. Previously shops had to shut at 4 pm on Saturdays, but now they can stay open until 8 pm. Petrol stations with even longer opening hours have stretched the definition of travel provision, which they are allowed to sell. These changes only represent a marginal change to the restrictive regulatory environment of German business.

These reforms seem to be driven by German domestic considerations, notably the need by the government to be doing something about the unemployment problem. Views vary on the outcome of these reforms – all are agreed that further reforms are needed, but some see these reforms as a good beginning (Posen, 2003), others as limited and inadequate (*Economist*, 2003b; Schröder and Walter, 2003). The emphasis on the treatment of the unemployed is important because this is one of the crucial factors influencing employment and unemployment (de Koning *et al.*, 2004). The reforms have been limited by the weakness of the German government, the need to placate opposition within the SPD and the compromise resulting from negotiations with the FDP to achieve *Bundesrat* approval. The reforms can be seen as being inadequate in tackling German over-regulation of product, the wage-setting mechanism and labour regulation (Muchau, 2004). A more profound criticism is that the reforms are aimed at the wrong target – the fundamental problem of the Germany economy is low investment, so reform of public sector banking, regulation of venture capital markets and the general underdevelopment of the capital market should be tackled first (Munchau, 2003). Another problem was that these complex reforms of the healthcare, unemployment benefit and pension systems created considerable uncertainty over their effects on disposable incomes. Uncertainty was worsened by the suggestion that the reforms would be ongoing.¹⁸ This uncertainty, combined with a lack of clarity over the reform process and its aims, undermined popular support and contributed to the continuing weakness of German consumer demand. These reforms aim to adjust the welfare state to one that Germany can afford, rather than raising growth so that the economy can finance the society Germans want.

¹⁶ Up to €50,000.

¹⁷ In 6 of the 41 trades the *Meisterbrief* is still required.

¹⁸ Given the weakness of the current government, this is now unlikely, although the FDP are committed to further reform.

4 German and UK employment performance

4.1 Germany and the UK and EES targets

The EES contains seven quantifiable targets for employment performance in the EU:

1. An increase in the overall employment rate to 70% or more.
2. An increase in the female employment rate to 60% or more.
3. An increase in the overall employment rate for older workers to 50% or more.
4. A reduction in the rate of youth unemployment.
5. A reduction in the level of long-term unemployment.
6. An improvement in labour market matching.
7. The reduction in the pay gap between men and women (not considered in this paper).

Table 2
EES targets, German and UK employment performance (%)

Objective	Target	Germany		UK	
		1997	2001	1997	2001
Overall employment rate	70	63.7	65.8	70.0	71.7
Female employment rate	60	55.3	58.8	63.2	65.1
55–64 year olds employment rate	50	38.1	37.7	48.3	52.3
Youth unemployment ratio	4.1 ^a 3.1 ^a	5.4	4.8	9.1	7.7
Long term unemployment rate	1.5 ^b 0.8 ^b	4.9	3.9	2.6	1.3
Labour market matching	Improvement	NO		YES	

^a: average of three best performers EU 15, 1997 and 2001

^b: average of four best performers EU 15, 1997 and 2001

Source: European Commission, 2002c, 2002i; Eurostat, 1999

Measured UK employment performance is superior to Germany's for most of these targets. The UK's overall, female and older workers' employment rates are higher than those of Germany and exceed EES target levels. The long-term unemployment rate in the UK is below that of Germany and was falling over the 1997–2001 period, although it still exceeds the EU benchmark. There has been an improvement in the matching efficiency of the UK labour market, demonstrated by a shift in the Beveridge curve (discussed later in the report). The one area of relatively poorer UK performance is youth unemployment. The UK's youth unemployment ratio has fallen less rapidly than in the EU as a whole, and

was still well above the EU average in 2001. Germany's youth unemployment is well below the EU average and close to the best performers in the EU, despite the problems of the German economy.

4.2 Breakdown of differences in employment rates

However, this simple comparison of employment performance in Germany and the UK is flawed for four reasons. First, with unification, the inclusion of East Germany has depressed the employment performance of Germany. Second, the age structure of the population and its changes over time can affect employment rates. Third, employment change is relatively slow, and therefore historical differences can be important explanations of the current situation. Thus part of the explanation of the UK's relatively high total and female employment rates is the traditionally high levels of female employment. Fourth, concentration on total and female employment rates can conceal important developments in the employment situation of men.

The direct effect¹⁹ of East Germany on German employment rates is surprisingly limited: in 2001 it reduced the overall German employment rate by 0.7%. This is the result of the small size of the working-age population (17.2% of the German total in 2001) and the relatively high East German female employment rate. The East German male employment rate was 9.0% below West Germany's in 2001, but the female employment rate was only 1.4% lower.

Table 3
Contributors to differences between German and UK employment rates, 2001 (%)

	Contribution to difference in employment rate	Employment rate	
		Germany	UK
East Germany	-0.9	65.8	71.6
		West Germany	UK
Population	-0.7		
Total 15–24 years	-1.6	46.9	55.6
Male 25–54 years	0.2	88.2	87.9
Female 25–54 years	-0.8	61.6	67.6
Male 55–64 years	-1.1	48.1	61.6
Female 55–64 years	-1.0	30.5	43.2
Total	-4.9	66.7	71.6

Source: Eurostat, 2002, own calculations

¹⁹ The considerable net cost to the German government of East Germany is a drag on the overall economy, which together with the problems associated with the process mean that unification is an unprecedented economic shock (Czada, 1998).

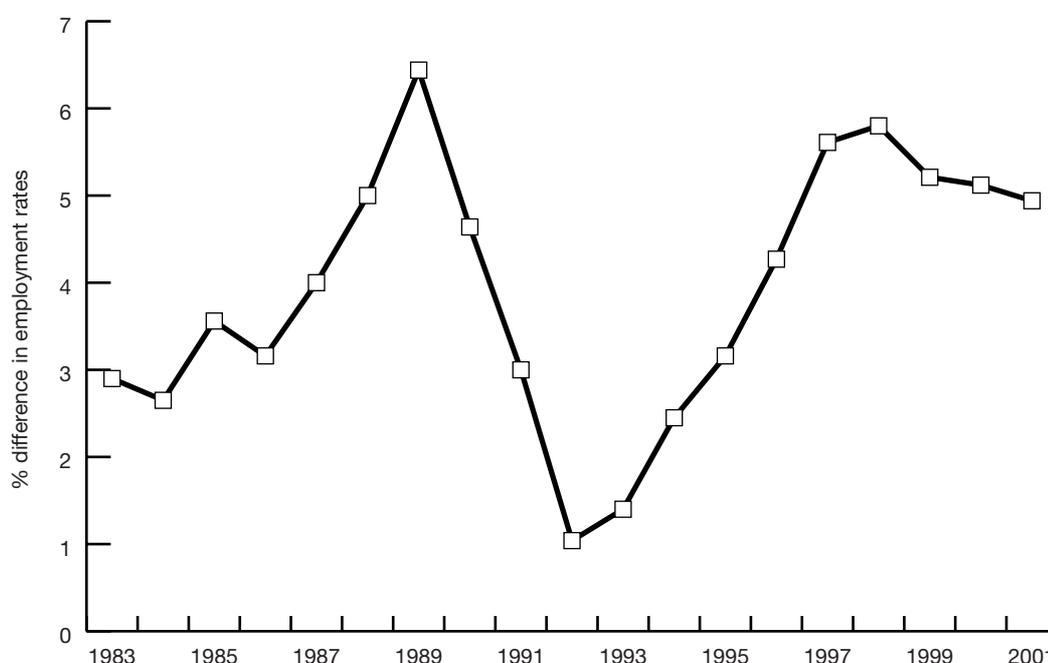


Figure 4
Difference between UK and West German employment rates 1983–2001

Source: Eurostat, 2002a

The difference between West German and UK employment rates in 2001 is the result of the unfavourable age structure of the population, notably the low employment rates of 55–64 year olds,²⁰ young people and women of prime working age (25–54 years). The population age structure adversely affects employment in Germany in particular, because the higher average age means that more people are in the low-employment older age group.²¹

The difference between West German and UK employment rates is not stable, and it has fluctuated over time with the cyclical situation of the economies and the extent to which these were correlated (Figure 4). The 1983–2001 period was one of exceptional instability for both economies, and there was therefore considerable variability around the average employment rate gap of 3.9%²² (Figure 4).

Since 1983 two factors have led to the observed widening of the gap in employment rates between the UK and Germany (Table 4).²³ The first factor is the ageing of the German population combined with a failure to improve the employment rates of older workers. The second is the elimination of the gap between West Germany and the UK in male employment rates of 25–59 year olds.²⁴ By contrast, the reduction of the gap in female

²⁰ It could be argued that higher employment rates among older people should compensate for the ageing of the population.

²¹ The exact extent of the effect is sensitive to the age sub-division of the population.

²² The observed upward trend in the gap in employment rates is of little significance because 1983 was a trough for UK male employment rates, after a steep decline from 1978 (OECD, 2002a).

²³ Some differences between Table 2 and Table 3 are related to the different age categories used because Eurostat Labour Force Survey (LFS) time series data are not available for the 25–54 age group.

²⁴ A substantial proportion of this deterioration is probably among older men.

Table 4
Contributors to differences between West German and UK employment rates, 1983–2001 (%)

	Contribution to difference in employment rate		Change 1983–2001
	1983	2001	
Population	0.5	-1.1	-1.6
Total 15–24 years	-1.6	-1.6	0.0
Male 25–59 years	1.3	0.0	-1.3
Female 25–59 years	-2.1	-1.2	0.9
Male 60–64 years	-0.6	-0.7	-0.1
Female 60–64 years	-0.4	-0.5	-0.1
Total	-2.9	-4.9	-2.0

Source: Eurostat, 2002a, own calculations

employment rates was an important factor limiting the growth of the overall employment rate gap.

The gap between West German and UK employment rates for women aged 25–60 has narrowed from 6.1% in 1983 to 3.2% in 2001. Full-time equivalent employment increased less in West Germany because the new jobs taken by women were predominantly part-time (60.1%), whereas in the UK they were predominantly full-time (67.8%). To a large extent, this was unwinding the previously limited part-time female employment in West Germany where, by 2001, the balance between part-time and full-time employment was very similar to the UK's.

The differences between the employment rates of older workers in West Germany and the UK are large. The male employment rate of 60–64 year olds in both countries drifted lower over the 1980s and 1990s, but the difference has remained stable. The UK female employment rate of 60–64 year olds rose much faster than the West German rate,²⁵ so the gap in female employment rates widened. The employment rate of older workers has remained the largest contributor to the German/UK employment rate differential. Lower employment rates reflect historically earlier retirement of men, lower employment rates of women, the use of early retirement for labour market adjustment, and the generosity of state benefits.

Germany has a low youth employment rate (46.9% in 2001), but a low youth unemployment ratio of 4.8%, while the UK has a high youth employment rate (55.6%) but a high youth unemployment ratio of 7.7%. The German situation indicates success in encouraging young people to remain in education/training and the effectiveness of the transition from education to employment. This appears to be largely the result of the German system of education/vocational training. The UK is successful in academic education, with short degree courses and high completion rates contributing to the high

²⁵ Despite the fact that the official retirement age for women is 60 in the UK and 65 in Germany.

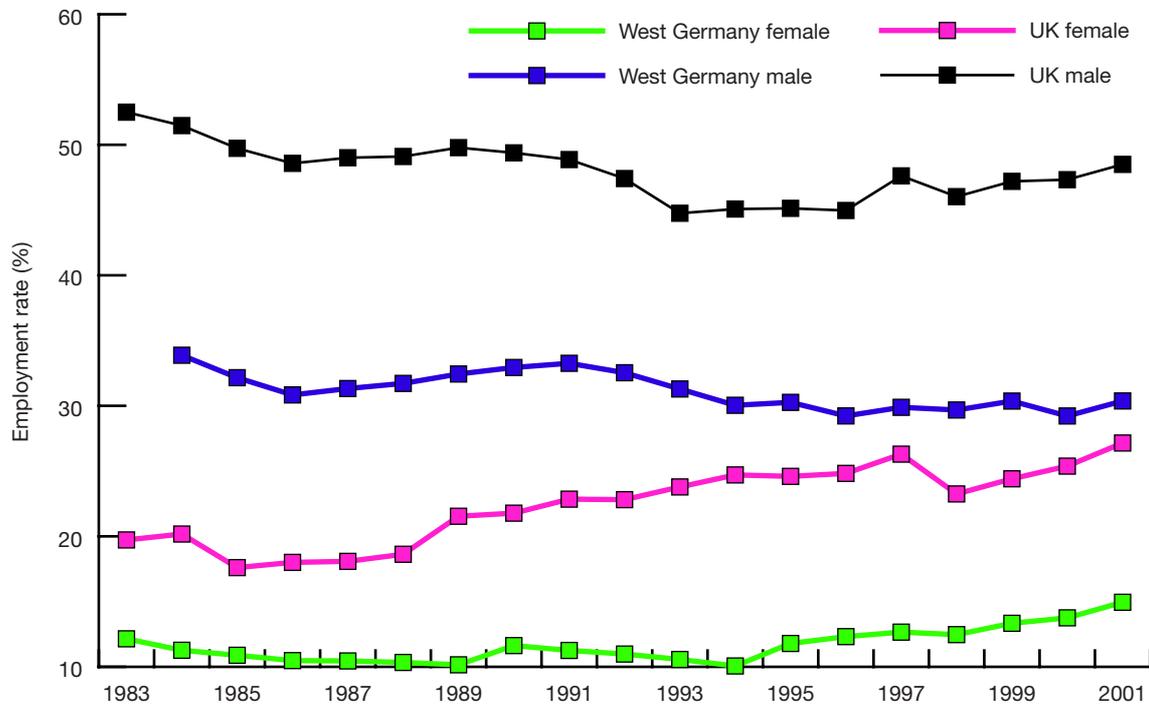


Figure 5
Germany and the UK employment rates 60–64 years

Source: Eurostat, 2002a

employment rate. The UK has problems in vocational education with a significant proportion of young people leaving school at the earliest opportunity and without qualifications, and then drifting into unskilled employment, unemployment and inactivity.

4.3 Hidden unemployment

In the UK fluctuations in economic activity and in employment rates have led to fluctuations in male unemployment, but the predominant trend has been rising inactivity (Figure 6). In Germany the fluctuations in male unemployment are smaller but the trend rise is clear. Inactivity fell in the 1980s, but since then the increase has been modest. An increase in inactivity is to be expected when unemployment is rising as was the case in Germany, but what is unusual in the UK is falling unemployment coupled with rising inactivity. The growth of male inactivity, especially in the UK, is masking the extent of the unemployment problem.²⁶ There is good evidence that in both the UK and Germany official unemployment figures underestimate unemployment. There is considerable hidden unemployment in both countries. In the UK this is primarily the result of the unemployed claiming sickness/invalidity benefit even when it is still possible for them to

²⁶ Male inactivity rose 1983–2001 by 2.4% of the population in the UK but only 0.9% in Germany.

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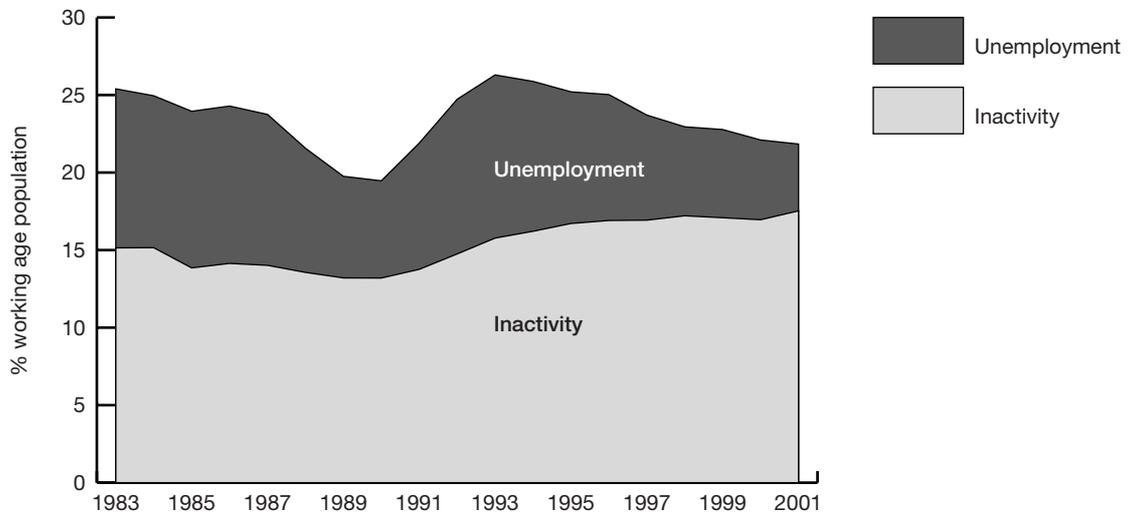


Figure 6
UK male unemployment and inactivity 1983–2001

Source: Eurostat, 2002a

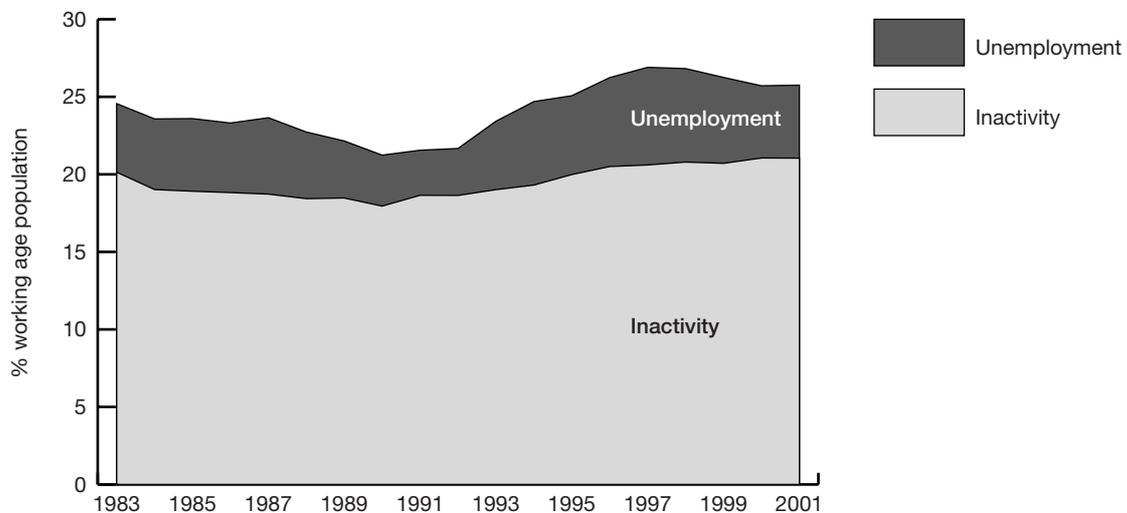


Figure 7
West Germany male unemployment and inactivity 1983–2001

Source: Eurostat, 2002a

work. In Germany hidden unemployment is the result of government measures to manage the unemployment problem such as short-term working, government education/employment programmes and early retirement. These problems with unemployment statistics support the choice of employment rates as targets in the EES.

As can be seen from Figure 8, 'hidden' unemployment²⁷ in the UK became particularly large in the 1990s and has fallen much less rapidly than the International Labour

²⁷ Hidden unemployment in the UK is calculated as the difference between the relevant year's age-specific participation rate and the rate in the 1970s. There was a correction for the trend increase in female employment.

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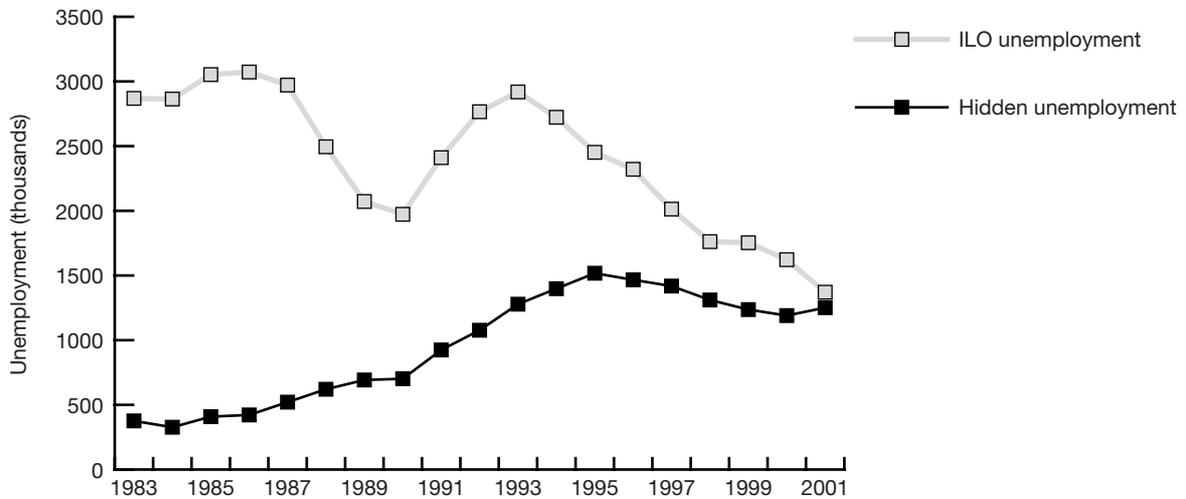


Figure 8
UK: ILO unemployment and hidden unemployment

Source: Eurostat, 2002, own calculations

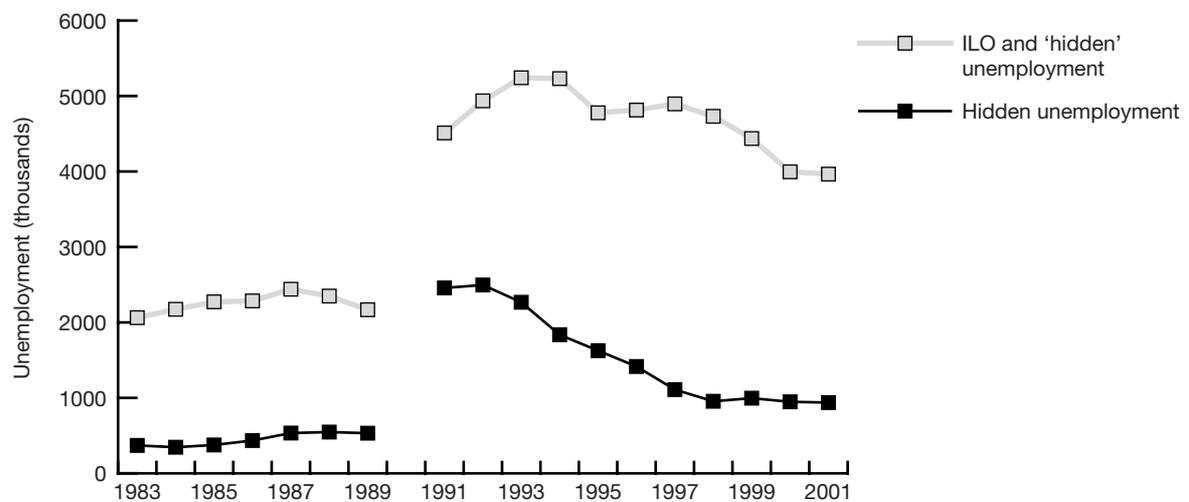


Figure 9
Germany: ILO and 'hidden' unemployment

Source: Eurostat, 2002; IAB, 2003

Organization (ILO) definition of unemployment. So ILO plus hidden unemployment (ILOH) has been reduced much less than ILO unemployment. In Germany, by contrast, unification was accompanied by a huge leap in hidden unemployment (Figure 9) which, combined with a large increase in ILO unemployment, meant a large rise in ILOH.²⁸ Hidden unemployment then fell steeply, but 'real' unemployment fell by very much less.

²⁸ Figures for German hidden unemployment are not available for 1990.

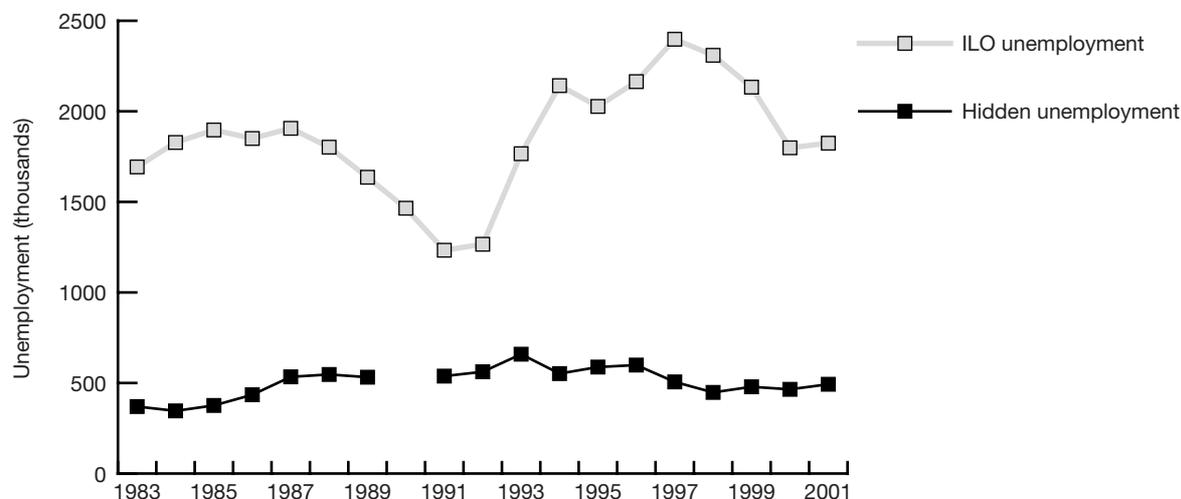


Figure 10
West Germany: ILO and 'hidden' unemployment

Source: Eurostat, 2002; IAB, 2003

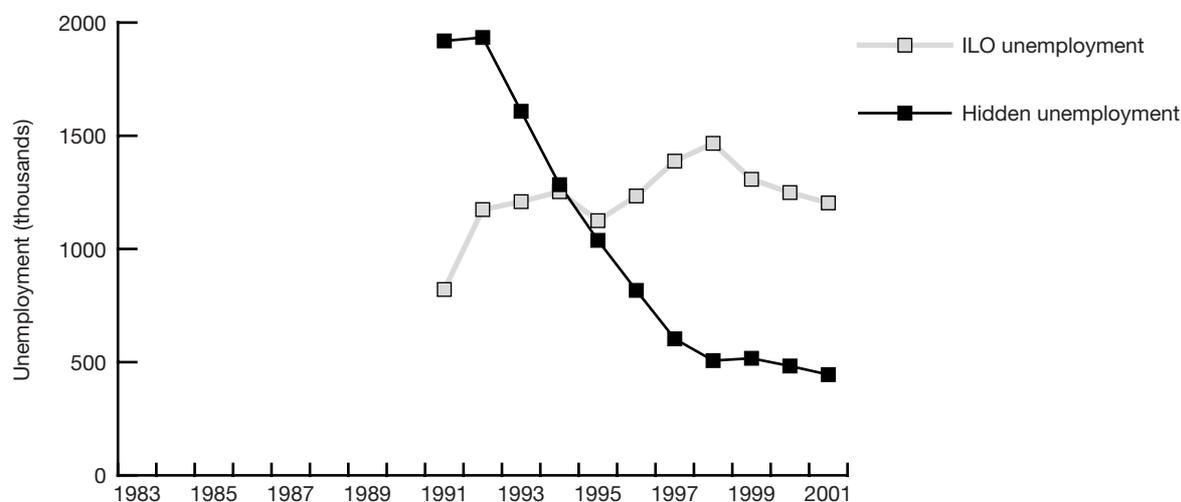


Figure 11
East Germany: ILO and 'hidden' unemployment

Source: Eurostat, 2002; IAB, 2003

In West Germany by contrast (Figure 10) hidden unemployment was stable throughout the period, but ILO unemployment fluctuated with the unification boom and subsequent recession.²⁹ In East Germany it is developments in hidden unemployment which are driving ILOH (Figure 11). Unification problems were dealt with initially by special measures but, as these were phased out, unemployment and inactivity in East Germany rose.

²⁹ Hidden unemployment in West Germany is stable, even if the higher Sachverständigenrat (2003) estimates are used.

Table 5
Long term unemployment in Germany and the UK, 2001 (%)

	ILO	ILO + official early retirement	ILO + Sachverständigenrat early retirement
West Germany	3.9	4.6	6.1
	ILO	ILO + hidden unemployment	
UK	1.3	5.6	

Source: EU 15: European Commission, 2002a; Germany and UK: Eurostat, 2002; IAB, 2003; Sachverständigenrat, 2003.

This growth in hidden unemployment raises questions over the accuracy of unemployment statistics, particularly with regard to long-term unemployment. It also poses difficulties for the measures of overall labour market efficiency that utilise unemployment, e.g. structural unemployment and the Beveridge curve.

The long-term unemployment rates in West Germany (3.9% in 2001) and the UK (1.3%) are underestimates because of hidden unemployment. Table 5 shows the effect of allowing for these adjustments. In West Germany's case there are three estimates: first, ILO unemployment; second, ILO plus the official figure of workers on state benefits who have retired early; and third, the higher estimate provided by the Sachverständigenrat. In the UK the estimate of hidden unemployment is added to the official long-term unemployed to provide an upper limit to long-term unemployment in the UK. As can be seen, the inclusion of the hidden unemployed indicates that the long-term unemployment is considerably more of a problem than ILO unemployment rates imply, and the gap between West Germany and the UK is much less than the official figures suggest.

4.4 Labour market efficiency

Economic theory provides two measures of labour market efficiency: structural unemployment and the Beveridge curve. Structural unemployment is the non-accelerating inflation rate of unemployment (NAIRU), the lowest level of unemployment compatible with stable inflation; this provides a measure of the sustainable level of unemployment.

The level of structural unemployment is estimated to be unchanged in Germany (Figure 12) and West Germany, but it has fallen in the UK (Figure 13). This remains the case when hidden unemployment is taken into account. The estimated level of structural unemployment (i.e. the NAIRU) does, however, seem to follow the trend in the actual unemployment rate, leading to doubts over the robustness of this measure. In addition, part of the improvement in the UK has been associated with the restraining effect on prices of the rising exchange rate between 1995 and 2001, so that the sustainability of the improvement could be questioned.

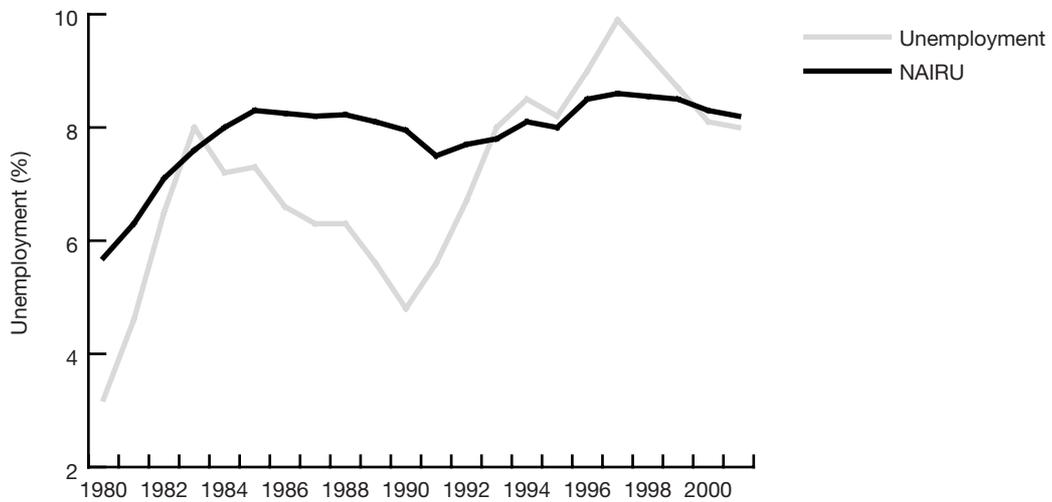


Figure 12
Germany: NAIRU and unemployment

Source: Eurostat, 2002a; OECD, 2002e



Figure 13
UK: NAIRU and unemployment

Source: European Commission, 2002a; OECD 2002a

The Beveridge curve shows the relationship between unemployment and vacancies, and measures the labour market’s ability to match the unemployed with the available jobs. The lower the level of unemployment associated with a given level of vacancies, the more effective the labour market is in matching the jobs available to the unemployed. A downward shift in the Beveridge curve indicates an improvement in labour market matching efficiency. Germany’s Beveridge curve appears to move outward in the 1990s indicating a reduction in labour market matching efficiency (Figure 14). Using ILOH leaves the shape of the Beveridge curve unchanged, although its position has moved (Figure 15).

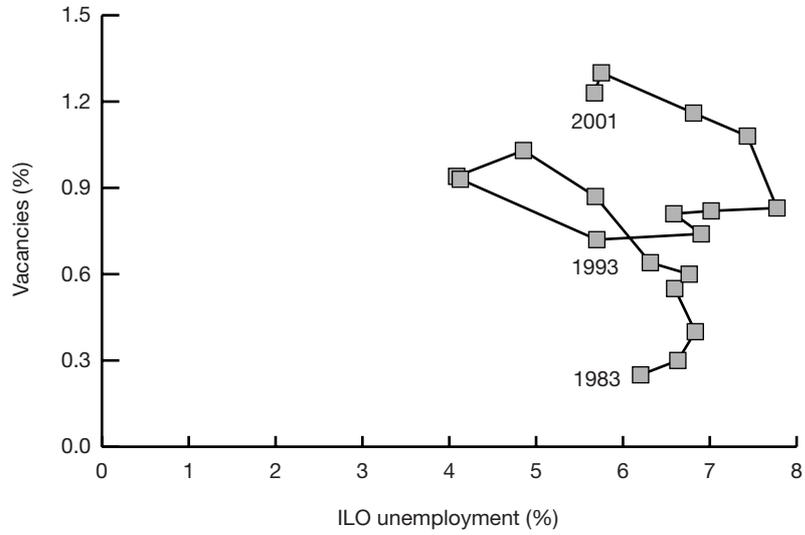


Figure 14
West Germany: Beveridge curve 1983–2001 (ILO unemployment)

Source: Eurostat, 2002; IAB, 2003

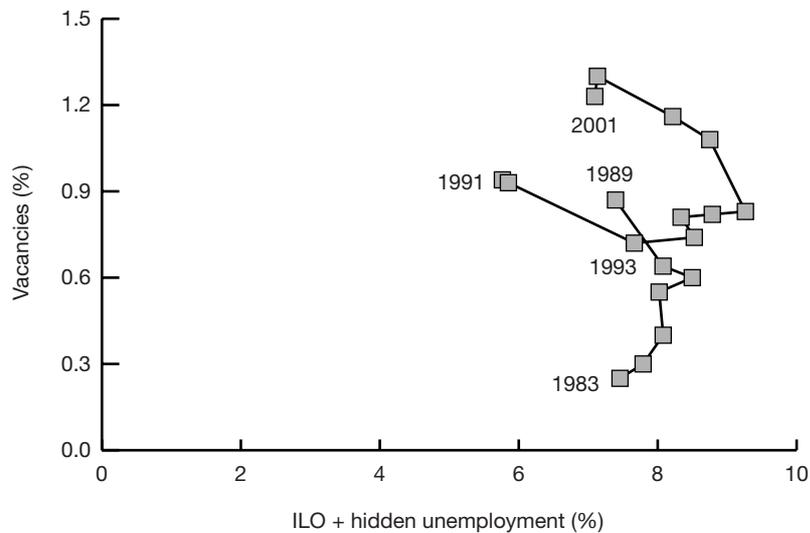


Figure 15
West Germany: Beveridge curve (ILO and 'hidden' unemployment)

Source: Eurostat, 2002; IAB, 2003

In the UK, when vacancies are plotted against ILO unemployment, there is a clear improvement in the relationship, with points after 1989 (Figure 16), indicating an improvement in the labour market's matching efficiency. Using ILOH, the situation is reversed, with the observations after 1993 lying above those before (Figure 17), indicating a worsening of the labour market's efficiency.

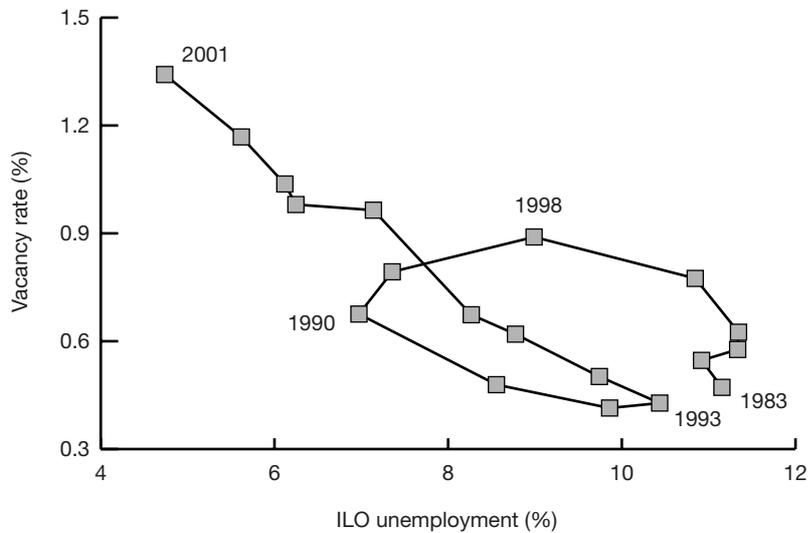


Figure 16
UK: Beveridge curve (ILO unemployment)

Source: Eurostat, 2002a; National Statistics, 2002c



Figure 17
UK: Beveridge curve (ILO and 'hidden' unemployment)

Source: Eurostat, 2002a; National Statistics, 2002c

4.5 Economic growth and employment

In the conventional theoretical framework, long-term trends in employment and unemployment are determined by structural characteristics of the labour market and persistence effects. Variations in economic growth will cause fluctuations around these long-term trends, but an efficient labour market would adjust to economic growth shocks

so as to maintain employment.³⁰ If the poor performance of an economy persists, this could be argued to be the result of structural factors. The gap between Germany and the UK has widened, particularly over the period since unification from 1992 to 2001, but the annual growth rate of West German³¹ GDP averaged 1.2% compared with 2.7% in the UK. There were two external shocks working through the German economy in this period – unification and membership of EMU. Unification has been a substantial continuing burden on the West German economy. In EMU interest rates have been set with reference to the Euro area average inflation which, it could be argued, is above the levels needed by Germany with its low inflation and high unemployment. EMU also locked in the sharp appreciation in the exchange rate of the Deutschmark that occurred after unification. Although the competitiveness of Germany does not seem out of line with longer term values (IMF, 2002: 65–74), such judgements are difficult to make for the unified Germany.

If the slow GDP growth rate of the 1990s is accepted to be the result of external shocks rather than internal factors, then the effectiveness of German growth in generating employment, and whether it has changed, can be estimated. Modelling this relationship makes it possible to separate the long-term changes from the short-term cyclical elements of employment and unemployment performance.

The most straightforward approach is to relate changes in employment/unemployment directly to changes in GDP. An example of the first approach is provided by IMF (2001) with the following equation estimated:

$$dn_t = \beta_0 + \beta_1 dy_t + \beta_2 dy_{t-1} + \beta_3 D_{90} dy_t + \beta_4 D_{90} dy_{t-1} + \beta_5 dn_{t-1} + \beta_6 dn_{t-2} + \varepsilon_t$$

where d is the difference operator. The variables n and y are the rates of change of total employment and GDP respectively. The dependent variable dn_t is employment measured in full-time equivalents to allow for variations in the volume of part-time work. Changes in full-time equivalent (FTE) employment are explained by changes in the demand for labour caused by changes output (GDP) in this year dy_t and the previous year dy_{t-1} . This allows for some lagged effect of the change in GDP on employment. D_{90} is a dummy with a value of 1 for 1990–2000 and a value of zero for 1973–1989. A significant estimate for β_3 suggests that the effect of output on employment in the 1990s was different from that of 1973–1989.³² 1990 is used as the break in order to give sufficient observations to capture a change in the relationships. For the UK the break in the relationship in 1990 could possibly be the result of changes in the labour market introduced over the previous decade. β_5 and β_6 are lagged dependent variables capturing some of the dynamics of employment change. For Germany the break in 1990 can be used to see if unification had an impact on the functioning of the labour market. The use of first differences means the equation captures the short run relationship between output and employment. The results of the estimation of this equation for 1973–2000 are shown in Table 6.

The relationship achieves a reasonably good fit as shown by the R^2 – all the estimates of β_1 are significant at the 5% level. A 1% increase in real GDP is associated with a contemporaneous increase in employment of 0.63% (Spain), 0.52% in Germany and 0.30% in the UK. The UK's employment response to increases in GDP is larger than that in

³⁰ Cycles can have long-term persistence effects, which are difficult to disentangle from the trend.

³¹ Excluding West Berlin (SABL, 2003).

³² β_4 measures the lagged effect of the structural break after 1990.

Table 6
Regression of employment on real GDP growth

	β_1	β_2	β_3	β_4	β_5	β_6	R ²	DW
France	0.57* (0.08)	0.14 (0.16)	0.15** (0.08)	0.12 (0.09)	0.07 (0.25)	-0.12 (0.11)	0.93	2.33
Italy	0.39* (0.06)	0.06 (0.10)	0.39* (0.15)	-0.04 (0.19)	0.47* (0.21)	0.13 (0.19)	0.73	1.75
Spain	0.63* (0.19)	0.01 (0.20)	0.49* (0.25)	-0.06 (0.26)	0.31 (0.21)	-0.08 (0.16)	0.78	2.23
Germany, western	0.52* (0.06)	-0.07 (0.11)	-0.01 (0.08)	0.01 (0.08)	0.08* (0.19)	-0.23** (0.13)	0.91	2.38
UK	0.30* (0.15)	0.47* (0.16)	0.32** (0.23)	-0.32** (0.24)	0.28** (0.18)	0.06 (0.15)	0.78	2.17

Employment measured in FTEs.

Standard errors in parenthesis, * indicates significance at the 5% level, ** at 10% level.

Source: IMF, 2001: 40; UK own calculations on data from European Commission, 2003a

the other countries but more lagged with a significant β_2 as large as β_1 .³³ The estimates of β_3 imply that during the 1990s this employment intensity of GDP growth significantly increased in Spain, Italy and France,³⁴ but not in the UK and western Germany.³⁵ The fact that the negative β_4 is as large as the positive β_3 means that the overall improvement in the UK's employment intensity of growth in the 1990s was insignificant. This is not surprising when the UK already had the highest employment intensity of growth. What this does indicate, however, is an increase in the speed of response of employment to changes in economic conditions, which is one of the characteristics of a flexible labour market. Although a rapid response of employment means individuals are made unemployed more quickly in a recession, they are also hired more rapidly when economic circumstances improve. Since length of unemployment affects employability adversely, this increased speed of response could be regarded as an improvement in labour market efficiency.

Up until 1990, the employment intensity of growth was similar in West Germany to that in the other large EU economies. The fact that it did not increase after 1990 meant that Germany had the lowest employment intensity of growth among the large EU economies. This lower employment intensity of growth (the counterpart of which is relatively better productivity performance) could be associated with limited labour market reform (European Commission, 2002d: 2), but it could also be related to unification and its aftermath.

If the distinction between part-time and full-time employment is ignored and employment is measured simply in terms of jobs, then the employment intensity of growth is very similar in Germany and the UK. Thus, in terms of the expansion in employment, the only differences between the two countries are the results of the difference in GDP growth since 1992. If German GDP had grown at UK rates, growth in employment over the 1992–2001 period would have been similar in the UK and Germany.

³³ The relationship for the UK was estimated for this study.

³⁴ An increase in the employment intensity of growth in the EU is confirmed by European Commission (2002a).

³⁵ When estimated using data on the numbers employed rather than FTEs, β_3 is significant, indicating that the amount of hours generated by a 1% increase in GDP is similar, but in the 1990s it created part-time rather than full-time jobs.

5 Conclusion

The OMC is sometimes seen as a potential precursor to the Communitarisation of policy, but this does not seem to be the case in employment policy. National policy and processes remain distinct and the impact on policy limited, particularly in politically controversial areas, e.g. social partner involvement in the UK. The impact of the EES is limited by its low national political significance, and it is clear that the focus of attention in the media and parliament remains on national policy. This low visibility in public discourse means that the EES exerts little direct leverage over national employment policy. Indeed, it is noteworthy that the German government has not used the Strategy as a justification for the difficult changes in employment policy it is currently trying to effect.

The EES procedure until 2002 has had problems associated with the annual cycle, notably its complexity and co-ordination with other policies. The streamlining of economic policy procedures meets some of these concerns, but the annual NAP process will remain, even if in a reduced form. This places considerable burdens on national political actors and is of limited utility, given the length of time for policies to be implemented and their effects to be felt. The governance and 'ownership' of the EES is problematic, national parliaments' involvement is cursory and the European Parliament is merely consulted. The involvement of the social partners is problematic given the tightness of the annual schedule and their (often limited) resources.

The UK has embraced the policies advocated by the EES more enthusiastically than Germany. This seems to be reflected in most measures of employment performance. Between 1991 and 2001 the UK created 1.8 million jobs, while German employment contracted by 0.6 million. The UK unemployment rate in 2001 was 5%, Germany's was 7.9%. This evidence supports the view that the policies advocated by the EES should be effective in improving the employment performance of EU member states. A deeper analysis suggests that the outcome is much less clear-cut. Although employment, particularly female employment, has expanded in the UK, a larger number of people of working age have become hidden unemployed. When account is taken of this hidden unemployment, the improvement of UK labour market performance is more marginal. West Germany's labour market performance has been surprisingly good, despite the enormous strains caused by unification and its aftermath. The comparison of UK and German labour market performance, therefore, provides only limited support for the view that pursuing the flexible labour market policies, partially advocated by the EES, is necessarily going to lead to significantly improved labour market performance. The effect of EES policies on employment performance will be subject to considerable lags, may be limited and will be mediated by national economic circumstances. A significant improvement in employment performance is dependent upon higher economic growth, suggesting that supply-side measures are not enough and that a better mix of demand-side and supply-side measures is required.

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Appendix 1

List of acronyms

BEPGs	Broad Economic Policy Guidelines
DFES	Department for Education and Skills
EES	European Employment Strategy
EGs	Employment Guidelines
EIRO	European Industrial Relations Observatory
EORG	European Opinion Research Group
EPL	Employment Protection Legislation
FES	Federal Employment Service
FTE	Full-Time Equivalent
ILOH	ILO plus Hidden unemployment
IMS	Internal Market Strategy
JER	Joint Employment Report
NAIRU	Non-Accelerating Inflation Rate of Unemployment
NAPs	National Action Plans
OECD	Organisation for Economic Co-operation and Development
OMC	Open Method of Co-ordination
TEC	Treaty Establishing the European Community