Adjustment patterns of enterprises in the German labour market during the Great Recession – selected results of a special survey

The German labour market was characterised by a comparatively high degree of stability in terms of employment and unemployment during the Great Recession of 2008-09. Such resilience was exceptional both historically and by international comparison and was the outcome – as is well documented in numerous studies – of the interaction of a number of steps taken to enhance flexibility under collective agreements and labour market policy reforms in the past which allowed enterprises to provide a calibrated response to the massive global shock in the fourth quarter of 2008 and the first three months of 2009.

The present study adds to existing investigations on this topic by examining whether enterprises that were exposed to a more persistent structural shock behaved differently during the crisis from those that were acutely affected but only in the short term. The data were derived from a survey of enterprises conducted in the summer of 2014 by the Ifo Institute on behalf of the Bundesbank among firms which usually take part in the Ifo business survey. The analysis focused on the production sector (excluding construction) since this sector was hit particularly severely by the global slump in demand.

All in all, the survey results indicate that enterprises subjected to only a temporary dip in demand were more likely, in the crisis, to implement cyclical staffing measures such as short-time working and to pay greater attention to not losing skilled labour. By contrast, enterprises facing the prospect of a lasting slump in sales tended to make greater use of structural staffing instruments with a more lasting impact.

Generally speaking, there is a risk that labour market interventions motivated by economic policy considerations will be used by enterprises to delay necessary structural adjustments. However, in the specific situation of the Great Recession, it appears that a necessary process of structural change was still taking place to a certain extent in some sectors, despite the labour market policy measures of the Federal Government, which notably included making it easier to claim short-time working benefits. One indication of this is the differentiated behaviour of enterprises, as cyclical labour market policy measures were chiefly adopted by those firms which had to cope with no more than a temporary lull in sales.

Special survey among enterprises

Special survey on wages, employment and financing …

Unemployment rose sharply in many euro-area countries during the economic and financial crisis as well as the ensuing sovereign debt crisis and resulting large-scale economic adjustment processes. In order to learn more about the response patterns of the various European labour markets not only to cyclical but also to structural changes, in particular, the central banks in the European System of Central Banks (ESCB) conducted a survey among enterprises on wages, employment and financing. This was a harmonised survey carried out in parallel in 25 European countries. The survey results were analysed under the aegis of the Wage Dynamics Network (WDN), a research network coordinated by the European Central Bank.[1]

… conducted in summer 2014

For Germany, the Ifo Institute conducted the survey in summer 2014 on behalf of the Bundesbank. The survey was carried out among enterprises from manufacturing, construction, the wholesale and retail trade and the (other) services sectors. Of the total of around 10,000 firms that were contacted, one-quarter returned a completed questionnaire. This is a fairly good response rate for a survey of this kind. Roughly 29% came from the production sector (excluding construction), 14% from the construction sector, and 57% from the wholesale and retail trade and the other services sectors.[2] Large and very large firms are somewhat overrepresented not only in the number of enterprises that were contacted, but also among those enterprises that provided a response. For the descriptive analysis, weights were therefore selected to reduce this bias.

… relates mainly to the period 2010-13

The majority of questions in the harmonised questionnaire cover the years 2010-13. During this period, the need for structural adjustment – especially in the labour markets and in the wage determination processes – became evident in a number of euro-area countries, as they became decoupled from the upside tendencies in the global economy, sliding into a new recession in some cases, and saw a considerable increase in unemployment. The survey therefore provides insights into approaches to structural reforms in these areas and/or even their initial impact where measures had already been taken at an early stage in the wake of the Great Recession of 2008-09.

… but in some instances also to 2008 and 2009

Moreover, some questions relate not only to the main period: responses were also requested in relation to the immediately preceding period, ie the Great Recession of 2008-09. This produced a number of interesting results with regard to enterprises' adjustment strategies in response to the massive slump in demand that affected industry in particular in the final quarter of 2008 and the first quarter of 2009. The German economy – unlike the economies of many other euro-area countries, especially in southern Europe – was hit harder by the global recession but recovered from it very rapidly. Given this cyclical profile, the survey results supply information, for example, on what adjustments the enterprises made in terms of employment and remuneration when faced, in some cases, with a considerable slump in sales. One factor in this context was whether enterprises deemed the slump in demand to be tem-

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1 Along with the Bundesbank, most of the other euro-area central banks took part in the survey (Austria, Belgium, Cyprus, Estonia, France, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia, Spain) and, additionally, other European Union countries (Bulgaria, Croatia, Czech Republic, Hungary, Poland, Romania and the United Kingdom). It was the third such survey carried out by the WDN. For the results of the first wave of the survey, see, for example, Deutsche Bundesbank, Wage setting in Germany – new empirical findings, Monthly Report, April 2009, pp 17-29. The Bundesbank did not participate in the second wave of the survey. An overview of the results of the first two surveys at the European level may be found, for example, at http://www.ecb.europa.eu/home/pdf/wdn_finalreport_dec2009.pdf.

2 With regard to services, in addition to the wholesale and retail trade, the survey covers primarily services listed under industrial activity codes H to N and, in some cases, also P to S as defined in the 2008 classification (NACE Rev 2). The collected data therefore relate predominantly to the wholesale and retail trade, transportation and storage, accommodation, information and communication, financial and insurance activities, real estate activities, professional, scientific and technical activities as well as other service activities. The remaining 2% of respondents comprises, for example, laundries and cleaning services.

porary or persistent and whether they had already been encountering difficulties in recruiting skilled labour in the period prior to the crisis. Furthermore, comparing the periods also allows conclusions to be drawn as to whether appropriate use was made of the wage bargaining and labour market policy instruments designed to cushion cyclical downturns. The results of the WDN survey of German enterprises presented here therefore focus on these particular aspects.

Employment, working hours and wages during the Great Recession

Stylised facts on the labour market response during the Great Recession in Germany

During the Great Recession, real gross domestic product slumped by 7% in Germany. Economic activity in Germany recovered extremely quickly, however, and had already returned to its pre-crisis level by early 2011.[3] Given this pronounced cyclical pattern, the labour market in Germany was characterised by a comparatively high degree of stability in terms of employment and unemployment.[4] This outcome, which is remarkable both historically and by international comparison, was due to the interplay of several factors. In the preceding years, the groundwork for enterprises responding as flexibly as possible to exogenous disruptions had been laid by steps taken to enhance flexibility under collective agreements, like opening clauses for the event of firms encountering severe difficulties, the widespread introduction of working time accounts, and labour market policy reforms such as the liberalisation of temporary employment. Besides this, the firms had traditional labour market policy instruments like short-time working benefits at their disposal, with the Federal government even temporarily making it more attractive to take up this option.

Hoarding of labour

Generally speaking, during this period, enterprises seem to have been keen to retain qualified and skilled staff for as long as possible. A key factor in this context was that industry, in particular, had previously experienced increasing difficulties in recruiting suitably qualified staff. Nevertheless, the costs associated with the hoarding of labour were considerable. Even though it was possible to contain these costs to some extent by using the available adjustment instruments, this gave rise to substantial pressures on earnings – above all in industry which had been very hard hit – and, besides this, access to external financing was impeded owing to the financial crisis. Enterprises only managed to get through this because they had significantly improved their profitability earlier and the cyclical upturn set in before the balance sheet buffers had been used up.

Adjustment through working hours

The Great Recession was reflected in employment by no more than a moderate dip. The considerable shortfalls in temporary agency employment and perceptible losses in manufacturing as well as in transport and logistics were offset by an ongoing expansion during this period in the health, welfare and household services sectors. In the recession year of 2009, average working hours were nevertheless 3¾% lower than prior to the economic and financial crisis, but, even so, this was a significantly smaller decline than the slump in output. At the same time, there was a considerable reduction in productivity per hour worked. With regard to hours worked, use was made of the large number of available adjustment instruments. Nearly half of the decrease in the effective average working hours per employee was due to the fact that overtime was cut and positive balances on working time accounts were reduced. More than one-quarter was due to the temporary reduction of standard working hours, whereas only one-quarter was connected with the use of short-time working. Even though the reduction of standard work-

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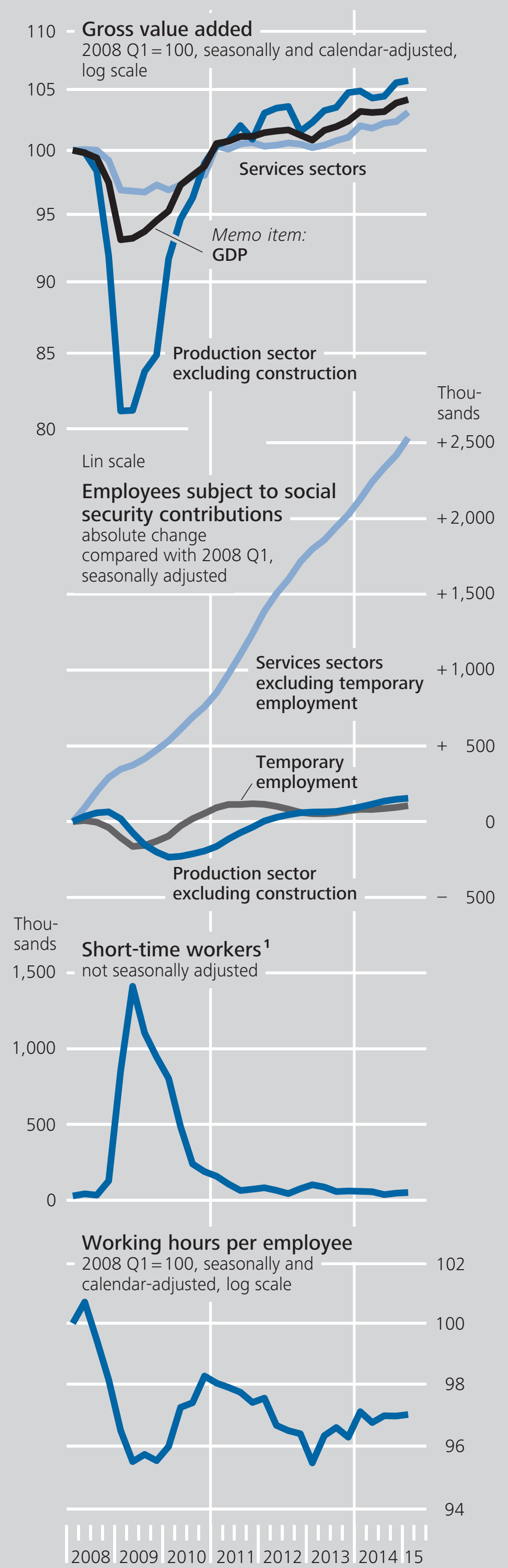
3 In the production sector (excluding construction), which was particularly affected by the slump in demand, price-adjusted gross value added declined by one-fifth. Here, too, the loss was regained within two years, however.
4 See also, for example, Deutsche Bundesbank, Germany in the financial and economic crisis: Labour market, Monthly Report, October 2010, pp 55-69.

Output, employment and working hours since the Great Recession



Sources of the unadjusted figures: Federal Statistical Office and Federal Employment Agency. **1** Number of recipients of short-time working benefits pursuant to section 95 of Social Security Code III.

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ing hours was largely linked to cuts in wages and salaries, there was a sharp rise in unit labour costs given the significantly lower hourly productivity. At the beginning of 2009, unit labour costs, taking an average of the economy as a whole, were one-tenth higher than their level before the crisis.

Evidence about adjustment responses from the corporate survey

Cyclical labour market instruments harbour risk of delaying structural change

During the Great Recession, the Federal government took various measures to stabilise the labour market. In particular, the period of entitlement to short-time working benefits was extended, the eligibility criteria were lowered, and many of the costs of social security contributions for short-time workers were assumed by central government.[5] The aim of these labour market policy measures was to mitigate the effects of the dramatic economic collapse on the labour market and, above all, limit the rise in unemployment. Nonetheless, such labour market policy measures harbour the risk of delaying potentially necessary structural change. Enterprises facing not just a temporary, but rather a permanent attenuation of demand for their products, might put off necessary adjustments to their existing business model by falling back on such labour market policy instruments. This would mean that economic resources like capital and labour are kept in less productive uses for longer periods and that, as a consequence, welfare-enhancing growth opportunities are not exploited.

From this perspective, it is of interest whether enterprises exposed to a more persistent struc-

5 Alongside statutory short-time working, many industries have short-time working arrangements as part of their collective agreements. This involves employers making an additional payment on top of statutory short-time working benefits through a special fund. The level of this additional payment varies from industry to industry and, according to the Institute of Economic and Social Research (WSI), safeguards, together with the statutory benefits, between 75% and 100% of previous net working income.

Differing behaviour of enterprises studied

tural shock behaved differently during the crisis from those that were affected only in the short term. It would temper the above-mentioned reservations about labour market policy interventions if it proved to be the case that mainly the latter made use of labour market policy measures facilitating the hoarding of labour, while enterprises affected over the longer term took staffing policy measures with a more lasting impact.[6]

Splitting the enterprises into two groups

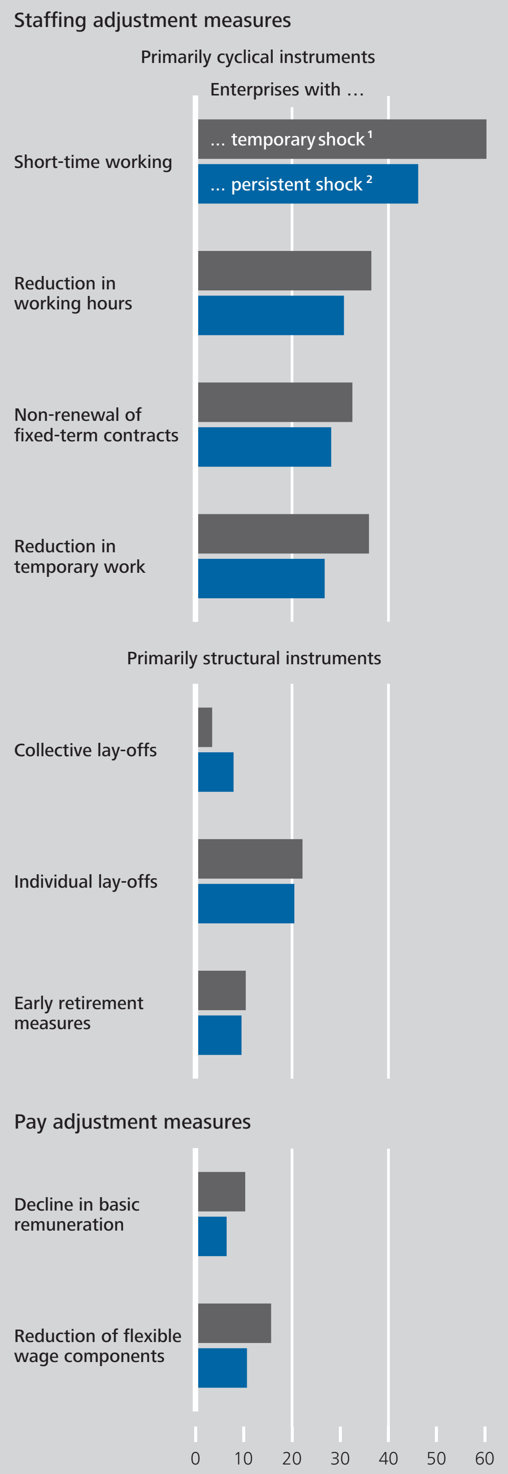
To investigate this question, the first step was to split the surveyed enterprises into two groups. Enterprises stating that the level of demand for their products in the period 2010-13 was "worse" or "much worse" than before the crisis were regarded as being exposed to a more persistent shock. This was true of one-quarter of the responding enterprises in the production sector (excluding construction).[7] The other group was formed by enterprises that saw an "improved" or "much improved" demand in comparison with the pre-crisis level (more than two-fifths of the enterprises).[8] In this context, it is assumed that, during the crisis, at least some of the enterprises were already in a position to tell to which of the two groups they would quite likely belong. Otherwise, a lack of information meant that they would not have been able at that point in time to undertake any differing staffing policy measures.

Cyclical versus structural staffing policy measures

In a second step, the surveyed staffing policy measures were likewise divided into two groups. The first group consists of the measures designated here as "structural", which are

Adjustment measures of enterprises during the Great Recession in 2008-09

Percentage of firms in each subgroup



Source: Ifo Institute survey on behalf of the Bundesbank. For staffing adjustment, sum of the "relevant" and "very relevant" responses. For wage adjustment, sum of the "decrease" and "strong decrease" responses. Multiple answers possible. **1** Demand for the enterprise's products in the period from 2010 to 2013 *higher* than before the outbreak of the financial and economic crisis. **2** Demand for the enterprise's products in the period from 2010 to 2013 *lower* than before the outbreak of the financial and economic crisis.

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6 In contrast to the present analysis with firm data, a closer look has already been taken at industry level at the scale and duration of cyclical short-time working in the production sector (excluding construction). This sectoral analysis does not provide any indications of a delay in structural change owing to an inappropriate use of this labour market policy instrument. See Deutsche Bundesbank, Germany in the financial and economic crisis: Labour market, Monthly Report, October 2010, p 62.
7 Enterprises from other economic sectors were not included, because they were less affected by the slump in demand.
8 Enterprises which regarded demand for their products as unchanged were excluded (one-third).

Qualification and lay-offs in the production sector (excluding construction)

Percentage of enterprises in each subgroup; relevance of an individual lay-off; deviations from 100% due to rounding

Item	Not relevant / not applicable	Not very relevant	Relevant	Very relevant
Enterprises with temporary shock				
More highly qualified and skilled labour ≥ 50%	42	40	17	2
More highly qualified and skilled labour < 50%	31	38	20	11
Enterprises with persistent shock				
More highly qualified and skilled labour ≥ 50%	35	45	17	4
More highly qualified and skilled labour < 50%	37	41	18	4

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more likely to be expected in the case of a permanently impaired business model. Included in this group are collective lay-offs, individual lay-offs, early retirement measures and cuts in basic pay.[9] The second group comprises measures which are to be expected more in the event of a temporary slump in demand and which prevent qualified and skilled workers, who are needed for the expected ensuing upswing, from having to leave the enterprise ("cyclical measures"). This group covers short-time working (statutory or under the terms of collective pay agreements), shorter working hours including the reduction of balances on working time accounts, cuts in flexible wage components, allowing fixed-term contracts to expire, and the reduction of temporary employment.

Enterprises with a temporary demand shock tended to take cyclical staffing policy measures

Overall, it is apparent that enterprises experiencing only a temporary slump in demand were more likely to take cyclical staffing policy measures during the crisis. In fact, 60% of such firms stated that short-time working (statutory and under collective pay agreements) was a "relevant" or "very relevant" instrument. By contrast, the corresponding figure for enterprises undergoing a structural demand shock was only 46%. Besides this, in enterprises with a temporary slump in demand, shorter working hours and a falling share of flexible wage components, such as bonuses and holiday pay, also played a somewhat larger role. All three instruments allowed firms to reduce their costs of hoarding labour and thus adapt to the (temporarily) lower level of demand without losing know-how that is very difficult to get back later. Much the same applies to letting fixed-term contracts expire and the reduction of temporary work, assuming that the affected employees possess fewer qualifications and abilities which are important for the enterprises and difficult to reacquire at a later point in time. During the crisis, both instruments were used more frequently by enterprises encountering temporary difficulties than by enterprises facing a permanent shortfall in demand.

Enterprises with a persistent decline in demand placed more weight on staffing policy instruments with a lasting impact

By contrast, enterprises facing the prospect of a persistent slump in sales tended to make greater use of structural staffing instruments with a more lasting impact. This is shown by the collective lay-offs, although only a comparatively small number of firms contemplated

9 Wage adjustment measures (changes in basic remuneration and in flexible wage components) cannot easily be assigned with absolute certainty to either the cyclical or structural adjustment instrument category. Enterprises affected merely by a temporary drop in demand might also cut basic rates of pay in a downturn, for example. Unlike firms subjected to a persistent shock, however, they would be in a better position to raise rates of basic pay again in the following upturn.

such adjustment measures. In this instance, the percentage of enterprises ascribing a relevant or, indeed, very relevant role to this instrument was significantly higher than it was among enterprises with no more than a temporary shortfall in demand. Such a correlation is not evident with regard to cutting basic rates of pay and early retirement, however. Basic remuneration excluding bonuses was in fact reduced somewhat more often in enterprises with a temporary demand shock than it was by enterprises with a permanent slump in demand.[10] Early retirement was equally relevant for about 10% of enterprises in each group. This may be connected to the fact that early retirement is less at the discretion of the employers than other staffing policy instruments and that the individual decision of the employee has a greater weight.

Individual lay-offs at enterprises with a temporary slump in demand mainly if there was a low percentage of more highly skilled employees

With regard to individual lay-offs, too, there is hardly any difference at first glance between the two groups of enterprises. This view changes, however, if one looks additionally at the percentage of skilled labour and highly qualified employees in the respective enterprises. In the case of enterprises experiencing a permanent weakness in demand, individual lay-offs played a similarly large role for enterprises with an above-average percentage of skilled workers and more highly qualified employees as it did for firms with a smaller proportion of skilled employees. For enterprises with no more than a temporary slump in demand, individual lay-offs were concentrated on firms with below-average skilled staff. This may be taken as an indication that enterprises with a temporary fall in demand made greater efforts to retain well-trained and experienced staff.

Conclusion

Structural change still taking place despite labour market policy measures

Overall, the results of the survey suggest that, during the economic slump in late 2008 and early 2009, some of the enterprises in the production sector (excluding construction) were already accurately estimating whether the decline in demand for their products would be more temporary or permanent in nature and that they geared their specific adjustment measures to this. Enterprises that soon exceeded pre-crisis levels in the years after the Great Recession were already taking greater care during the crisis to retain skilled and qualified staff than firms faced with a permanently lower demand. Such differentiated behaviour on the part of enterprises indicates that, in the specific situation of the Great Recession, necessary structural change in some industries was still taking place to a certain extent despite the labour market policies of the Federal government.

10 Nevertheless, enterprises with a temporary demand shock increased both basic rates of pay and flexible wage components significantly more strongly after the recession than enterprises suffering a permanent decrease in demand.