



The effects of pay reforms and procurement strategies on wage and employment inequalities in the public sector: the case of Germany

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EXECUTIVE SUMMARY

The German public sector is relatively small compared to other OECD countries and the share of the state in GDP has been reduced. Because of the strong economic and employment performance in the last few years there have been no special adjustment programs for the German public sector in the crisis. Substantial adjustments, such as reductions in employee numbers, pay freezes or cuts and reductions in pension entitlements, have instead been taking place gradually over the past 20 years, with important cumulative effects. This report addresses the current outlook for public sector pay and procurement in Germany by presenting a broad overview of trends, as well as original empirical evidence from the local government sector consisting of case studies of three municipalities. The report addresses the following key questions.

- Can the German public sector sustain a tradition of strong internal labour markets with jobs for life?
- What are the trends in public sector pay compared to the private sector?
- What are the consequences of the radical reforms in 2005 of the system of collective bargaining on pay and other conditions of municipal employees?
- Is there variation in the organisation of in-house or private provision of municipal services?

Steady decline in the size of the state

Most of the reductions in public sector employment occurred between 1991 and 2000 and tended to be experienced by non-civil servant employees rather than civil servants (*Beamte*). Their number decreased from 3.9 million in 1991 to 2.7 million in 2010 while there was only a slight reduction of the number of civil servants in the same period. As a result, the proportion of civil servants in total public sector employment increased substantially in recent years. The overwhelming part of staff reduction in the public sector is the result of outsourcing and privatization.

And changing composition

The German public sector is still an example of a strong internal labour market with life-long-employment. Today, however, there are an increasing number of peripheral employees with temporary contracts. The average skill level in the public sector is higher than in private

industry because many highly and middle skilled activities like education, jurisdiction or tax offices are concentrated in the public sector.

In the last decade the number of women employed in the public sector remained nearly constant while men's employment diminished by approximately 9%. Consequently the share of women increased and, at 54%, is around eight percentage points higher than in total employment. Moreover, the share of highly skilled women in the public sector is 43%, fourteen percentage points higher than in private industry.

Patterns of pay and the reform of collective bargaining

Wages in the public sector at the lower end of the wage scale are above those in the private sector and they are more compressed. In the last decade collectively agreed wages in the public sector have fallen behind the wage increases in most private industries.

Industry wide bargaining is still common in the German public sector. However, the interests of both sides became progressively more heterogeneous during the 1990s and early 2000s, which in turn led to a decentralization and fragmentation of collective bargaining. The 'turning point' in public sector collective bargaining was the negotiation of new framework agreements, which began in 2003. The former highly standardized national agreements which covered the whole public sector were replaced by a multitude of collective agreements in 2005/2006. These new agreements reflect a completely new model for the public sector and include the following key features:

- a greater emphasis on performance rather than automatic seniority-related pay;
- the creation of a low-wage pay grade;
- dual level collective agreements - one for the Länder (TdL, 2006) and one for the municipalities and the federal state (TVöD, 2005);
- supplementary agreements for different occupational groups or sub-sectors, such as hospitals, care, and local transport; and
- a separate directive for the civil servants.

Evidence from local government

The report presents original empirical data from case studies of three municipalities and interrogates the recent changes in pay, working conditions and procurement strategies in the current context of considerable budget constraints. Staff cuts have been substantial at local level, as they have at national and regional level, and have affected non-civil servants in particular. By outsourcing and awarding contracts to external providers, the core area of municipal administration has been continually squeezed. However, to date these measures have not led to an effective reduction in structural municipal debt.

The analysis focuses on two main issues: 1) what are the effects of the 2005 collective agreement (TVöD) on the pay levels and pay practices in municipalities?; and 2) is there evidence of different patterns among municipalities in how they organise public services? In particular, do they tend to keep as many services as possible in public control or is there a creeping erosion of public services as contracts are awarded to private providers and services are spun off as independent private-law entities?

➤ **What effects of the new collective agreement on procurement?**

In terms of the impacts of the new collective agreement since 2005, it is notable that there are limited possibilities at municipal level to improve employees' working conditions and pay using the collective agreement instruments. By introducing a new base rate of pay at a lower level, the employers and trade unions intended to prevent as far as possible the outsourcing or privatisation of simple services. This can be interpreted as a reaction to the pressure on public sector employment caused by privatisation and outsourcing. To date, the effectiveness of this measure has been fairly limited. Although some municipalities have brought (parts of) outsourced services back under public control and safeguarded public sector jobs, external contracts continue to dominate.

➤ **New practices of merit pay?**

Performance-related pay, which was included in the new collective agreement primarily at the request of the employers, has been introduced very cautiously. We found that it did not really produce the desired increase in motivation and performance among employees because of the limited financial resources available for performance-related bonuses.

Judging by our case studies, it is likely that even where municipalities have signed an agreement on performance-related pay and have involved the employee council in defining suitable criteria, the practices followed for awarding the bonus payments for a large number of employees are often unclear. According to the expert interviews the risk of unmerited bonuses being paid 'routinely' exists. In many cases, the budget available for performance-related bonuses is distributed evenly, which means it does not make a noticeable difference to individuals.

➤ **Convergence or divergence in procurement policy and practice?**

As regards municipalities' procurement and outsourcing policy, based on our findings there is no evidence of a systematic and coordinated procurement policy. Even though fiscal policy considerations always play an important role, the factors which determine make-or-buy decisions in the municipalities vary widely, even across various departments within the same municipality.

What is missing is a systematic comparison that evaluates whether a particular service is really less expensive and above all better if it is contracted out to private providers. According to the managers interviewed there is no one best way. The pressure to make savings varied depending on the level of debt, the scope and cost of mandatory services and the economic strength of the municipalities.

➤ **A trend towards insourcing (re-municipalisation)?**

For a long time, the 'private before public' approach dominated as a way of achieving quick, short-term savings in the provision of municipal services. However, this approach is gradually being replaced by the view that municipal structures that resemble corporate groups are slowly depriving themselves of their political control. Moreover the recent financial crises have also undermined trust in the reliability of

markets and the efficiency of private providers. Accordingly, there are signs of cautious moves towards the insourcing of services that had been previously outsourced.

However, against the background of the difficult budget situation in many municipalities, the decision to bring service areas back under municipal control is closely linked to a requirement for further efficiency gains, which translates as increased workloads for employees. The situation is aggravated by the fact that the number of newly recruited staff in recent years has been low, generating a top-heavy age composition. As a result of the increased workloads and the higher average age, levels of sick leave (especially psychosomatic illnesses) have increased in recent years.

Lessons for research, policy and practice

The growing indebtedness of the German public sector (especially at local level) over the last years and further cost cutting in order to produce balanced budgets (debt brake) conflict with the issues of service quality and improving working conditions. Our research evidence indicates that several points have to be considered in that regard:

1. An ageing labour force and minimal replacement of employees in the last years has led to work intensification and growing sickness rates. Therefore middle and long-term oriented human resource management and social dialogue concerning the quality of working conditions in the public sector seem to be necessary in order to improve the relative attractiveness of public service employment especially for higher skilled employees.
2. The rationality and the impacts of make- or buy decisions need to be explored more carefully and systematically. It has to be taken into account that municipalities may lose their capacity to influence and control delegated public services (quality-criteria) and a lack in competence may follow. The recent efforts to deprivatise certain services are particularly interesting in that regard. The same applies to an earlier involvement of staff councils according to the reformed LPVG NRW (law concerning rights of staff councils) and the impacts and effectiveness of the new attempts to establish minimum pay standards (via prevailing wage laws) in public procurement which should be monitored carefully.
3. The precarious financial situation of many municipalities raises the question whether the federal state level can commit the municipalities to provide more and more services without additional central funding (principle of connectivity). Indebted municipalities will never be able to balance their budgets unless the state pays a greater proportion towards their structural deficit. Possibly, increased and reformed taxation maybe necessary to achieve this.