

Implementing the new basic allowance for job seekers in Germany

Discussion Paper

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Introduction

The German labour market policy reforms that took effect in 2005 (in want of a concise and comprehensive terminology often technically referred to as 'Hartz IV') are not entirely straightforward and logical. As a result of compromise between the divergent majorities in the two legislative chambers at the time of law-making, they are being implemented in ways quite different from original intentions. This compromise is to temporarily balance irreconcilable principles stemming from different social policy traditions. In such a situation, it appears that only a critical analysis can yield a comprehensible explication. So it is not only because of the presumed independence of the host country expert but also because of instructive concerns if the following discussion paper is taking a critical perspective. By doing so, it is by no means intended to pre-empt scientific evaluations of the outcomes that have just come under way (cf. ISG 2006) or to take a negative stand against the fundamental intentions of the reform.

A. Description of the main elements of the reform

A.1 Background

Ever since the short-lived post-war era of full employment ended, which was around 1975, (West) German unemployment has grown more strongly during each downturn of the business cycle than it decreased during subsequent upturns. It is not so much the risk of *becoming* unemployed that would have increased considerably, but rather the probability of *remaining* in unemployment for a long time – in many cases, until retirement (Knuth / Kalina 2002) – that has massively grown (Erlinghagen / Knuth 2004). Between 1990 and 1993, German unification led to the destruction of roughly 40% of the jobs that existed in East Germany before, thus aggravating the unemployment problem of Germany as a whole. As compared to the 1980s, exits out of unemployment into re-employment declined since the 1990s, and they became increasingly insensitive to the business cycle (cf. Figure 2 in the annex). The share of unemployed persons in new hires decreased. In 2000, those 20% of individual unemployment spells that had lasted one year and longer accounted for about 65% of the total days spent in unemployment (Karr 2002 – see Figure 3 in the annex).

The 'New Economy' boom brought the German unemployment rate from 12.7% (1997) only down to 10.3% (2001), according to the national administrative count.¹ Whereas Germany's position with regard to employment and unemployment rates remained close to EU-15 average (see Figure 4 in the annex), the European 'open method of co-ordination' raised awareness in

¹ Internationally comparable figures are 9.1% (1997) and 7.4% (2001). (European Commission 2005)

Germany that some other countries (e.g. the UK, Denmark, Sweden, the Netherlands) experienced considerable improvements while Germany was standing still. Around the turn of the century, the feeling had widely spread that something was going fundamentally wrong about the way the system of wage replacements for the unemployed, the Public Employment Service (PES), and the active labour market policies it delivered were supposed to connect the unemployed to the labour market.

Against this background, in the beginning of 2002 criticism by the Federal Audit Bureau of misleading and ‘massaged’ PES placement statistics rapidly developed into a political scandal. The PES, with some 90,000 employees, was condemned for being the country’s single largest public authority and yet unable to deliver effective placement services because too few of its staff were actually working on the customer frontline, resulting in frontline caseloads of between 600 and 800. In the run-up to federal elections due in the autumn of that year, the ‘placement scandal’ called for immediate political action. The government (then still the first of two successive Social Democratic / Green Party coalitions) appointed a commission of renowned individuals from business, consultancies, trade unions, politics, and academia headed by then Human Resource Director of *Volkswagen*, Peter Hartz. The commission’s official assignment was to draw up a master plan for reforming the PES according to the principles of New Public Management in order to enable it to deliver ‘Modern Services on the Labour Market’ – the title of both the Commission and its report (Hartz Commission 2002). The Commission, however, broadened its ambitions towards actually making suggestions for reducing unemployment by two million within three years. After the commission had presented its proposals and after the incumbent coalition had been re-elected on the promise of following them, the major part of the commission’s scheme was implemented in four consecutive legislative steps which took effect between January 2003 and January 2005.

From an analytical perspective, these reforms can be categorised into five elements:

- 1) Modernising the governance, controlling and customer management of the Federal Agency for Work (*Bundesagentur für Arbeit*), a body of public law under tripartite governance² and traditionally responsible for administering unemployment benefits, counselling and job placement services, and implementing active labour market policies³;
- 2) Introducing some new instruments of active labour market policy, and fine-tuning others;
- 3) Once again, after many times before, overhauling the tax and social security contribution privileges for ‘small jobs’⁴;

² The board is made up of representatives of employers and trade unions plus representatives from the Federal Government, the *Bundesrat* (the second parliamentary chamber which represents the Länder) and of the association of municipalities.

³ It should be noted that the trilogy recommended by the OECD (2001) – placement and counselling, payment of unemployment benefits, and management of labour market programmes – have been in one hand in Germany since the beginnings of a national PES in 1927. ‘Active’ measures, by contrast, have always been mostly delivered by third parties, most of them non-profit organisations or public bodies. The arrival of private for-profit providers and of competitive tendering is a relatively recent development.

⁴ ‘Mini-jobs’ or ‘marginal part-time jobs’ exempt from social security contributions and with low flat-rate taxation originally were a reaction to labour shortages in the 1960s. The idea was to attract additional female labour without interfering with the male breadwinner model that had just been consolidated through the social security and tax reforms of 1956/57. Until today, ‘mini-jobs’ aren’t stepping stones out of unemployment (Fertig / Kluwe 2005; BMAS 2006). It was only through the Hartz Commission that they were mistakenly drawn into the context of active labour market policy.

Reforms of the benefit system for workless people:

- a) Cuts of the maximum periods of eligibility for contribution-based unemployment benefits for older workers with long contribution records from 32 to 18 months, thus bringing them closer to the general standard of 12 months⁵;
- b) Reshaping of the benefit system for those workless people who have exhausted their contribution-based benefit claims, or have failed to earn such, by merging two previous benefits administered by the municipalities and the PES, respectively, into one;

Through this merging of benefits attempting to create 'unified single gateways' called 'Job-Centers' for all unemployed and jobseeking persons, *however failing to achieve this goal for reasons which will be explained in this discussion paper.*

According to the focus of this Peer Review, the remainder of this paper will concentrate on topics 0 b) and 0.

A.2 Goals and target groups

Germany had already attempted to catch up with the European paradigm shift from merely 'active' to 'activating' labour market policies and towards 'contractualism' in its twofold meaning⁶ through a reform developed and debated in 2001 and taking effect as of January, 2002. Through a bill called *JobAQTIV*⁷, concepts like employability, profiling, individual action plans and customers' discretion were introduced, the latter through the issuing of vouchers for private job broking services and for training courses. This reform did not get a chance to take root but was virtually 'run over' by the placement statistics scandal. The Hartz Commission could and did build on the spirit and ideas of the 'activation' discourse but might not fall short of producing suggestions impressively going beyond.

The fundamental idea underlying the Hartz Commission's report was to reduce the level of unemployment by shortening individual unemployment spells through activation and through more effective and more rapid job placement. The report's focus was on using labour market 'churning' to the better of the unemployed, thus attempting to '*attract more people in employment*' (European Employment Guidelines). Triggered by a 'placement scandal', the improvement of placement services was at the forefront, although the exact significance of job broking in an information society with electronic self-service facilities was not discussed. Of the three outstanding features of the long-term unemployed – age, impaired health, and migrant backgrounds –, the first was only addressed in terms of financial incentives, the second by mentioning 'health counselling' as an example of services to be delivered in jobcentres, and the third did not figure at all in the commission's report.⁸ By contrast, and for good reason, high

⁵ This was not part of the Hartz Commission's proposals but added in March, 2003 as part of what the government called 'Agenda 2010'.

⁶ Contractualism in the two meanings of 'contracting out' (using private placement services) and 'basing the relationship with customers on a quasi-contract' (individual action plans).

⁷ Activation, Qualification, Training, Information, Placement (*Vermitteln*).

⁸ The unemployment rate of non-nationals in Germany is twice the overall rate. While the foreign population is small in the Eastern part of Germany, they account for almost one quarter of the West German customers in the new regime for the non-insured. In a wider definition of migrant background irrespective of legal citizenship, this proportion is above one third.

priority was given to the activation of young people who should not get accustomed to living on benefits.

In the government's assignment to the Commission, benefit reform and the creation of a one-stop centre by merging the services of the PES and of municipalities had not figured as an immediate goal but only as a further consideration for the medium term (Hartz et al. 2002: 16). The Commission, however, put this issue at the centre of its considerations. The integration of services was not only seen as a necessity for overcoming institutional fragmentation and overlap, but also for innovation through synergies between the more immediately labour-market oriented competencies of the PES and the more 'holistic' approaches of municipal social services (see Figure 5 in the annex for a representation of the Hartz Commission's Concept). In terms of the European Employment Guidelines, this would fit the priority area of '*modernising social protection systems*'. Individual assessment or 'profiling', case management through continual contact with supposedly the same personal adviser, and specified 'back-to-work-agreements' (*Eingliederungsvereinbarungen*) were the key elements of what the commission envisaged as 'modern services on the labour market'. Taking on board the tradition of social assistance implied a much more complex definition of the problem of 'worklessness' (or of poverty despite work) than was previously prevalent in the PES, and the ensuing more comprehensive activation strategies would have to address not only the individual but also the whole family or 'community of needs' (see p. 8 for explanation of this concept). Whereas the more holistic framing of the problem is certainly an achievement, it remains still an open question whether the services actually delivered can match the complexity implied (see more on this issue on p. 24).

It should be noted at this point already that a crucial element of the Commission's proposals was not implemented as intended. In mid-2006, the semantic hallmark of the Hartz concept, the '*Job-Center*', was removed from the legal text, only 18 months after being introduced. The official justification for this step in the draft bill (Fraktionen 2006) translates like this:

"The obligation of the local agencies for work to establish 'Job-Centers' as single gateways for all has not worked well in practice. Because of the restructuring of the agencies for work, as well as because of the heterogeneous structure of the consortia and the licensed municipalities have prevented the implementation of a universal organisational model. Therefore, this clause shall be removed."

It will have to be explained further down (see p. 11ff.) what these 'consortia' and 'licensed municipalities' are, and why a reform aimed at creating 'single gateways' actually deepened and broadened institutional fragmentation (see p. 23 for examples). At his point, however, it should be noted that the removal of the 'Job-Centers' from the legal text was no more than an adaptation of the law to reality. The authors of the draft law had proposed 'Job-Centers' on the assumption that services and benefits for the insured and for the non-insured would be administered within one organisation which, through those 'Job-Centers', would maintain one face to the customer. By contrast, the result of legislative conflict and compromise was the creation of two separate organisations the second of which comes in different variants and is ridden with internal organisational tension. Therefore, the original concept had to be given up for the time being.

A.3 Legal and financial provisions

The previous benefit system

Until the end of 2004, Germany had three benefits relevant to workless claimants:

- 1) Contribution-based unemployment benefit (*Arbeitslosengeld*), defined as a percentage of former net income (60% or 67% for unemployed persons without or with dependent children respectively), without means-testing but of limited duration of normally 12 months⁹;

Subsequent to the exhaustion of the eligibility period for (1), there was tax-funded unemployment assistance (*Arbeitslosenhilfe*) at a lower percentage of former net income (53% and 57% respectively), open-ended but means-tested;

The third tier was tax-funded social assistance (*Sozialhilfe*), flat rate, open-ended, means-tested, and open to all persons unable to support themselves – i.e., not restricted to people regarded or registered as unemployed.

Benefits (1) and (2) were dependent on availability for work and, since 1998, on actively seeking work, and they were both administered by the PES within a uniform 'regime' of acceptability for job offers, of sanctions, and of instruments of active labour market policy. Benefit (3), by contrast, emerging from an older tradition of parish and local relief, was administered and financed by the municipalities (counties and the larger cities which are independent of counties). Increasing difficulties of labour market entry as well as increasing precarisation and volatility of working lives had led, in tier (3), to growing caseloads of people of working age and able to work – which was not the kind of personal situations for which the modernised system of social assistance had been designed in 1962. Where benefits of type (1) and – more often – type (2) were below subsistence level because previous earnings from which they were calculated had been low, those concerned might have to supplement their payments by claiming additional social assistance, especially if they had families in which they were the only breadwinner. Therefore, these customers had to visit two offices, neither of which would take full responsibility for their integration into employment.¹⁰

The mainstream discourse contended that unemployment assistance and social assistance, since they both were tax-funded and means-tested benefits paid predominantly to people out of work, constituted an anachronistic duplication (cf. Berthold et al. 2000), and international assessments tended to follow this view (cf. Adema et al. 2003). It was generally overlooked that these two benefits belonged to two different social policy regimes and that the very meaning of 'means-

⁹ During the 1980s, longer durations of up to 32 months for older people with long contribution records were introduced as means of pre-retirement. This has now been reduced to a maximum of 18 months, and with a higher age threshold for getting anything beyond 12 months.

¹⁰ According to the figures cited in the Hartz Commission's report, this problem of institutional overlap applied to only 7% (270,000) of the persons then registered as unemployed. However, it figured as the central justification in the Hartz Commission's report (Hartz et al. 2002: 126) and the subsequent legislation (Bundesregierung 2003: 96ff.) for integrating the benefit system. When the reform took effect, the number of persons who had actually received both benefits was established as 210,000 (Kaltenborn / Schiwarov 2006), because the necessity to supplement low contribution-based unemployment benefit by filing a separate application remained unchanged.

testing' was quite different in the one as compared to the other. This difference of 'regime'¹¹ will be emphasised here because the independent expert's explanation of why the intended institutional streamlining failed hinges on this concept.

Unemployment assistance as an extension of the 'Bismarckian' unemployment insurance regime

Though funded from taxes, the gateway into *unemployment assistance* was the previously possessed but now exhausted eligibility for contribution-based unemployment benefits.¹² Calculated as a percentage of former earnings, unemployment assistance was a *wage replacement, not a poverty relief*. As a wage replacement, it was paid at the end of the month, just like wages are paid after the work has been done. It may be understood as the tax-funded extension of an unemployment insurance scheme following Bismarckian principles of universal contributions and linear relationships between earnings¹³, contributions and benefits. Where other countries tend to mix wage-related contributions and tax revenue in the funding of their unemployment benefit schemes, which is most prominent in the so called 'Ghent system' of unemployment insurance existing in Belgium and in Scandinavian countries, Germany kept the two sources apart and allocated them to different stages of people's unemployment careers. From the point of view of the individual contribution payer this made little difference: By paying unemployment insurance contributions, they bought themselves into a scheme that guaranteed relative, albeit after 12 months decreasing, status maintenance – which was perhaps unique by international standards¹⁴ in that it was open-ended.

Sanctions, e.g. for not accepting a suitable job offer, would be of the same logic as in unemployment benefit: The benefit would be completely suspended for a certain period under the assumption that the claimant was not really unemployed because he or she was not searching or not available for a job. As during receipt of unemployment benefits, claimants of unemployment assistance would have contributions paid for them to health and care insurance as well as to pension funds, payments to the latter corresponding to a level of 80% of what they and their employer used to pay when they were still working, thus earning the respective pension increases while unemployed. Rent subsidies (*Wohngeld*) were available under the same rules and conditions as for any other lower income family, but in a separate administrative process in which the PES was not involved.

When establishing claims for unemployment assistance, means testing only served as a *limitation* to eligibility. A person would be individually entitled to unemployment assistance by virtue of being unemployed and having paid contributions, but then payments might be reduced (even to zero) because of family circumstances that precluded neediness. However, where own means were too small to be taken into account, the full amount paid was not gauged to the needs of the

¹¹ A 'social policy regime' is defined here by distinct rules and mechanisms of funding and of granting benefits, by definitions of social situations and groups that would qualify for the benefit, by institutionalisation in a bureaucracy of its own with its own staff and career patterns, and by a set of rights and obligations governing the relationship between (potential) benefit recipients and the bureaucracy (Knuth 2006).

¹² There once was a 'direct' gateway into unemployment assistance for new entrants and re-entrants into the labour market. 'Direct' unemployment assistance was calibrated with regard to a hypothetical income depending on a person's skills level. Introduced in times of labour shortage and intended as a job-seeking allowance for new entrants or re-entrants into the labour market, justification for this kind of benefit became questionable when drawn over long periods. Between 1976 and 1999, this was abolished step by step, thus contributing to the growth in the numbers of social assistance claimants.

¹³ Actually, there is a cap on the earnings base used to calculate both the contribution and the wage replacement.

¹⁴ Among the countries participating in the Peer Review, the same is to be found only in Austria.

family but to the former earned income of the individual. Likewise, the obligation to actively seek work and to overcome unemployment was only on the individual claimant, not on other family members with whom he or she might be sharing the benefit. In a family living according to the *male breadwinner model*, which is still stronger in Germany than in most European countries (cf. Pfau-Effinger 2004), depending on unemployment assistance would reduce income levels but not necessarily interfere with established family and gender roles.

Social assistance as a regime of poverty relief

In the regime of social assistance, by contrast, the absence of sufficient means within a household was the fundamental *justification* of eligibility, which was established irrespectively of employment history or contribution record. Flat-rate payments consisted of components for each household member without regard to earlier income or living standards. Sanctions would consist of lowering the benefit or giving food vouchers, but considered to be the last resort of subsistence, the benefit would not be withheld completely. As a system of relief, social assistance would be paid in advance, in contrast to wage replacements which were paid in arrears. Full costs of 'adequate' housing plus heating costs would come on top of the benefit, excluding, of course, the household claiming social assistance from the kind rent subsidies other low-income individuals and families would be entitled to. The aim of social assistance was poverty relief, not status maintenance. No social security contributions would be paid for the claimants; necessary health care would be directly covered as needed. Administered by the municipalities, social assistance was not part of the labour market regime, and so the grounds for claiming were not unemployment but neediness. Low earners, especially with families, could claim supplementary benefits even though not unemployed. It seems that the endorsement of a 'merger' between this regime and unemployment assistance was motivated by expectations that its holistic, familialistic and 'life-world' oriented approach would have the potential to solve employability problems of the long-term unemployed which the Federal Agency for Work was unable to address, focussing solely, as it did, on the individual and his relation with the labour market (see p. 24 for conceptual contradictions between a 'work first' and a holistic approach).

Another supposedly attractive feature of the social assistance regime was that all adult family members were obliged to utilise any working ability and opportunity they might have in order to secure subsistence for themselves and their dependents, or in order to at least reduce their neediness and thus the benefits paid to them. The legislation on social assistance also foresaw the possibility to establish a 'comprehensive plan' (*Gesamtplan*) for assisting a needy person or household. The comprehensive plan should be developed in consultation with all actors concerned, including the needy person, but it was not framed as a bilateral contract like today's back-to-work agreements (*Eingliederungsvereinbarungen*). Albeit 'dormant', i.e. not enforced vigorously and on large scales, there was always a 'workfare' element inherent in the regime of social assistance, where the acceptability of a job was not limited by considerations of labour market regulation (e.g. collective agreements, 'going rates') but only by personal ability and caring responsibilities.

Finally, in coincidence with the public contempt for the Federal Agency for Work as a 'mega-bureaucracy', the view was widespread that at least some municipalities were doing a better job than the Agencies for Work when it came to connecting their social assistance clients to the labour market. As a matter of necessity, the larger cities with high social assistance caseloads had gradually built up labour market services of their own, and in doing so they were much less constricted by legal regulations and entirely free from any centralistic controlling. In such an

environment, some innovative and skilful individuals in leading positions managed to earn reputations for 'their' cities as good performers in labour market services. Actually, exactly because of the absence of central controlling, there was not reliable database let alone rigorous evaluation. All that is known beyond a host of case studies are repeated surveys conducted by municipal associations among their members (cf. Fuchs 1994, 1999, Fuchs / Troost 2001). These surveys were more input than outcome oriented.

One of the municipal practices that were seen critically was the creation of fully subsidised fixed-term jobs for one year which would earn the participants a claim for contribution-based unemployment benefits and, subsequently, for unemployment assistance. Unless the candidate made mistakes later (like failing to properly register and re-register or provoking sanctions), the municipality would be rid of such a claimant forever, even if he or she would never find regular employment. This is what was referred to as 'switchyards' (*Verschiebebahnhöfe*) between the two regimes.¹⁵ In the opposite direction, there was also a 'switchyard' mechanism insofar as a recipient of unemployment benefit or assistance whose benefit was suspended as a sanction could claim social assistance as a last resort in case of neediness.

The new regime of basic income support for jobseekers

As of January 1, 2005, unemployment assistance as well as social assistance for those considered 'able to work' have been replaced by a new benefit called 'unemployment benefit II' (UB2). Unlike suggested by the wording, the regime in which the new benefit is embedded comes much closer to the principles of social assistance just explained than to those of unemployment benefit proper. The intention to 'borrow' so extensively from the social assistance regime had not been explicit in the report of the Hartz commission, presumably because those members who were affiliated to the trade unions would otherwise have withdrawn from the commission. It was Chancellor Schröder who, in his memorable television speech introducing his 'Agenda 2010' in March 2003, announced that the level of the new benefit would be 'closer to social assistance than to unemployment assistance'. The issue of 'regime', i.e. of the rules and principles attached to the benefit, was only very selectively debated with regard to the acceptability of jobs offered and to the judicial branch that should be responsible for disputes. Aside from those two points, the implications of 'borrowing' from social assistance were not publicly addressed and presumably not clear to many of the decision-makers involved.

In order to characterise the new regime of 'basic income support for jobseekers' (BIS), only the following points must be added to what has already been said about social assistance:

- The concept of 'family' or 'household' has been broadened through replacing it by the 'community of needs'. Wherever partners of different or the same sex are living together with children or have been living together for more than one year, they will be considered as a 'community of needs' where one has to care for the other. In assessing own means, the whole 'community of needs' will be taken into account. On the other hand, the principle of family subsidiarity was somewhat restricted so that parents are no longer responsible for children above 25 years and vice versa.

¹⁵ The 'switchyard' narrative was very prominent in the justification of the reform even though the actual number of such transfers was never assessed.

- Any ‘community of needs’ with *at least one member of working age and considered ‘able to work’* now comes under the responsibility of the regime of BIS. Individuals unable to work yet not qualifying for a disability pension or any other contribution-based benefit have remained in social assistance, unless they belong to a ‘community of needs’ with one member ‘able to work’.
- ‘*Ability to work*’ is defined as “being able to work for at least three hours per day under normal conditions of the general labour market” or “being expected to become able to do so in the foreseeable future”.¹⁶ Both the temporarily ill and those not available because of caring responsibilities (lone parents of young children) are considered ‘able to work’ though not required to seek jobs for the time being.
- UB2 is worth 345 € per month for a single adult or lone parent considered to be able to work; two partners in a community of needs will each receive 90% of that rate; other working-age members and children from the age of 14 on will receive 80%, while it is 60% for children under 14.¹⁷ Youngsters under 25 leaving their community of needs in order to become ‘single’ without permission from the authorities will stay at 80%. Cost for housing ‘adequate’ for a given community of needs as well as heating costs will come on top. Other housing-related costs like water supply, electricity and telecommunication have to be covered out of the basic allowance.
- The aforementioned benefit rates are somewhat higher than those of social assistance used to be, because the flat rates are now supposed to include many expenses that were previously covered by ‘supplementary grants’, e.g. for broken household appliances, extra clothing needs etc. The acceptable justifications for extra payments have been considerably reduced.¹⁸
- Accounting for other sources of income and for assets is somewhat more generous than it used to be for social assistance, but it is stricter than it was for unemployment assistance. There are indications that in practice deductions of other sources of income are being implemented more strictly than was the custom and practice under social assistance. Advocacy organisations advise claimants not to talk to their case managers about birthday presents or dinner invitations from friends or relatives.
- There are privileges for income earned through gainful employment. They work similar to earned income tax credit schemes as they exist in some other countries, but here they are a residue of the benefit. The proper design of incentives for taking up work, for staying in work and for reducing neediness through extending work is a matter of continuous debate and experiment, and the rules have already been changed once with effect of October 1, 2005. Currently, there is a complete disregard of the net income resulting from the first 100 Euros of gross earnings; between more than 100 and less than 800 Euros, the marginal withdrawal

¹⁶ These definitions are taken from the legal regulations for disability pensions: The medical criteria for qualifying for a disability pension have been transformed into criteria for defining the target group of labour market oriented activation.

¹⁷ The benefit for all members of the community of needs who are not of working age or not able to work is called „social allowance“ (*Sozialgeld*).

¹⁸ The old system of ‘supplementary grants’ was under criticism because it made claimants depending on the discretion of their case managers. The new system, however, is meeting criticism that the claimants are not really in a position to make savings from their benefits and that there is no provision for household ‘catastrophies’ that go beyond what even a thrifty individual can reasonably anticipate. In addition, it appears that children of school age are mostly at disadvantage from the new system because they used to profit the most from supplementary grants for school trips, equipment for outdoor activities during the school trips, extra tuition etc. There is reason to believe that the introduction of BIS contributes to Germany’s inability to properly educate children from low-income families.

rate is 80%, and between more than 800 Euros and 1,200 Euros (1,500 Euros with dependent child), the marginal withdrawal rate is 90% (see Figure 7 in the annex).

The abovementioned features are all very much within the regime logic of social assistance or poverty relief. So then what remains of the 'Bismarckian' unemployment insurance regime, except for the name 'unemployment benefit II'?

- As a reminiscence of the earlier principle of status maintenance, there is a temporary supplement for those who have received a contribution-based unemployment benefit before entering UB2, which is paid on top of UB2 for two years. For a single person, the supplement is a maximum of 160 € during the first and of 80 € per month during the second year. – This provision is contested as a possible disincentive against taking up work.
- Contributions to health, long-term care and pension insurance are being paid for recipients of UB2. As for health insurance, this does not really make a difference¹⁹ since doctors' bills were covered directly in the previous system of social assistance. With regard to contributions to the national pension scheme, the improvement for former recipients of social assistance is minimal since contributions paid for them are equivalent to those which would be due if they were earning 205 € per month, resulting in monthly contributions of 40 €. ²⁰ In comparison to unemployment assistance this is a harsh cutback, since contributions were then paid as if recipients were still earning 80% of their former income.
- Legal disputes concerning the basic income support for jobseekers will be handled by the social courts, as is the case for unemployment insurance, but unlike social assistance for which the administrative courts are responsible.
- Finally, most of the many instruments of active labour market policy legally designed for recipients of contribution-based unemployment benefit are now also legally available for recipients of UB2 (which is an improvement only for the former recipients of social assistance, as these instruments formerly applied to recipients of unemployment assistance anyway). However, in the tradition of social assistance, there is a general clause allowing all services and measures necessary for integrating claimants into working life, so that there does not really seem to be a need for any legal catalogue.

All in all, these changes from wage replacement to a regime of poverty relief were of a fundamental nature for those roughly 2 million persons receiving unemployment assistance at the end of 2004. They are also far-reaching for those about 26 million employed contributors to unemployment insurance who can now, in the case of becoming unemployed, expect a status-maintaining wage replacement for no more than 12 – or at most 18 – months. Without unemployment assistance as an extension to unemployment benefit, Germany's balance between contributions and benefits in cases of unemployment appears quite unfavourable by international comparison.²¹ An implicit goal here was to increase incentives for long-term unemployed to take up low wage jobs. This goal was neither spelled out in the Hartz

¹⁹ It does make a difference for the health insurance funds, which are loath of the new customers with high health risk and low contribution payments.

²⁰ Compared to the provision that was in effect during 2005 and 2006, this is a cutback of roughly 50%. A full year of unemployment with contributions of this magnitude will earn an additional monthly pension of 2,20 €. For comparison: A full year of employment at average income from which contributions are paid will earn an additional monthly pension of 26,13 €.

²¹ This was somewhat corrected by lowering the contribution rate from 6.5 to 4.2% as of January 1, 2007.

Commission's report nor in the government's justification for its draft legislation 'Hartz IV', but it was present in the political and academic discourse.

Pointing out the epochal significance of the reform does not mean to say that status maintenance, and more specifically for unlimited durations like in unemployment assistance, has in the past been supportive for the smooth functioning of the German labour market (Eichhorst et al. 2006). However, it was a typical German or 'Bismarckian' tradition that dates back to the introduction of unemployment insurance and a national PES in 1927. The breaking away from this tradition changed the feeling of social security, which explains why the reform was so poorly accepted (Eichhorst / Sesselmeier 2006) and why it had repercussions on the timing and the outcome of federal elections in 2005. Finally, the attempt of breaking away from path-dependence (Pierson 2000 and 2004), which was only partially successful, explains why we find institutional arrangements that were not intended by the architects of the reform.

The activation principle in the regime of basic income support

Activation has been deeply inscribed in the legal rules of the new regime. Claimants 'able to work' are obliged to make full use of all opportunities to end or reduce their neediness, employment being the prioritised way out. They are obliged to actively 'co-produce' in all measures taken with the objective of their integration into employment, namely conclude and abide by a back-to-work agreement. Claimants under 25 who are out of school should be sent to work or training immediately after the filing of their claim, so for them, in legal theory at least, a 'work first' principle applies in the strict sense.

The authorities administering the benefit are obliged to extend 'comprehensive support' with the perspective of integration into work. Each 'community of needs' (or each individual, where the claimant is single) shall have a personal adviser.

A.4 Institutional arrangements and procedures of implementation

Political compromise creates a large-scale experiment

The Hartz Commission as well as the government in its first draft legislation had envisaged that the Federal Agency for Work should administer the basic income support for jobseekers in parallel to its traditional task of administering unemployment insurance. The municipalities were compelled to assist the Agency with social and other concomitant services only until the end of 2006. As from 2007, the local Agencies for Work would be free to buy such services from the municipalities or from other non-profit or for-profit providers.

The outcome of two controversial rounds of legislation each involving the arbitration procedure between the two chambers, the *Bundestag* and the *Bundesrat*, is quite different:

- 1) In fiscal terms, the federal government is now responsible for income support, while the municipalities are responsible for housing and heating costs.²²

²² In order to let the municipalities receive the alleviation from previous costs that was promised to them, there is an additional lump sum paid by the federal government. Its assessment and distribution is an issue of continuous quarrel.

In institutional terms, the original responsibility for administering income support and labour market related services (like job placement, active measures) lies with the Agencies for Work, while the municipalities are responsible for administering housing costs and concomitant social services (e. g. psycho-social, drug abuse, and indebtedness counselling).

Agencies for Work and municipalities are expected to form 'consortia' (*Arbeitsgemeinschaften*) in order to pool their efforts and administer the aforementioned services together. The Federal Legislator compelled the local branches of the Federal Agency for Work to seek such co-operation; however, since legislation on the municipalities is a prerogative of the *Länder*, the municipalities cannot be obliged to enter a consortium. Out of 439 regional units, consortia have been formed in 351, their number being slightly higher because in some territories there is more than one.

For a period declared as 'experimental' and extending until 2010, 69 municipalities²³ have been licensed to administer the new benefit and activation regime alone. The experiment has to be scientifically evaluated with regard to which organisation is delivering more effective services, and after that there must be a new legislative decision on the institutional set-up.

For 19 territories for which neither license for full municipal responsibility was applied for or granted nor an agreement on the formation of a consortium was reached, responsibilities according to 0 are now fulfilled separately.

Since the regional compounds of the 178 district organisations of the Federal Agency for Work and the 439 German municipalities do not match and even occasionally overlap, this makes for complex regional structures. Berlin has created a consortium for each of its twelve districts, two counties have created two consortia each, while some other counties have united in forming border-crossing consortia, thus adding up to 455 organisational units administering the new benefit (IAW 2006a).

Though the local Agencies for Work are partners of the consortia, there is a clear tendency within the consortia to develop into organisations of their own which only use staff and facilities of the partners forming them. So, instead of the desired 'single gateway' or the uniform 'Job-Centre', Germany now has two separate regimes as before, but the second tier has become much larger. Public Employment Services in Germany now have two tiers, the second of which comes in three variants. In the 19 territories with 'separate fulfilment' not only two gateways exist, but the majority of workless people actually have to visit both of them in order to collect their means of subsistence. In the rest of the country, those whose unemployment benefits are below subsistence level for their families have to visit a second office in order to get supplementary income support.

The experimental competition between consortia and licensed municipalities is being scientifically evaluated. The evaluation is facing a fundamental analytical problem because the 'experiment' is not based on random selection but on self-selection of the municipalities that applied to be licensed. Labour market situations and developments differ systematically between regions with

²³ 69 is the number of delegates of the *Länder* in the *Bundesrat*, which reflects the relative weight of the *Länder* in the German population. Therefore, the number of 69 appeared to offer an *a priori* solution for the allotment of options to the *Länder*.

consortia and regions with licensed municipalities (IAW 2006a). On a simple descriptive level it can be shown that claimant counts relative to population of working age are lower in licensed municipalities from the beginning when compared with the same indicator of consortia in the same *Land*. In other words, the willingness of municipalities to apply for the option was higher where the problem was less acute than in neighbouring regions.

Why is this institutional outcome so different from the reformers' intentions?

On the level of politics, the answer seems simple: Party majorities in the *Bundestag* (the German Parliament) and the *Bundesrat* (the representation of the *Länder*) were different, as they often are. The Christian Democrats wanted to demonstrate their strength, and some Christian Democratic leaders like the Minister President of Hesse had a strong preference for municipal workfare-type policies. Hesse had introduced a bill that would have given the municipalities alone full responsibility for administering income support and 'services on the labour market' for unemployed persons without contribution-based benefit claims, and, incidentally, the 16 *Länder* would have gained far-reaching legislative powers regarding the details of discharging this responsibility. This shows how the reform, beyond mere party rivalry, became deeply enmeshed in the power struggle between the Federation and the *Länder*.

But then, why did 'Hartz IV' so fully become a matter of 'concurrent legislation', thus giving the *Bundesrat* veto power over key elements of the government's proposals? Without being able, not being a lawyer, to fully explore the constitutional legal implications, the host country expert wants to suggest that the crucial reason for falling into the traps of German federalism was the government's endeavour to 'merge' unemployment assistance with social assistance. Borrowing so largely from the principles of the regime of poverty relief infringed on municipal prerogatives and thus on the legislative powers of the *Länder*. In other words, if the government would have contented themselves with simply transforming unemployment assistance from a wage replacing to a flat-rate benefit (like, for example, the ASS in France) and extending its family component in such a way as to render supplementary social assistance unnecessary, it appears unconceivable how – and why! – the *Bundesrat* should have prevented that.²⁴ So it seems that it was the 2nd Schröder administration's preference for certain regime elements of poverty relief²⁵ as a template for labour market policies that made it miss its purported target of creating a single gateway for all jobseekers.

Finally, carrying the analysis onto the level of vested interests potentially affected by the draft legislation, it must be observed that the government's plans had thrust both municipalities and their professional staff employed in social assistance administration into deep uncertainty. For if the local Agency for Work, from 2007 on, would have decided not to buy social services from the municipality, then professional careers would have been at stake, and the municipality affected would have had a redundancy problem – under the legal framework of the German public service

²⁴ It should also be reminded here that there once was a 'direct' entry into unemployment assistance (see endnote no. 12). By re-opening this for those who were able and willing to comply with the Federal Employment Agency's job search regime, which at the time was being re-enforced through the other parts of the Hartz legislation, employable recipients of social assistance could have been transferred into Federal responsibility.

²⁵ Namely the principles that any job is acceptable even below the collective agreement or the 'going rate', the 'activation' of all family members of working age and able to work, and that any reduction of neediness through work is desirable even if it does not end unemployment – which would require employment of at least 15 hours per week.

without proper means to solve such a problem. In this way, the red-green coalition estranged its own followers in large city administrations.

Aspects of participation and governance

The Federal Agency for Work, representing the 'old' Public Employment Service, is traditionally controlled by tripartite boards at central and local levels. The principal rationale of the participation of social partners in the governance of the PES is that they represent the contribution payers of unemployment insurance. As long as unemployment assistance existed as a follow-on benefit administered in a uniform process and according to the same rules as unemployment benefit, the responsibility of the social partners unquestionably extended to the services rendered to claimants of assistance. However, establishing BIS as a separate and fully tax-funded²⁶ regime removed it from the statutory participation of the social partners. Nevertheless, most consortia and licensed municipalities have established advisory boards with social partners, local non-profit organisations, and NGO's on a voluntary basis. For the social partners on the ground, this has multiplied their tasks of representation: Not only are there now two tiers of PES to be monitored, but in addition consortia and licensed municipalities cover much smaller territories than the local branches of the Federal Agency for Work. Consequently, one social partner representative may be responsible for participating in several of them. It may be hypothesised that this multiplication of representative bodies of a voluntary nature does not lead to a strengthening but to the dilution of social partner participation.

What are the effects on the implementation of policy?

Since consortia have been formed in 80% of the territorial units (which are responsible for even 85% of the 'communities of needs' to be served – IAW 2006b), the outcome of the reform in terms of activation and integration into employment will be largely shaped by this type of service organisation. However, the legal nature of a consortium is quite difficult to describe even in German (cf. Trümner 2005; Blanke / Trümner 2006), let alone in English, a language unburdened with certain subtleties of German public law. Having their own direction and governance structures and being able to issue legal acts, the consortia are legal entities of their own²⁷ (albeit of theoretically and juridically contested nature) and thus much more strongly integrated than, e.g., the French or Belgian *maisons d'emploi*, the Swedish co-operation centres or the Finnish LAFOS. On the other hand, just like in Denmark (except for the pilot jobcentres), employees seconded into the consortia are maintaining their employment relationship with their original organisation. This implies separate bodies of employee representation, different collective agreements, different job grading and pay, different working time patterns etc. Obviously, such a consortium is quite difficult to manage (Czommer / Knuth / Schweer 2005 and 2006; Wiechmann et al. 2005), which hinders their performance. They are torn between influences from local government, central bureaucracy and federal politics and policies (Ombudsrat 2006). – With regard to the licensed municipalities, the Federal Government lacks direct control of their performance since, following the general constitutional pattern, the supervision of municipalities is a prerogative of the *Länder*.

²⁶ Unemployment assistance was tax-funded, too, but with regard to administrative staff costs and active measure, no differentiation was made between the insured and the non-insured customers. See p. 20 for the fiscal consequences.

²⁷ Most of them were set up as consortia of public law, a new invention brought about by the parliamentary compromise. In some cases, the partners founded a limited company of private law.

A second observation concerns the lack of any roll-out period. Whereas the UK allowed six years for the introduction of 'Jobcentre Plus', an organisational reform without a benefit reform (cf. Knuth et al. 2006), the German legislator only allowed a 'juridical second' between December 31, 2004 and January 1, 2005 for the implementation of both a complex organisational and an epochal benefit reform. The Federal Audit Bureau, tending to take such legislative fiction as a norm against which to assess reality, severely criticised that 'back to work agreements' (*Eingliederungsvereinbarungen*) had been concluded with only 50% of the claimants who, again on average, had had to wait for three months for the first interview with their personal adviser (Bundesrechnungshof 2006). This criticism was based on a survey capturing, on average, the situation 7½ months after the introduction of the new regime. It should be borne in mind here that we are talking about roughly 4 million 'communities of needs' in each of which there is, by definition, at least one person with whom such an agreement should be made.

Another occasion to criticism is that the new service providers by far failed to spend all the funding available to them for active measures in the first year. Obviously, the criticism would have been even more vigorous and more justified if they had spent it all – without proper knowledge of the potentials and needs of their customers and without the administrative capacity needed to monitor the performance of contracted providers and the conduct of customers while participating in the measures. Even in 2006, the utilisation of funds for labour market integration was incomplete. Funding from the European Social Fund (ESF) is not yet being used in the BIS regime because the current ESF programming period was already in operation when the new regime was established. Since the Federal Agency for Work has downsized its active programmes for insured jobseekers in the course of closer targeting, we end up with the paradox that spending on active labour market policies as well as numbers of participants have considerably declined as an immediate result of a reform aiming at boosting active support for jobseekers.

A third observation concerns the administrative software used. Here, the problems are manifold:

- 2) In the course of its organisational overhaul, the Federal Agency for Work is replacing IT processes some of which date from 1975. This creates disturbances in important statistical time series, and some annual structural analyses have been abandoned. Consortia are affected by these changes because one of the partners in each consortium is the local Agency for Work.

New software had to be introduced to administer the new benefit. This software started with many bugs, and, because of poor specification at the time of tender, it lacks data that would have been needed for statistical monitoring and evaluation.

For reasons of property rights and data protection, municipalities licensed to be responsible for BIS on their own are not allowed to use this new software. Therefore, the 69 licensed municipalities continue to work with the 20 different software systems from eleven different software houses that they previously employed to administer social assistance. Some of this software is well suited for computer aided case management, but none of it is adequate to serve macro statistical needs. Consequently, data from the 69 licensed municipalities are still largely lacking in central databases.

This explains why data on the results of the reform is still insufficient, thus making the following chapters shorter than desirable. It also implies that the lack of administrative data can only insufficiently be compensated by survey data because the data base needed for drawing survey

samples is incomplete.

B. Results so far

B.1 Quantitative results

Shifting of responsibilities for customers

The introduction of the new system brought about a vast reallocation of customers plus, with regard to former recipients of unemployment assistance, a re-definition of the customer count: Where previously only the former contribution payer was considered the customer, now all individuals belonging to his or her 'community of needs' are counted. This is why Table 1 does not add up, even though, for simplification, it includes only persons of working age. For the full picture, about 1.6 million minors would have to be added.

Table 1: Re-allocation of working-age customers (millions)

| Responsible Type of benefit | Federal Agency for Work | | Providers of ... | Municipal Units for |
|--------------------------------|-------------------------|---------------|----------------------|---------------------|
| | UE Benefit | UE Assistance | Basic Income Support | Social Assistance |
| December 2004 | 1.8 | 2.05 | --- | 1.66 |
| January 2005 | 1.8 | --- | 4.5 | 0.07 |

Source: Kaltenborn / Schiwarov 2006; Federal Agency for Work (UE Benefit)

The shift of customers due to the benefit reform implies that the Federal Agency for Work as such, i.e. insofar as it is not tied into a consortium with a municipality, was rid of the majority of its customers just while it was being modernised in order to serve them better through Hartz reforms I to III (see p. 2). Municipalities were alleviated of 95% of their former recipients of social assistance, which was more than expected. Anecdotic evidence suggests that the criterion of being 'able to work' was implemented generously, to the financial advantage of the municipalities.

Loss of benefit eligibility by former recipients of unemployment assistance

Even though Table 1 demonstrates a growth in numbers due to individualisation of the count, it must be noted that an estimated 150,000 former recipients of unemployment assistance did not qualify for the new benefit because of tighter criteria for means-testing. However, this number was much smaller than previously projected. One reason is that the projections had been based on the 2003 income survey, and Germans below the median income had simply become poorer since then. A second reason is that non-Germans are under-represented in this income survey. Thirdly, projections depend heavily on the assumptions made, and near the poverty threshold, in particular, there are hundreds of thousands of households in which a few Euros more or less of own means may determine whether they qualify for the benefit or not. A third reason could be administrative neglect: Where the means of more than 4 million families had to be checked within only a few weeks, often using auxiliary staff unfamiliar with the task, assessments could not be very strict. As time goes by and applications have to be renewed, this is being corrected, with noticeable effects on the claimant count.

Even where eligibility was not totally lost, the benefit may have been lower after the reform, either because of stricter criteria for means-testing or simply because the new benefit is a flat-rate allowance, not a wage replacement. Survey data that will allow assessing the financial impact of the reform on individuals have been sampled but are still awaiting analysis and publication. Simulation studies suggest that previous recipients of unemployment assistance lost income in 60% of the cases (Becker / Hauser 2006), but here again caution against projections and simulations is advisable.

Rise of the unemployment count

It came as a shock to the general public in spring, 2005, that the reform enacted on the promise to curb unemployment temporarily boosted the national unemployment count to an all-time peak of more than 5 million. In addition to cyclical and seasonal effects – labour demand in January and February is always lower, and the later improvement of the cyclical situation was then still unfelt – the increase can be explained by the ‘regime’ logic elaborated above (see pp. 5ff.). Until 2004, ‘inactive’ partners of the recipients of unemployment assistance did not have to be registered as unemployed because they were not claiming a benefit. As of 2005, in order to receive their part of the benefit now individualised for each member of the ‘community of needs’, they had to register if considered able to work and currently available. The same applied to all former recipients of social assistance, whose registration as jobseekers previously had not been thoroughly monitored by the municipal authorities. Consequently, although the reform had not changed anything on the labour market, the national unemployment rate was now higher than before, whereas the ILO rate actually fell (cf. Figure 1 in the annex).

Caseloads still too high

One of the promises of the reforms was to bring frontline caseloads, which used to be 600 to 800 in the old system, down to 75. This promise was later restricted to customers under 25, whereas otherwise caseloads were projected at 150 – ‘communities of needs’, not individuals. Considerable amounts of new hires brought staffing in the income support system up to an estimated 50,000 (Ombudsrat 2006). Nevertheless, most local organisations are still far away from the caseload target, one reason being that the numbers of eligible claimants continued to grow beyond expectations, the other being that more staff than expected was needed in benefit processing and general administration and therefore not available for frontline services.

While the legal promise is that each ‘community of needs’ should have a personal adviser, that each customer of working age and able to work should conclude a back-to-work agreement, and that all new claimants as well as all claimants under 25 should get an immediate offer for training or work, little is known on a representative statistical basis what is actually happening. Case study evidence (Wiechmann et al. 2005; Baethge-Kinsky et al. 2006; Czommer et al. 2006; Knuth et al. 2007) suggests that the everyday practice of the providers of BIS is still far from the legal promise, and this for justifiable reasons. Frontline caseloads seem to be still closer to 300 than to 150, and personal advisers are saying that it makes little difference whether they can do nothing for 600 or for 300 customers.

Integration into employment

Obviously, the most relevant question is whether the new system is succeeding in bringing more people back to work. Fortunately, the last two years (2005 and 2006) show not only a decrease of job separations leading into unemployment but also increasing movements out of unemployment into employment (see Figure 6 in the annex). However, without econometric evaluation we do not know whether this is purely the result of increasing labour market demand or whether the reformed system of labour market services has any share in this success.

The breakdown of flows out of unemployment between the two regimes of unemployment insurance and of BIS reveals very unequal patterns.

Table 2: Unemployment in the two regimes: Stocks, outflows into regular employment, and resulting exit rates (thousands)

| | unemployment insurance | | | basic income support | | |
|-------------|------------------------|--|--------------------|----------------------|----------------------------------|--------------------|
| | average annual stock | outflows into regular ²⁸ employment | re-employment rate | average annual stock | outflows into regular employment | re-employment rate |
| 2005 | 2091 | 2206 | 105% | 2770 | 563 | 20% |
| 2006 | 1664 | 2017 | 121% | 2823 | 800 | 28% |

Source: Bach et al. 2007, based on Federal Agency for Work Statistics; re-employment rates own calculations

While unemployment in the insurance regime has fallen in 2006 in comparison to 2005, it has slightly grown in the regime of income support. Increased demand on the labour market has resulted in a 14% decline of inflows from employment into 'insured' unemployment. At the same time, those who were in reciprocity of unemployment benefit in the beginning of 2006 exhausted their claims during the course of the year. If they were not eligible for means-tested income support, they might not care to register as unemployed any more and disappear into 'inactivity'. Those who were eligible made up for about 400,000 inflows into income support. Increased outflows from income support into employment, remarkable as they are, could not compensate the fundamental mechanism that makes those weak on the labour market 'sift through' the insurance regime and then pile up in the regime of income support. Surprisingly enough, even in the positive business climate of 2006, outflows from 'insured' unemployment into employment have *decreased*²⁹; it is only against declining stocks that the re-employment rate of the insurance regime has risen well above 100%. The drastic difference in re-employment rates between the two regimes underlines the different chances of the short-term and the long-term unemployed. Finally, it must be remembered that this comparison is only about those claimants of income support that are available for the labour market and thus registered as unemployed.

If the original philosophy of the Hartz reforms was to concentrate on shortening the very long durations of individual unemployment because this would have the highest effect on stocks (cf. Figure 3), it seems that this target has been largely missed until now. However, detailed analysis of spell durations, which is presently not available, would be needed for a conclusive judgement. One would need to compare re-employment rates of unemployed people with equal

²⁸ 'Regular' employment means employment not created as a means of active labour market policies. It includes 'atypical' or non-standard forms of employment.

²⁹ The same pattern could already be observed during the long upturn in the second half of the 1980s and into the early nineties (see Figure 2).

characteristics, above all equal previous durations of unemployment, under similar cyclical conditions in the old systems.

At any rate, it may be observed in this context that the institutional split between insurance and income support tends to pose perverse incentives. From a budgetary perspective of the Federal Agency for Work, acting on behalf of the unemployment insurance fund, 'activation' only pays if the resulting saving in unemployment benefits is higher than the expenditure for extra staff or active measures. This is only the case in the beginning of individual eligibility periods for unemployment benefits and only for short measures with immediate results. By contrast, the gains of measures that would result in re-employment only at the end of the period of insurance benefit eligibility would be entirely reaped by the income support regime which would be spared claimants they would otherwise have. The Federal Agency for Work has introduced a four-tier system of customer segmentation similar to the Dutch '*kansmeter*', and it does no longer invest in customers allocated to segment 4 (about 1/3 of customer entries). There is a penalty (*Aussteuerungsbeitrag*) that the Federal Agency for Work has to pay out of the unemployment insurance fund into the Federal Treasury for each passage from the insurance into the regime of BIS. It is intended as an incentive to bring people back to work before the passage occurs. However, it does not have this effect with regard to customers who would need a long-term investment (e.g. for training) that would not lead back into work before the penalised passage takes place. It may be concluded, then, that the institutional split between the two regimes tends to work against a 'preventive', 'pro-active' or 'investive' approach and that it has opened up a new huge 'switchyard'³⁰ through which problems and risks are let to 'sift through' into the system of BIS.

The statistics in Table 2 is incomplete for technical reasons, and therefore not exactly in line with the overall estimate presented in Figure 6 in the annex. Due to the software problems discussed before (see p. 15), such flow data are entirely lacking from the 69 licensed municipalities. Finally, even though the significance of job broking as an indicator may be questionable both with regard to the availability of information technologies and to the very idea of *activating* people (instead of 'placing' them), one would like to have some indicator of the role the providers of services on the labour market had in making unemployed people return to work. However, no such data are presently available³¹, and there is not even a consensus on which indicator might be used.

Benefits complementary to earned income

In the regime of basic income support, *neediness* rather than *unemployment* is the key category. Where there is neediness despite income from gainful employment, complementary benefits will be paid, granting certain incentives as explained before (see p. 9 and Figure 7 in the annex). It makes no difference whether the claimant takes up work out of benefit reciprocity, or whether the benefit is applied for out of low-paid work. Neither does it make a difference whether the reason for belonging to the 'working poor' is low hourly pay or small hours – unlike in the British system of tax credits, there is no minimum threshold of hours.³² It should also be noted that there is no

³⁰ It should be remembered that the closure of institutional 'switchyard' was one of the key justifications of the reform – see p. 8.

³¹ There are data for placements, but these make no difference between placement into the regular labour market and into jobs created as a labour market policy measure.

³² It should also be taken into account that receipt of a complementary benefit, even where small, will automatically provide health insurance for persons not paying health insurance from their earnings, reasons for exemption from compulsory contributions being either the mini-job privilege (see endnote 4) or self-employed status

legal minimum wage in Germany, and that the coverage of collective agreements is on the decline. About 21% of German employees are earning low hourly wages of less than 2/3 of the median wage, with medians calculated separately for East and West (Kalina / Weinkopf 2006).

It must be seen against this background that the number of claimants of complementary benefits has grown by 60% within 17 months (BA 2006), running at 1.1 million in May, 2006 (most recent figures), of which around 400,000 are working full time. In other words, almost 20% of those receiving basic income support 'for jobseekers' actually do have a job. However, around 500,000 (the vast majority of those not working full time) are working a so-called 'mini-job', which means earning less than 400 Euros per month. Mini-jobbers enjoy substantive contribution and tax privileges.³³ However, since eligibility for the supplementary benefit is calculated against net wages, the mini-job privilege is levelled out when combining a mini-job with BIS. Contrary to common wisdom, there is no lock-in effect for recipients of complementary benefits around gross earnings of 400 Euros. The preponderance of mini-jobs among the recipients of supplementary benefits can only be explained by the fact that the mini-job is an institution deeply ingrained in the German job culture. Since many of these jobs should imply work of less than 15 hours per week, the holders of jobs with such short hours should be included in the national unemployment count. However, there is no statistics to date cross-tabulating benefit reciprocity, earned income and unemployment status.

As the benefit is gradually supplemented and replaced by other sources of income, the subsistence allowance paid by the Federal Treasury is reduced first. Only after its full displacement by other sources of income, the coverage of housing and heating paid by the municipalities will be reduced. Theoretically, this might imply poor incentives for the licensed municipalities to promote customers' employment integration unless their neediness will be overcome completely. To date, there is no evidence that municipalities would actually act according to this lopsided incentive.

B.2 Other results and achievements

Unemployment insurance surplus

While the numbers of BIS recipients were growing, the unemployment insurance fund was experiencing an unprecedented surplus, allowing for the lowering of contributions (see endnote 21). One of several reasons³⁴ for this was that the costs for administration and active measures for the recipients of unemployment assistance used to be paid from contributions, whereas the new system of income support is entirely funded from taxes, administration and active measures included. So the introduction of the new regime of BIS can also be seen as a further step of 'fiscalisation' of the German system of social security.

³³ See endnote 4.

³⁴ Other reasons are the favourable economic situation, the shortening of eligibility periods for unemployment benefits for the elderly unemployed, and a downscaling of spending for 'active' measures.

Gender mainstreaming

The effect of the new regime on gender relations is ambiguous because it is both *familialistic* with regard to obligations of mutual support within the 'community of needs', and *individualistic* with regard to integration into the labour market. On the one hand, women living with a partner and losing their job will now more often than before experience that after exhaustion of their unemployment benefit period they will not qualify for the new benefit when their partner's income or assets are taken into account. In other words, the principle of *subsidiarity* within the 'community of needs' will emphasize female dependency as long as job opportunities are unequal. On the other hand, the traditionally inactive housewife, depending first on her partner's earned income and later on his benefits, is now, in the new regime, instated as a subject of her own, with her own part of the family benefit and as a target of labour market activation. Of course this threatens traditional male breadwinner arrangements – the Turkish housewife without vocational qualification unable to speak German is now supposed to accept a cleaning job in order to support herself and her unemployed husband, and neither of them may like this idea at all. Finally, the position of lone parents has been improved with a financial supplement and with the integration of responsibilities for childcare provision and for job counselling within the same organisation.

Empirical data on how women and men were affected by the reform, how they are affected when they exhaust their contribution-based claims, or how they are being activated and included in active measures are still largely lacking.

Lisbon Strategy and European Employment Guidelines

As a consequence of the Lisbon strategy, the priority of “*increasing investment in human capital through better education and skills*” has been included in the European Employment Guidelines. Traditionally, vocational training was at the forefront of German active labour market policies. However, reacting to a host of econometric evidence that these costly measures had no positive effect on labour market integration (cf. Staat 1997; Kraus et al. 1999; Lechner 1999; Hujer / Wellner 2000), vocational training as an instrument of active labour market policy is on the retreat. This is even truer for measures of longer duration that could be considered to produce human capital investments in contrast to mere employability training, and it is especially true for customers receiving UB2. More recent econometric evaluations now suggesting positive effects of vocational training (Lechner et al. 2005; Fitzenberger et al 2006; IZA / DIW / ifas 2006) are still awaiting political consequences.³⁵

Retirement policies

Germany is among the countries that, since the 1980s, have relied strongly on early retirement as a means of dealing with industrial restructuring and redundancies. Since 1997, numerous measures which have been introduced have aimed at reversing this trend by discouraging early exit from employment and encouraging people to work longer. As a result of these policies plus the different work orientations and employment careers of succeeding birth cohorts, employment

³⁵ “Typically, politicians are fairly impatient and econometricians tend to deliver the information that the policy makers request.” (Lechner et al. 2005)

rates in older age have slightly grown (Büttner 2005), and the average retirement age has increased by a whole year between 1996 and 2005 (Brussig / Wojtkowski 2006). However, inequality with regard to entering an old-age pension has grown: Unemployed persons tend to opt for remaining possibilities of early pensions, accepting considerable pension deductions that were introduced as disincentives against early retirement (Brussig 2007).

The regime of BIS might emphasize this undesirable trend: For one thing, even with deductions, the premature pension may be financially more favourable than UB2, and it is not means-tested. Furthermore, from 2008 on, recipients of UB2 may be obliged to opt for an early pension as a means of overcoming their neediness. The division of German social policy into 'pillars' traditionally represented by separate insurance systems fosters the tendency to solve problems in one policy area at the expense of another.

B.3 Obstacles and constraints

Customer heterogeneity

BIS claimants are a very heterogeneous group which makes it difficult to standardise procedures and approaches. Among them we find, among others

- fully integrated low earners, especially with large families
- fresh graduates from vocational schools or universities who have not had a job before and therefore are not entitled to unemployment benefits (whereas those graduating from an apprenticeship are entitled but may still be in need because the benefit resulting from the low apprenticeship wage is too low)
- formerly self-employed after bankruptcy of their small businesses
- lone parents or lone carers not currently available for employment
- previously well integrated older workers who were made redundant at the end of their careers and have exhausted their insurance entitlements
- highly educated migrants often from former Soviet Union territories whose diplomas are not recognised in Germany
- housewives of German or migrant origin without any job orientation who are now expected to utilise their earning power
- generally high proportions of people with low skills, impaired health, language deficiencies or of older age.

Overload with customers of low employability

A Western European comparison of the percentages of the working-age populations 'depending' on some kind of benefit rather than making a living from gainful employment, reveals that the relative size of 'surplus' populations differs less than the nationally specific allocation to certain kinds of benefits (see Figure 8 in the annex). To put it bluntly: While the unemployable in Britain are incapacitated, the German surplus population is unemployed until they reach the age threshold for a premature old-age pension. Entry into disability pensions (*Erwerbsminderungsrenten*) is regulated in a relatively restrictive way, by international comparison.

As mentioned before (p. 9 and endnote 16), the same restrictive medical definition which guards the gates towards disability pensions also defines who is to depend on the system of BIS. Consequently, the new system is replete with recipients who are too young for an old-age pension, not sick enough for a disability pension, but too old and of too poor health to find employment. Nearly *one quarter of the unemployed recipients of UB2* is recorded to suffer from health impairments (IAW 2006b), and there are unknown additional numbers who are not counted as unemployed because of acute illness that makes them currently unavailable for employment.

All in all, we are discussing a system of basic income support 'for jobseekers' who are supposed to be activated for integration into employment but of whom only a slight majority (55% in June 2006) is registered as unemployed. The other half is

- in general education or training (young people over 15 from needy families);
- or not available because of caring responsibilities (lone parents of children under three years old, or people nursing their parents, partners or other relatives);
- or not available because of sickness regarded as temporary so that they are in principle still considered 'able to work';
- or permanently unable to work themselves but allocated to the system of basic income support for jobseekers because another member of the community of needs is considered able to work;
- or actually working regular jobs of at least 15 hours per week but still in need (see p. 19);
- or working in additional temporary jobs created for them, or participating in other labour market policy measures, thus continuing to draw the benefit but not counted as unemployed.

The exact distribution among these – and possibly further – categories is presently unknown due to insufficiencies of statistical monitoring.

New institutional discrepancies

Fundamental intentions of the reform were to strengthen the activation approach, to provide claimants with job offers or active measures much sooner, and to tailor the 'treatment' to individual needs following assessment of individual potentials. However, since the designers of the legislation assumed that the new regime would be administered within the structures of the established PES, no specific provisions were made for job hunting (relating to employers) and for job broking. It was only after the establishment of the new regime as a separate one that the local units had to find solutions for job broking and employer services. While some consortia are still maintaining close co-operation with the local Agencies for Work (who are partners of the consortia) with regard to employer services, the licensed municipalities inevitably had to establish their own. But also some consortia that initially relied on the Agency for Work for job hunting experienced neglect by their partners and found that they had to establish their own services. Of course, these are now competing with the existing ones for acceptance by employers, with a tendency to boost hiring subsidies offered to them.

The strict division of responsibilities between the two regimes implies that a potential customer, before provided with a service, must first be classified with regard to his belonging to one or the other regime. This has particularly perverse consequences where the service, if provided, would potentially preclude paying a benefit. Job counselling and placement is a striking example: The

Agencies for Work are responsible for such services as far as recipients of unemployment benefits and persons not receiving any benefit are concerned. However, if a potential customer qualifies for UB II, then the providers of BIS are also responsible for counselling and placement. As a consequence, rather than placing non-recipients asking for service and thus preventing the reciprocity of a benefit, some Agencies for Work send them to the local consortium or licensed municipality. Here they must successfully apply for the benefit before they can receive a placement service.

To cut a long story short, a 'work first' principle is difficult to implement where eligibility for one or the other benefit determines who is responsible for implementing it. Furthermore, because of the customers' neediness, the benefit is more urgent than the service. So normally the first contact in a consortium or licensed municipality is with the department responsible for the benefit, and the first contact with the personal adviser takes place only weeks or months later.

Conceptual contradictions

There is also potential tension between an individualised 'work first' approach and a holistic case management approach addressing the whole family situation. This tension not only manifests itself in the confrontation between different professional backgrounds and work cultures in the consortia where job placement officers from the Agency for Work and social workers from the municipality come together with the task to produce a supposedly uniform work process. The same tension is also inherent in the very concept of the Hartz Commission which, triggered by a 'placement scandal', emphasised immediate job placement on the one hand but on the other hand advocated addressing the multiple barriers against taking up work – which may not only lie in the individual but possibly also in family relations. While both approaches appear justifiable, they usually cannot be applied to the same person at the same time by the same frontline officer. It is not feasible to simultaneously place a person in a job, deal with her debt problem and impending eviction from the dwelling resulting from it, organise child care, counsel for separation from the addicted partner etc.

The software used by the consortia reflects this conceptual contradiction. It does not provide a bridge between job broking, which is individual by nature (a potential employer will hire an individual, not a family), and case management, which addresses the whole community of needs. In other words, the underlying data model does not allow operating on different but connected unit levels.

Where local service units are actually addressing all these problems (as they should), they are still experimenting with priorities, sequencing and suitable division of tasks among their professional staff. However, where the inherent conceptual trade-offs and contradictions are not made explicit, the outcome may be neither rapid placement nor in-depth case work – caseloads will be simply 'administered' as before the reform.

Provisional nature of the provider structure

The experimental situation explained on p. 11 implies that after 2010 the consortia might be dissolved, or that even the municipalities now doing the job alone will then have to share it with the local Agency for Work, or that the municipalities will lose their role in this field altogether. For the consortia (80% of the providing units) this means that the motivation to overcome conflicting organisational and professional cultures is being stifled since the present situation might only be

an interlude. For all the providers the situation implies that they tend to hire additional staff needed only on a fixed-term basis because they might face redundancy problems in 2010. This makes it difficult to attract the best candidates, and it hampers investments in staff training.

While this is being written, some 70 consortia are under strain because the Federal Agency for Work has cancelled or threatened to cancel agreements claiming that the municipalities are not fulfilling their part of the contract. There is also a Federal Constitutional Court decision pending on whether the construct of consortia as such is at all possible under the German Constitution.

Traps of federalist interdependencies

Some fundamental obstacles resulting from contradictions of German federalism and from the institutional set-up of service provision have already been pointed out on pp. 13ff. The system of BIS is difficult to monitor and to steer, but a straightforward way out of paralysing counterchecks that would both be acceptable to all the parties concerned and compatible with the German constitution is not easily conceivable.

Lack of incentives for success

One of the rationales of the reform was to partially relieve municipalities from the financial burdens of unemployment. In order to achieve this, the federal government assumed full financial responsibility for the income support as such, for active measures and for the administrative costs related to the two, while the financial responsibility for accommodation and heating remained with the municipalities, with negotiated partial lump-sum compensations in order to give them further alleviation. On the individual claimant level, whenever a claimant takes up work but continues to be entitled to a part of the benefit, the income support will be gradually reduced first and the accommodation part only later as earned income rises and income support has been reduced to zero. As a consequence, there is no financial incentive for municipalities to get claimants into a job that will only partially reduce their benefit dependency.

C. Policy debate

C.1 Assessment of the arguments of different interest groups

Benefit levels

Trade unions and social advocacy organisations argue that income support (345 € for a single adult person, 207 € for a child) is too low and does not cover the cultural minimum necessary for inclusion in the German society. More specifically, civil society organisations dedicated to the protection of children are pointing out that disproportionately high percentages of children (14% in the West and 25% in the East) are living in 'communities of needs' dependent on BIS. Their parents are facing problems of supplying their kids with school equipment and of paying for extra school activities because, compared to social assistance, most 'supplementary grants' have been ruled out.

Employers and mainstream economists, by contrast, are maintaining that benefit levels are still too high in comparison to the wages paid for the jobs most people receiving the benefit could

reasonably expect to find. The fundamental incentive problem discussed with regard to social assistance during the preceding decade – wages being based on individual market positions, benefits based on standardised needs of the family or ‘community of needs’ – could not be resolved by the reform, and there is no way of resolving it altogether. The implicit ‘single breadwinner model’ still underlying the debate tends to cloud the issue: Of course an unskilled worker without recent work experience is unlikely to find a job paying him considerably more than the benefits he receives for a family of four or five. But the alternative to be properly considered would be that both partners take up jobs.

Introduction of a legal minimum wage

Because of the strong tradition of collective bargaining in West Germany and the constitutional principle of the autonomy of bargaining, there is no legal minimum wage in Germany. This creates a problem when coverage by collective agreements is weakening and when people earning wages below subsistence level automatically receive complementary benefits. The issue is becoming blurred whether people are receiving benefits because their market wage is so low or whether their individual wage is so low because they have the possibility to receive a complement. In other words, the complementary benefit may develop into a hidden and uncontrollable employers’ subsidy. This could only be changed if there would be a clear bottom line to wages.

Employers’ organisation and mainstream economists are strictly opposed to a legal minimum wage, and also those trade unions that still saw themselves in a strong bargaining position found this difficult to accept. However, the German Trade Union Confederation is now in favour of a legal minimum wage they would like to be set at 7,5 € per hour. A recent proposal by a group of economists would establish a minimum level of 4.5 € per hour (Bofinger et al. 2006). At the time of the Peer Review, there is still a very wide range of debate with regard both to the principle, the mechanisms, and the level of minimum wage standards.

‘Workfare’

Jobseekers on BIS have to accept any job that they would be physically and mentally able to do and that does not interfere with caring responsibilities. However, there are not enough job offers to test everyone’s availability and readiness to work. The Council of Economic Advisors has therefore proposed to cut BIS by 30% and to pay the current full amount only to those who are putting themselves at the disposal of a municipal work agency (SVR 2006). In order to make this ‘obligation to work’ real, the Council envisages that the current number of such ‘municipal jobs’³⁶ would have to be more than doubled to 700,000. The proposal has recently been recycled into public discourse by the Minister of Economic Affairs from the Christian Democratic Party. Critics argue that it might be impossible to actually organise and supervise work for 700,000 people of low employability, let alone displacement and substitution effects in public services and in fields the municipalities would normally contract out to private enterprises.

³⁶ These municipal jobs are not employment relationships in the usual sense. They are organised according to the logic of ‘working for the benefit’ plus an extra allowance of 1 to 1.5 € per hour.

C.2 Main questions and areas of debate

Since the mid-1990s, growing frustration with the apparent immobility of the Federal Agency for Work, plus the ever more conspicuous role of larger cities in designing their own labour market programmes for recipients of social assistance, have led to the debate whether perhaps municipalities could deliver more effective services on the labour market than a federal agency. This debate was based on personal experience and perspective, on case study evidence, and on political and ideological preference for the 'local' or the 'central'. Rigorous comparative evaluation was lacking; there was not even a reliable descriptive database on what the municipalities were doing or achieving.

The recent compromise about who is to deliver BIS for jobseekers has led to a large-scale real experiment (see p. 11) that is currently being scientifically evaluated with extraordinary effort. However, the contest under evaluation is not being conducted between Agencies for Work as such on one side and municipalities on the other; it is rather going on between consortia and licensed municipalities. So if the consortia formed by Agencies for Work and the municipalities should turn out to be the better performers, it will then still remain unclear whether this should be so *because of the complementarities* between the central and the municipal element or *in spite of the obstructions* inherent in the co-operation of such unequal partners.³⁷

Consequently, even if the evaluation should reveal a clear-cut superiority of the consortia, it would still remain an open question whether these joint ventures should be consolidated or whether the responsibility for BIS should be given to the Federal Employment Agency as such. If, on the other hand, the licensed municipalities should emerge from the evaluation as the superior performers, then the legislator will be faced with the problem how to implement full and permanent municipal responsibility for BIS within Germany's constitutional set-up. The principle of municipal self-government and the *Länder's* prerogative in legislating and supervising municipal proceedings will be in conflict with the central funding of BIS and the Federal Government's quest for steering and control. The debate will thus continue to be primarily based on political preference and to be deeply embedded in the struggle for power and financial resources between the federation, the *Länder* and the municipalities.

D. Summary and conclusion

In part explicitly, and partly in more clandestine ways, the reform reviewed in this discussion paper has addressed numerous problems of German labour market policy, such as:

- 1) caseloads of jobseekers being far too high for delivering an effective service aiming at re-employment for people with multiple problems;
- 2) organisational and professional cultures efficient in paying benefits but increasingly ineffective in relating jobseekers to employers, in activating people for effective and promising job search, and in addressing complex and multiple employability problems;
- 3) growing fiscal costs of under-employment;

³⁷ The 19 territories with separate responsibilities are too few in numbers as to scientifically establish superior performance of the Agencies for Work when acting alone.

- 4) the overburdening of municipal budgets with expenditures for social assistance that were caused by joblessness;
- 5) institutional discrepancies between the PES and the municipalities;
- 6) the expectation or illusion of German employees for never-ending wage replacements in case of their unemployment, and alleged immobility resulting from a preoccupation with status maintenance.

However, with regard to these problems and the aim of overcoming them, the reform has many shortcomings:

- The goal of relieving the municipalities from financial burdens and at the same time reducing the burdens on the Federal budget has not yet been met. If the new system should fail to take due advantage of the current economic upturn and to considerably reduce caseloads now, then the fiscal goal of the reform will remain distant for at least one more business cycle of presumably eight years.
- Case loads are still too high for helping the hard to place effectively. However, it is seen as undesirable to permanently increase frontline staff even further, and attracting qualified staff on fixed-term contracts is difficult. This reflects the inflexibility of employment relations in the German public service where jobs are either 'for life' or temporary in a distinct and discriminating way.
- German legal and bureaucratic traditions of equal treatment are not favourable for gradual strategies by which groups would be targeted in low caseloads one by one. According to implicit notions of equitability everyone should receive the same service even if it means the same poor and ineffective service.
- Case management has now been introduced in employment services; however it is largely subject to experiment and improvisation what it exactly means, which customers should get it, and how it is to be fitted into the workflow of employment services.
- The reform has created a new institutional set-up that is unstable both politically and legally so that it will have to be revised soon, creating new friction.
- Institutional discrepancies and overlaps have not been removed but only shifted upward. As a consequence, more people are affected by such inconsistencies than before.
- The governance of the new system is difficult and sometimes contradictory at all levels.
- Proper steering by targets instead of rules and directives is still not possible because such an approach is alien to the regulations, culture and training of the German public service.
- The new flat-rate benefit has been constructed within the regime philosophy of poverty relief. This has strong negative effects on the quality of the German employment system at large. Namely, unconditional acceptability of jobs is incompatible with a labour market regime that has no legal minimum wage and where growing fringes are no longer effectively covered by collective agreements.

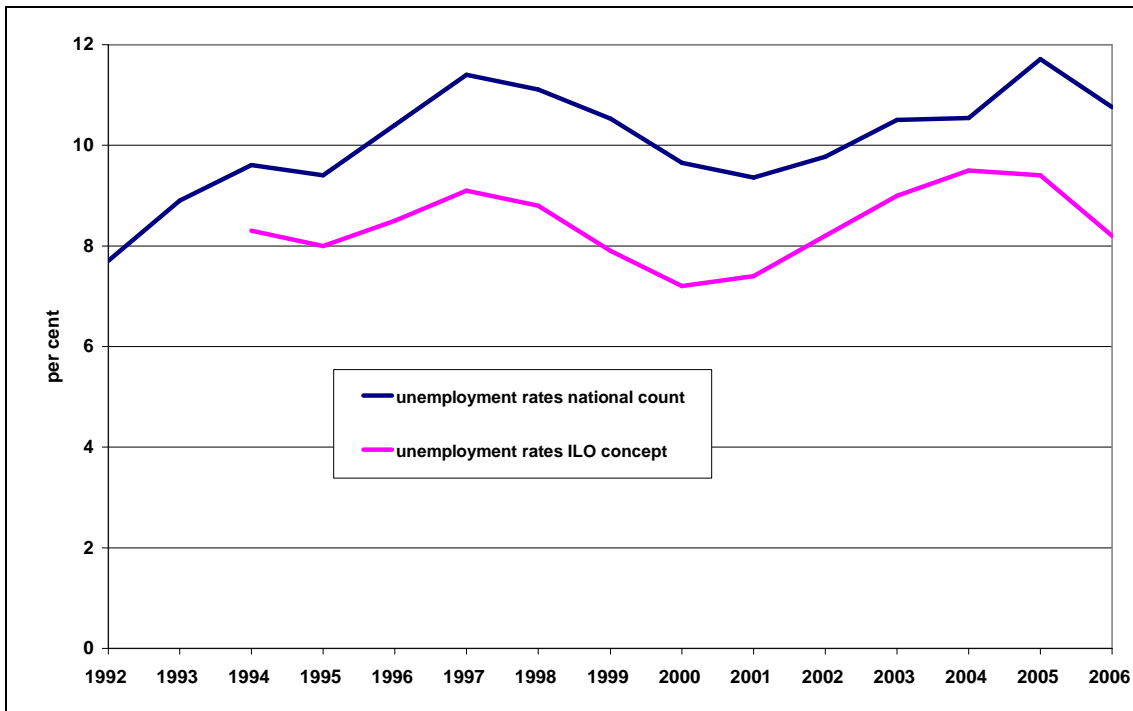
The reform has initiated an urgently needed process of modernisation in employment services, but it has failed to solve the institutional problems which had been defined as crucial. The reform was designed from a labour market policy perspective only so that the strategic question how the desired reform would fit into the larger institutional framework of the German state was not adequately addressed. The merger of the two benefits was treated as a technical problem, without regard for the difference between the two regimes in which these two benefits were

embedded. As a result of regime borrowing from social assistance, institutional path-dependencies came in through the back door.

Even though the resulting process of restructuring was not exactly the same as had been intended, it has created institutional break-up and has brought different organisational and professional cultures into close contact. In conjunction with institutional uncertainty, this has created an innovative climate of a fragile nature where freedom for creativity and experiment, lack of sustainability of the progress that is made, and cynical attitude of 'anything goes' are closely intermingled. It is still too early to predict the outcome, and hard data that would allow assessing whether the performance of employment services for the non-insured have been improved are not yet available.

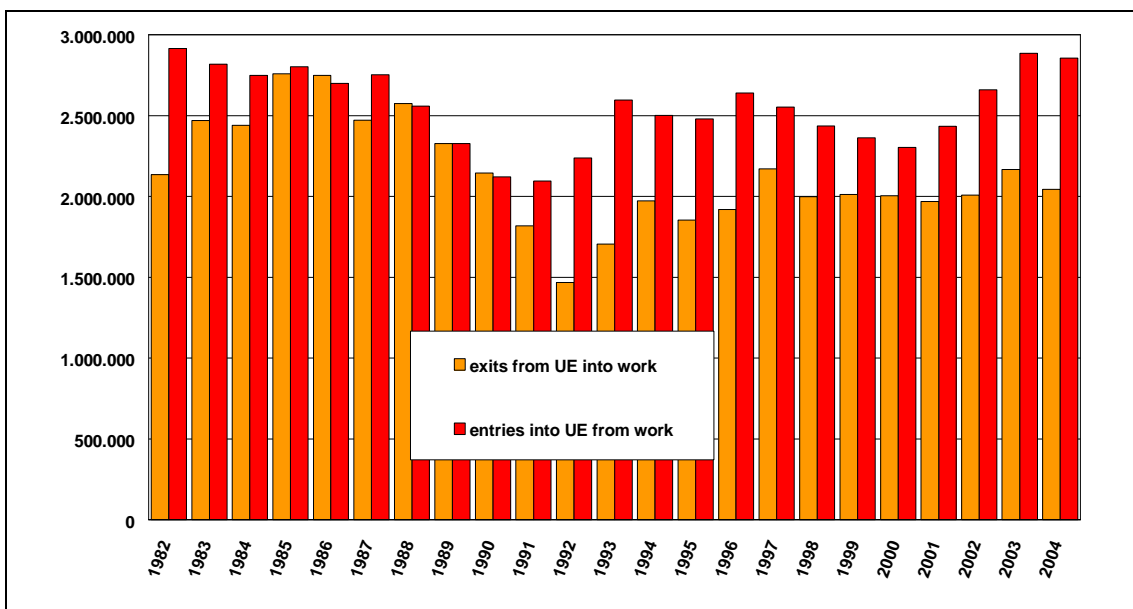
Annex: Figures

Figure 1: Unemployment rates, Germany, 1992 to 2006



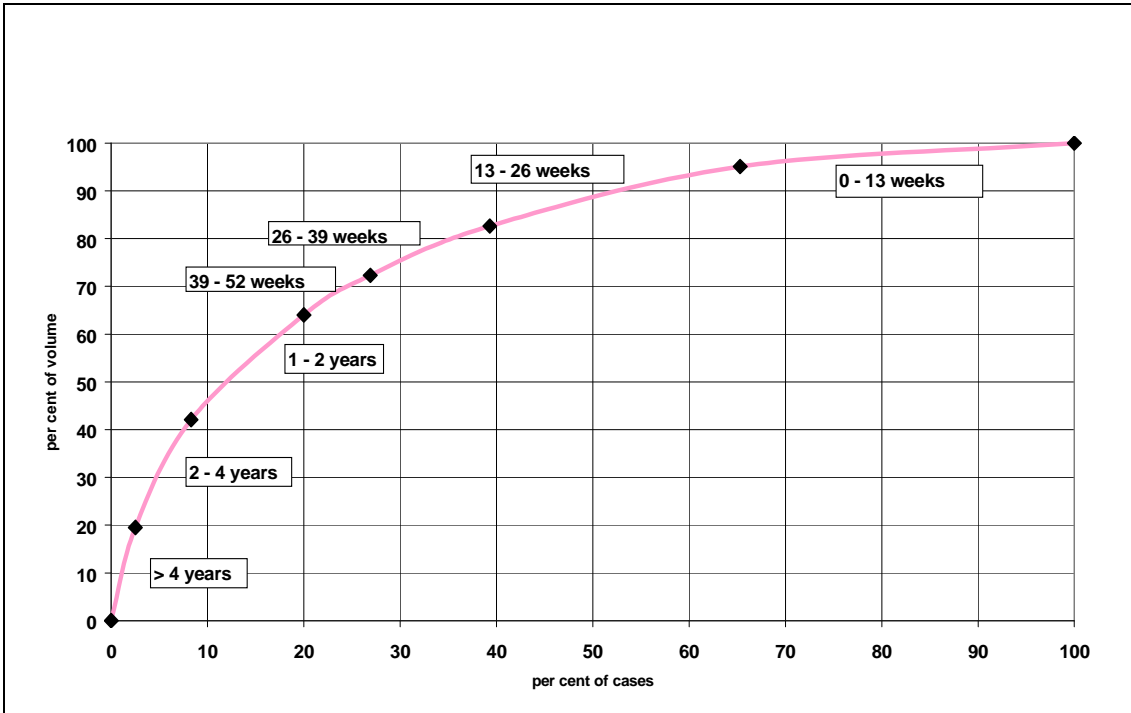
Sources: Federal Agency for Work / European Commission 2006 / Federal Bureau of Statistics <http://www.destatis.de/basis/d/vgr/vgrtab10.php>

Figure 2: Annual movements between unemployment and employment, West Germany, 1982 to 2004



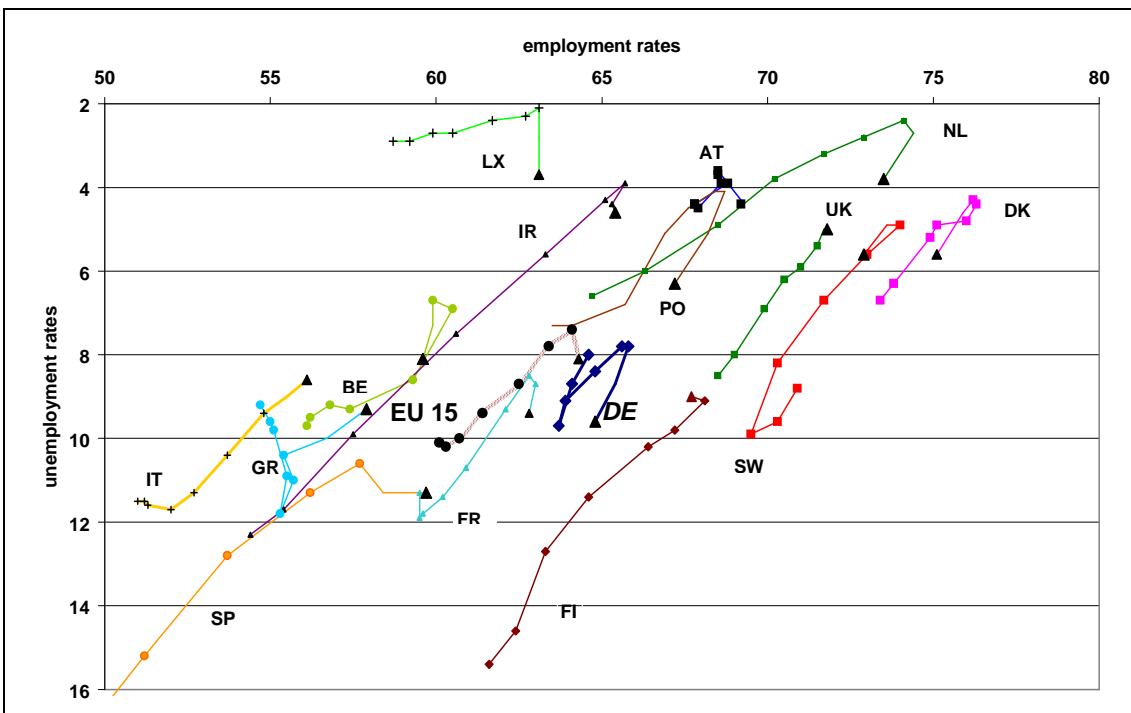
Source: Federal Agency for Work

Figure 3: Individuals' unemployment spells completed in June 2000 by duration and contribution to macro volume, Germany



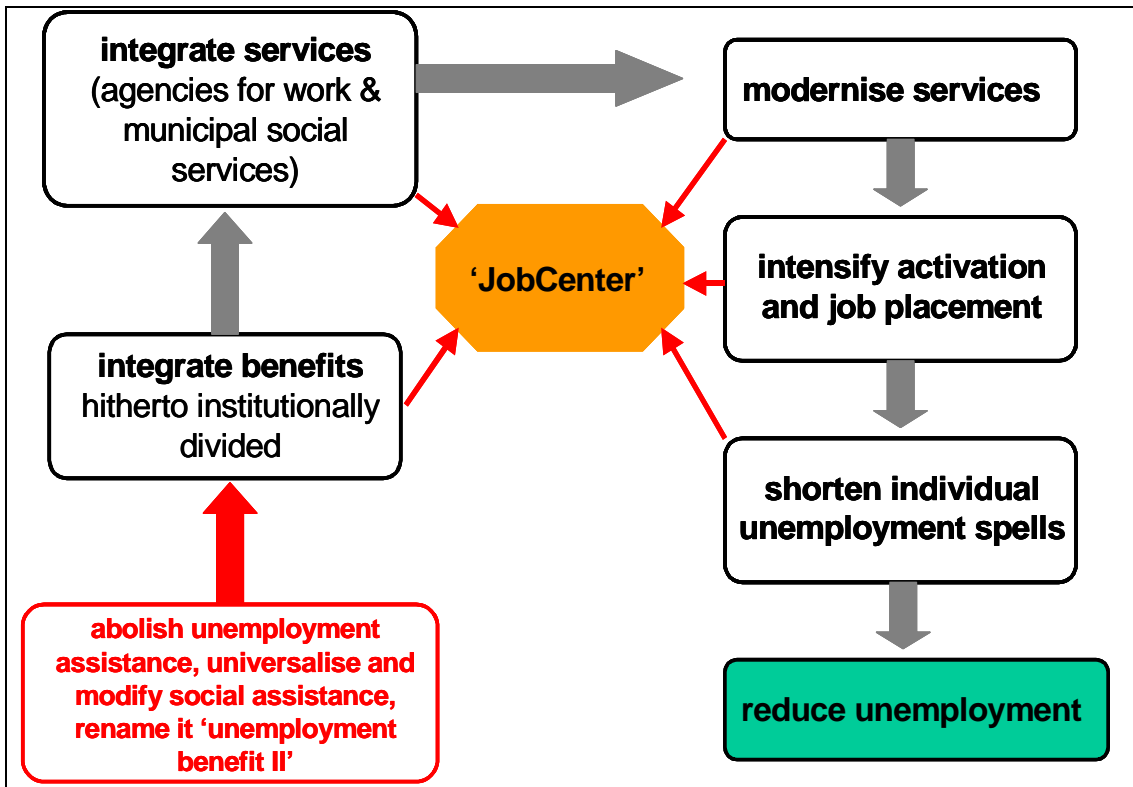
Source: Karr 2002

Figure 4: Employment and unemployment rates, EU-15, 1995-2003



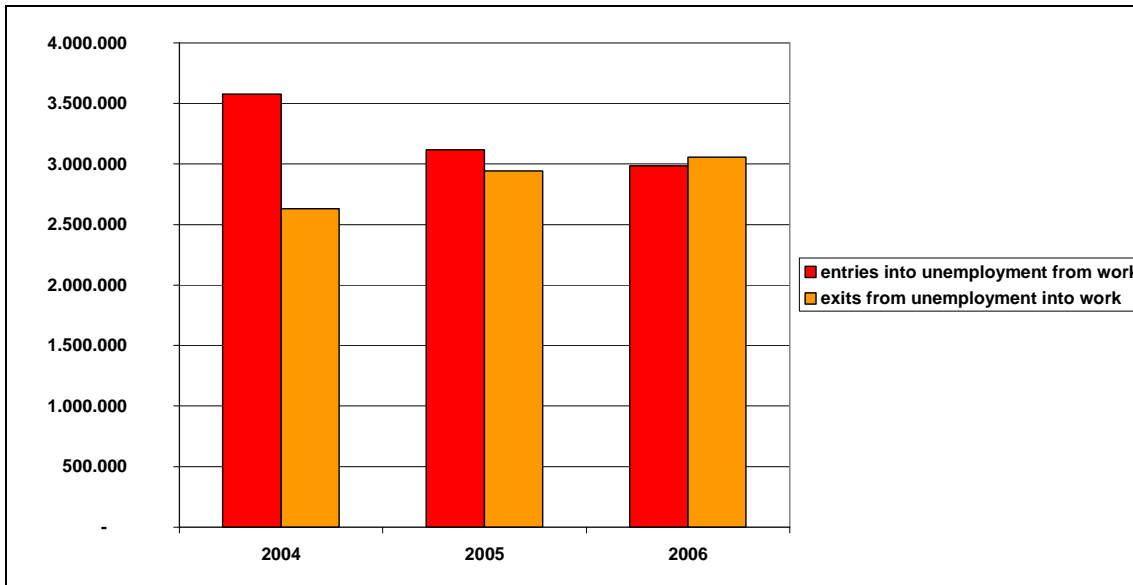
Source: European Commission 2004

Figure 5: The 'JobCenter' as the centrepiece of the Hartz reforms



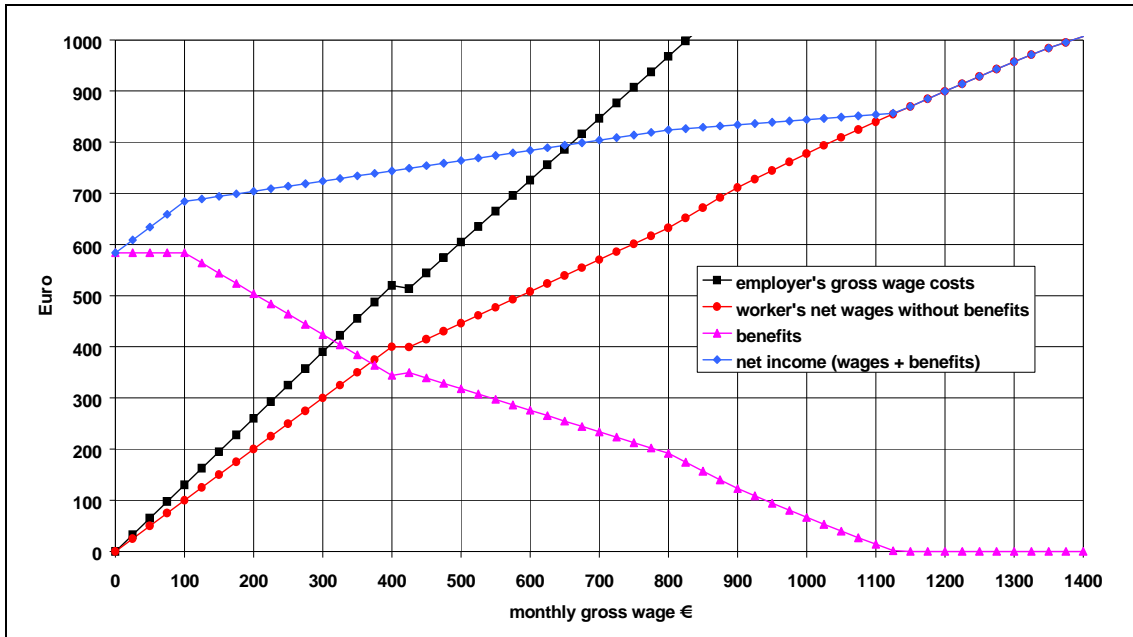
Read counter-clockwise, starting from bottom right.

Figure 6: Annual movements between unemployment and employment, Germany, 2004 to 2006



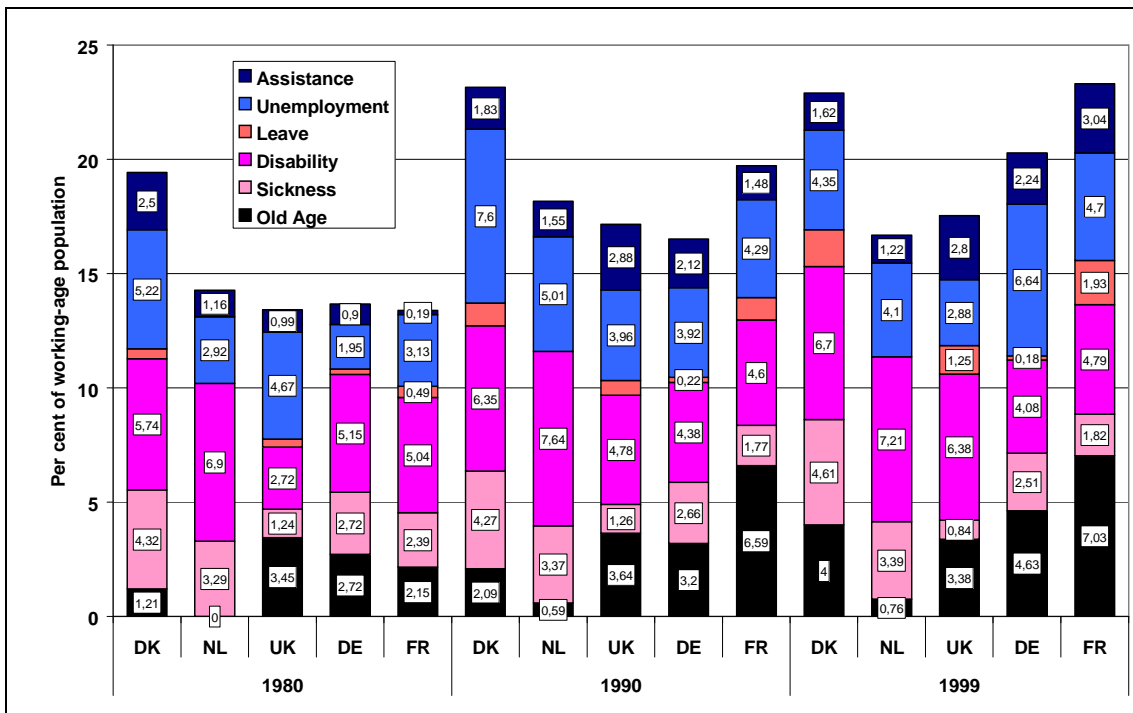
Source: Federal Agency for Work

Figure 7: Wages, benefits and combined income, single adult, West Germany



Net wages taking 'mini-job' privilege into account, benefits including average housing costs for single claimants

Figure 8: Percentages of working-age population depending on benefits: Denmark – Netherlands – UK – Germany – France, 1980 – 1990 – 1999



Source: OECD 2003: 224ff.

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