

# **How to make public policies supportive to employment in practice?**

## **Lessons from Germany**

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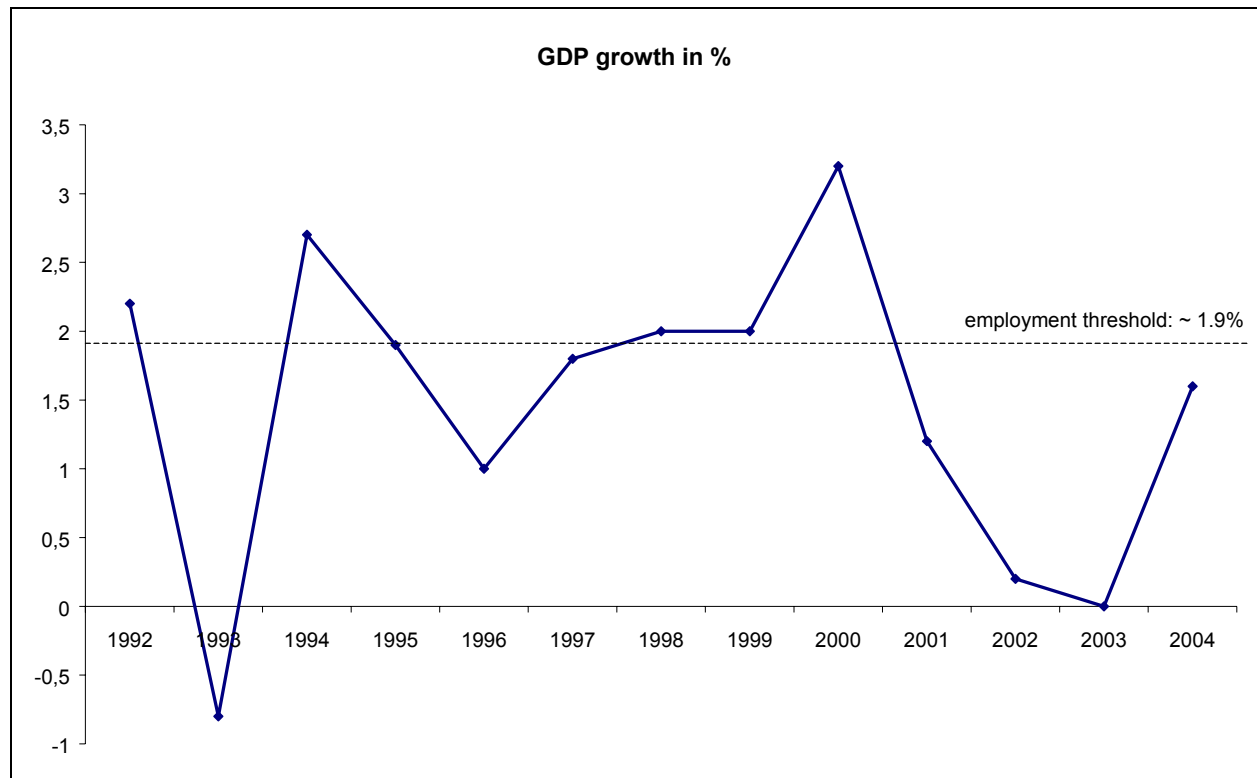
### ***Introduction***

Unemployment in Germany has been growing at an average yearly rate of four percent over the last fifteen years. Among the measures to stop this development making work pay policies have only played a small role. In fact, regional experiments of making work pay policies did not start earlier than 1996 and ran out in 2003/2004 when the political momentum turned towards the so-called "Hartz reforms". This new active labour market policy does comprise of various making work pay policy elements, too. However, these elements were not prominent in the public debate and most of them follow a different design than what is traditionally defined as making work pay policy<sup>1</sup>.

This contribution tries to give an overview over regional (and national) experiences with making work pay policies in Germany. Most of the regional programmes have been evaluated and evaluation reports are publicly available. The following pages are organised as follows: a first section will provide some statistical background of the German labour market over the last fifteen years. Section 2 will report the various regional (and national) programmes of making work pay policies in Germany. Evaluation results will be presented. The concluding remarks will summarise and give an overview of making work pay policies in the current political debate in Germany.

## The German Labour Market: 1991 to 2005

Since the reunification of Germany in 1990 the development of the German labour market has been everything but a success story. As graph 1 shows, low economic growth hardly ever crossed the employment threshold (i.e. economic growth that is needed to create additional jobs in the economy) that is estimated to have been around 1.9 percent during the period<sup>2</sup>.



Graph 1: GDP growth in percent - Germany 1992 to 2004

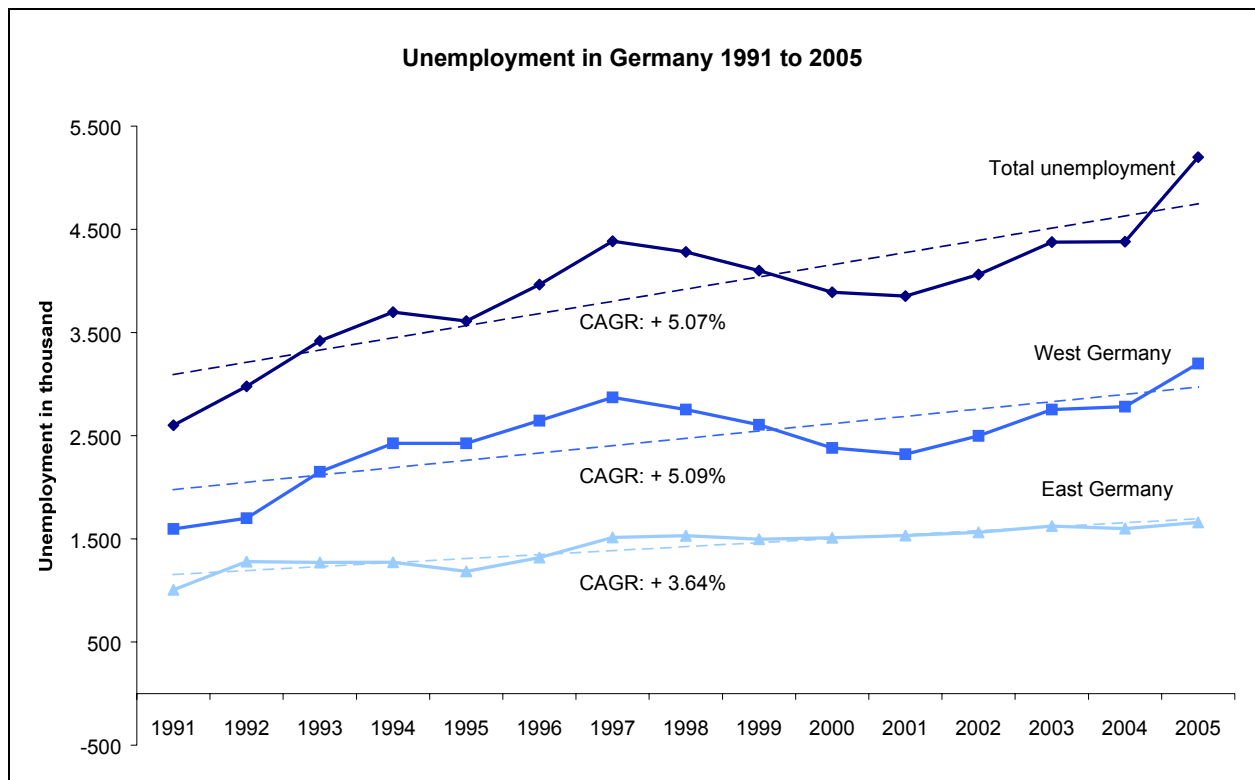
Source: Deutsche Bundesbank 2005

Consequently demand for labour has rather fallen than risen. This development is expressed very clearly by a steep rise in unemployment with a compound annual growth rate (CAGR<sup>3</sup>) of 5 percent between 1991 and 2005 (graph 2). If the 2005 data are taken out of the calculation the CAGR is still 4 percent. In January 2005 the number of unemployed in Germany crossed the line of 5 million people for the first time. Although this number is the result of a statistical rules change implemented by the fourth part of the Hartz reforms on January 1<sup>st</sup>, 2005 the number well represents the importance labour market policy has gained in German public discourse.

<sup>1</sup> Compare the opening remarks of section 2.

<sup>2</sup> This contribution is too short to enter the debate of the complicated story of the influence of the reunification on economic growth and the labour market in Germany after 1990. I will thus only report the numbers and refrain from any attempts to explain them.

<sup>3</sup> Calculated by taking the  $n$ th root of the total percentage growth rate where  $n$  is the number of years in the period being considered. Imaginary growth rate that pretends that growth has been steady over a certain period.

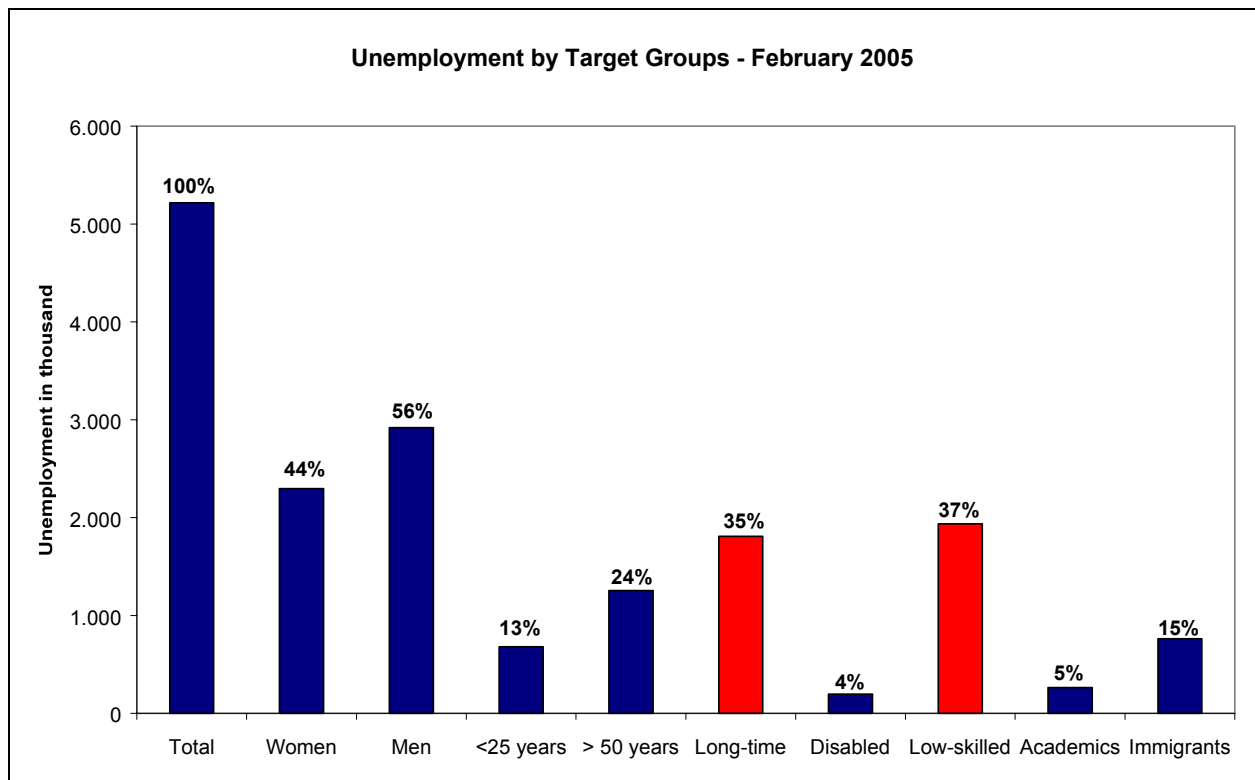


Graph 2: Unemployment - Germany 1991 to 2005 (February)

Source: Bundesagentur für Arbeit 2005

Unemployment in Germany varies regionally. To report the extremes: while the unemployment rate in Baden-Württemberg was 7.2 percent in February 2005, it was 23.6 percent in Mecklenburg-Western Pomerania. On average, East Germany had an unemployment rate of 20.7 percent in February 2005 while West Germany only had a rate of 10.4 percent (Bundesagentur für Arbeit 2005). At the same time the East German labour market is much less dynamic than the West German labour market. Long-term unemployment which for a long time was a unique feature of the West German labour market has now become a substantial problem in the East, too.

Looking at selected groups among the unemployed in Germany the February 2005 data show that the long-time unemployed account for 35 percent of all unemployed and the low-skilled for 37 percent (graph 3).

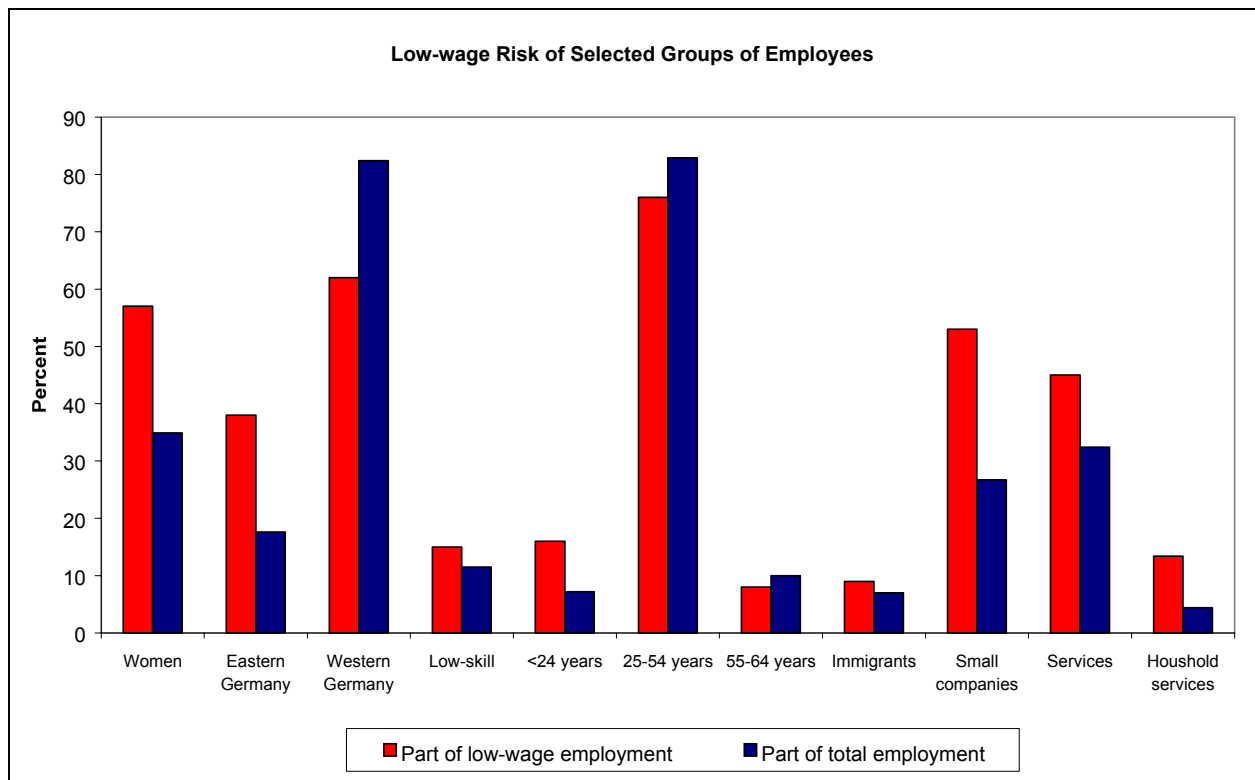


Graph 3: Unemployment – Target Groups, Germany, February 2005  
 Source: Bundesagentur für Arbeit 2005

But how large is the demand for low-wage labour that might be an exit option from unemployment for the long-time unemployed and the low-skilled? In 2001, 17.4 percent of the German work force (full-time employment covered by social security) worked for a low wage, translating into an absolute number of 3.6 million people. This share has slightly risen from 15.8 percent in 1997 (IAB Kurzbericht No. 3/2005). However, this number only expresses the existent low-wage sector of the economy. The rationale for making work pay policies is that supply and demand for low-wage labour could be higher if the incentive structure for employers and employees were changed<sup>4</sup>.

Among the low-wage employed, women, employees in East Germany and employees of small companies face the highest risk to have a job with low pay. Graph 4 looks at selected groups and compares their share of the total work force with their share among the low-wage employed. Wherever the pillar that represents the share of low-wage unemployment is higher than the pillar that represents the share of total employment these groups are over-represented in the low-wage work force. This is also true for the low-skilled, immigrants, young people and employees working in services.

<sup>4</sup> Compare the opening remarks of section 2.



Graph 4: Low-wage Employment – Selected Groups, Germany 2001

Note: Small companies are companies with less than 20 employees.

Source: IAB Kurzbericht No. 3/2005

A recent study from the Institute for Employment Research (IAB) reports that the upward mobility from low-wage employment has decreased over the last twenty years (IAB Kurzbericht Nr. 3, 10.03.2005). The IAB reports data from West Germany for the period of 1986 to 1991 and Germany for the period of 1996 to 2001. Of those who received a low pay in 1996 and were still in employment in 2001, 67.5 percent still received a low pay in 2001 while 32.5 percent now had an income above the low-wage threshold.

For the West German sample the upward mobility of two time periods can be compared. Of those people who earned a low wage in 1986 and still were in full-time employment in 1991 only 49.3 percent still received a low wage in 1991 while 50.7 percent had passed the low-wage threshold. Of those full-time employed who had a low-wage income in 1996 and still were in full-time employment in 2001, 62.9 percent still had a low-wage income in 2001, thus the share of the upwardly mobile had decreased to 37.1 percent (compare table 1).

	Low-wage income	Above low-wage threshold
<u>Germany</u>		
Low-wage income in 1996, still in full-time employment in 2001	67.5 percent	32.5 percent
<u>West Germany</u>		
Low-wage income in 1986, still in full-time employment in 1991	49.3 percent	50.7 percent
Low-wage income in 1996, still in full-time employment in 2001	62.9 percent	37.1 percent

Table 4: Upward Mobility

Source: IAB Kurzbericht No. 3/2005

### ***Making work pay policies in Germany between 1996 and 2004***

Making work pay policies usually take the form of either employment-conditional benefits or employment subsidies. Thus either the employee in low-wage employment receives an additional state benefit to increase the incentive to leave unemployment or the employer receives a state subsidy to increase his willingness to hire low-skilled or long-term unemployed people. Both measures aim at economic inclusion through more employment. A secondary aim of employment-conditional benefits is redistribution towards families and the poor (Pearson/Scarpetta 2000). This paper will concentrate on employment-conditional benefits and the experiences made with these in Germany between 1996 and 2004. Employment subsidies have a longer history in Germany, particularly among the active labour market policy instruments of the unemployment insurance system. Their impact will not be reported here due to the size of the contribution.

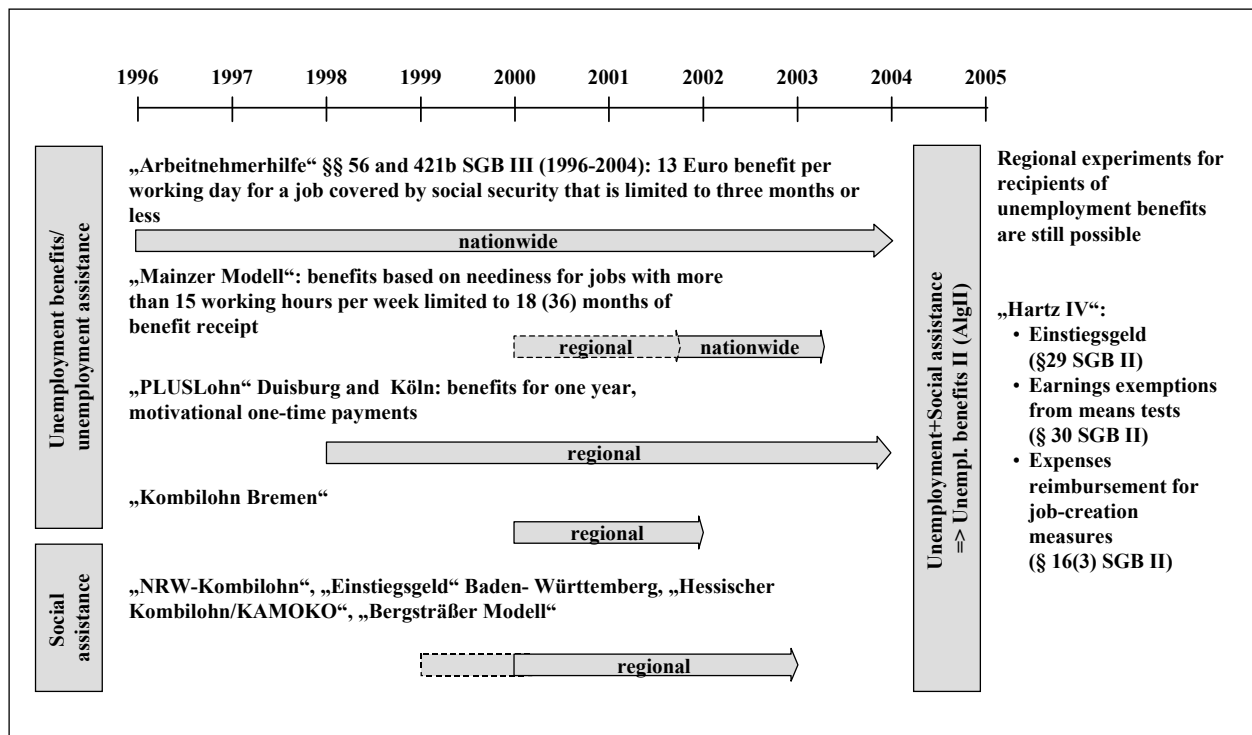
The general idea behind employment-conditional benefits is that because of high replacement levels in the unemployment insurance system the unemployed are not willing to accept a low-income job. Employers expect this and do not offer low-income jobs in the first place. Thus the low-income sector of the labour market is smaller than it could be. Giving employment-conditional benefits to people who accept a low income job shall motivate employers and employees to create and accept low-income jobs and thus make the low-wage sector of the labour market grow. However, the benefit is not meant to be given forever. Policy makers expect that after a period of benefit receipt the employees' motivation has grown sufficiently to keep the job without state support. Either they expect the employee to realise a higher income because of experience and/or training on the job, or habituation shall make him or her more motivated (Kaltenborn 2001).

In general, low income might have to sources: a small number of working hours or low hourly earnings. Target groups of employment-conditional benefits are thus either people who work in part-time employment (i.e. families, (single) parents, women) or low-skilled workers/people with out-dated skills that receive low hourly earnings.

Between 1996 and 2004 Germany made experiences with various forms of employment-conditional benefits. Graph 5 provides an overview. The variety of the programmes is large. Most of them were small regional experiments, only two, the Arbeitnehmerhilfe and the Mainzer Modell, were implemented on a national scale. Some of the larger programmes were financed through the unemployment insurance system or through the tax system. Some smaller ones were regional social assistance programmes. With the beginning of 2005 all the projects reported below came to an end (if they had not run out before) with the fourth Hartz reform that combined the unemployment assistance with the social assistance system in a new benefit system, the so-called unemployment benefit II (Arbeitslosengeld II). For the recipients of unemployment benefits (I) regional programmes with employment-conditional benefits are still possible after the reform. In addition, various active labour market instruments within the insurance system contain making work pay elements. Many of these were implemented by the Hartz reforms I to III<sup>5</sup>. For the recipients of the unemployment benefits II the new law implemented its own making work pay elements that differ from the earlier employment-conditional benefits programmes. The concluding section of this paper will provide a brief description of these making work pay elements.

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<sup>5</sup> Working on the incentive structure of the employee for example “Mini and Midi-Jobs” (§ 20ff. SGB IV), „Ich-AG“ (§ 4211 SGB III), „Eingliederungszuschuss“ (§ 218 SGB III)



Graph 5: Employment-conditional benefits in Germany, 1996 to 2005

Source: Kaltenborn 2001

In general, take-up of the above-mentioned programmes has been very low. Between its implementation in 1996 and 2001, 39,700 employees took part in the Arbeitnehmerhilfe. Considering that this was a national programme this is a rather disappointing result. For the regional programmes take-up is even smaller. The PLUSLohn had been used by 447 employees in 2001, the Einstiegs geld, a social assistance programme, by 596 people. Projects like the NRW-Kombilohn or the Kombilohn in Hesse had 125 and 70 participants respectively until 2001. By far the smallest experiment was the so-called Bergsträßer Modell that had 2 participants in 2001 (Kaltenborn 2001).

The most in-depth evaluation has been made of the Mainzer Modell and some of the main results will be reported in the following abstracts.

Take-up during the regional period of the programme was around 1,190 cases in total. During the national implementation of the programme, 13,800 people used the Mainzer Modell. 30 percent of the participants lived in East Germany. The evaluators could not find any correlation between the regional labour market situation and regional take-up (BMWA 2004).

Implementation studies found significant problems during the implementation of the national programme. The job agencies that were supposed to explain the Mainzer Modell to employers and the unemployed did not receive any additional resources (i.e. money or personnel). This was a problem because the rules of the Mainzer Modell were far from simple and not self-



explanatory. The result were substantial information deficits among the unemployed and the employers. Because of non-existent or bad PR work the Mainzer Modell had a negative public image from the very start and did not receive any support from employers' associations or chambers of commerce. However, these institutions would have been needed to promote the programme among employers (BMWA 2004).

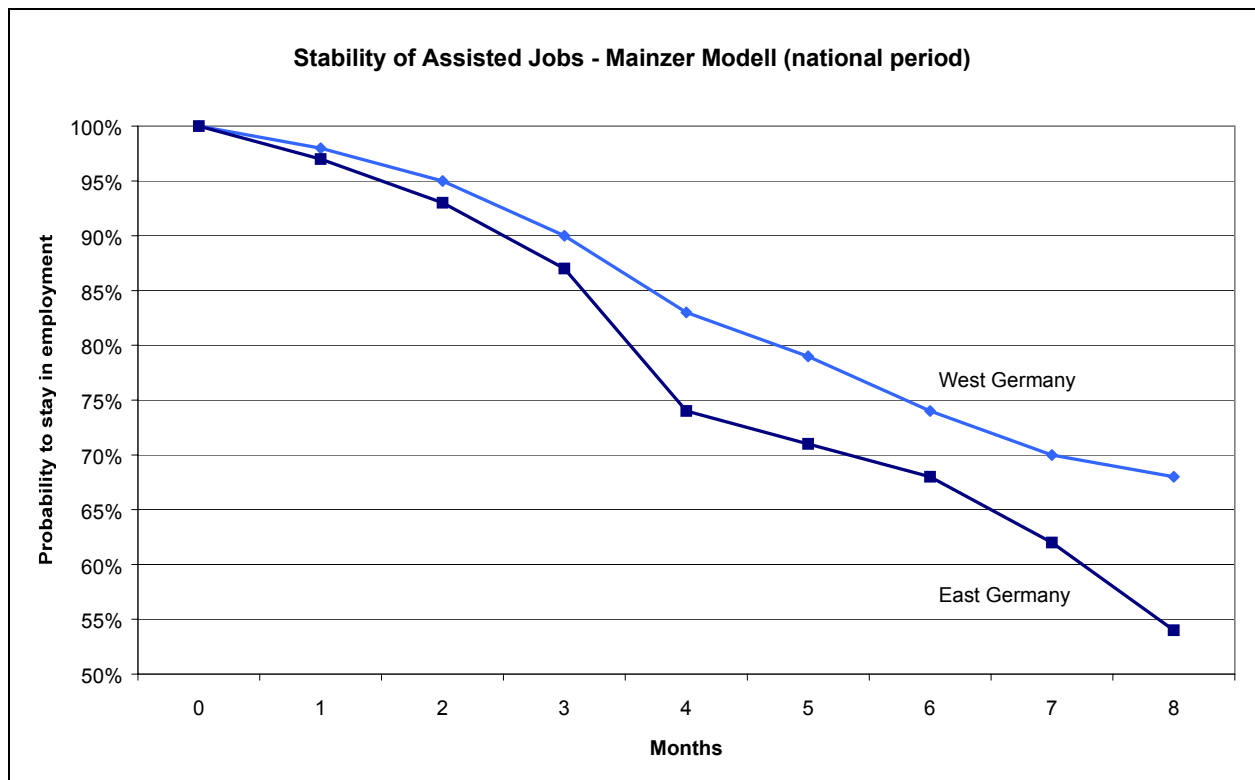
Looking at the structure of the participants of the Mainzer Modell one can see that only half of the beneficiaries were part of the target group "low-skill/long-term unemployed". However the target group "families with children" was well reached. Of all assistance cases during the national period 45 percent were single-parent women, 25 percent were other women, 19 percent were men with partner and child(ren), and 11 percent were other men. Most of the beneficiaries worked in part-time employment. Particularly women who took part in the programme worked part-time (89 percent of West German women who took part in the programme and 74 percent of East German women). The larger part of these part-time jobs were below 30 hours per week (BMWA 2004).

Looking at the two aims of an employment-conditional benefits programme

1. economic inclusion through more employment and
2. redistribution towards families and the poor,

the analysis suggests that only the secondary aim was partly reached. Although take-up in general was very low, those who did participate were those that the programme aimed at.

Concerning the first aim, the outcome of the Mainzer Modell looks rather sad. With its very small take-up the programme was far away from significantly creating jobs. And the jobs that were created proved not to be very stable over time. Graph 6 reports the probability to stay in employment over the months of benefit receipt. After eight months of benefit receipt around 30 percent of West German and almost half of all East German participants had lost their job again.



Graph 6: Mainzer Modell: Stability of assisted jobs  
Source: BMWA 2004

### **Conclusion**

The Mainzer Modell did not reach the policy makers' expectations particularly because of its very small take-up. Potential reasons are:

- Political opinion was discordant: there were on-going discussions about the necessity of the programme in general and its design features in particular.
- The programme's rules were too complex. The programme was not easy to explain and thus effective PR-work was very difficult.
- The job agencies that were supposed to implement the programme did not receive enough resources and had little motivation to promote the Mainzer Modell.
- During the time period the Mainzer Modell was implemented, there was very little demand for low-paid work in general.

Among those who actually participated in the programme, the secondary aim of redistribution towards families and the poor was well reached. However, jobs created through the programme did not prove to be very stable.

Making work pay policies have not been a dominant theme of the Hartz reforms implemented in Germany between 2003 and 2005. Hartz I to III comprise various making work pay elements that have not been the object of this paper. Hartz IV contains some making work pay elements but their focus lies on earnings exemptions from means tests rather than employment-conditional benefits. Specifically, Hartz IV comprises of three making work pay elements:

- “Einstiegsgeld” (§ 29 SGB II): For a maximum duration of 24 months beneficiaries of the unemployment benefit II who enter employment can receive an additional benefit if this is considered necessary for their accepting a job.
- Earnings exemptions from means test (§ 30 SGB II): Beneficiaries of the unemployment benefit II who are employed, are allowed to keep 15 percent of their gross earning up to EUR 400, 30 percent of the gross earnings between EUR 400 and EUR 900, and 15 percent of their gross earnings between EUR 900 and 1,500 (these rules are currently being modified by the German Bundestag).
- Expenses reimbursements related to job-creation measures (§ 16 (3) SGB II): Beneficiaries of the unemployment benefit II who enter job-creation measures without a regular payment shall receive reimbursements for the additional expenses they have because of being in the job-creation measure.

With the next federal election presumably taking place in September 2005, the Hartz laws will be modified by the new government. The conservative party are declaring their intention to implement employment-conditional benefits on a national level should they be elected in the current election campaign. It seems as if the last word on employment-conditional benefits had not yet been spoken in Germany.

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Data taken from:

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