

# Activating Labor Market and Social Policies in Germany: From Status Protection to Basic Income Support

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## **Abstract**

This paper provides an overview of the sequential shift towards activating labor market and social policy in Germany. It not only shows the changes in the instruments of active and passive labor market policies but also analyzes the implications of this change for the political economy and the legal structure of a “Bismarckian” welfare state. Our study points at the changes in Germany’s status- and occupation-oriented unemployment benefit regime that has been relinquished for a larger share of benefit recipients. Unemployment insurance benefit duration is shorter now and newly created basic income support for needy persons is not earnings-related anymore. Pressure on unemployed to take up jobs has increased considerably while more persons than before have access to labor market programs and individualized services.

## **Abstract**

Dieser Beitrag liefert einen Überblick über die schrittweise Reform hin zu einer aktivierten Arbeitsmarkt- und Sozialpolitik in Deutschland. Er zeigt nicht nur den Umbau bei den Instrumenten aktiver und passiver Arbeitsmarktpolitik auf, sondern analysiert auch die Implikationen dieser Veränderungen für die volkswirtschaftliche und rechtliche Struktur eines bismarckschen Wohlfahrtsstaates. Diese Studie weist auf den Wandel des status- und beschäftigungsorientierten Regimes der Arbeitslosenunterstützung hin, das für einen größeren Anteil der Beihilfeempfänger aufgegeben wor-

den ist. Die Dauer der Arbeitslosenversicherung wurde gekürzt und die neu eingeführte Einkommensbeihilfe bemisst sich nicht mehr am Einkommen. Der Druck auf Arbeitslose, Arbeit aufzunehmen hat sich beträchtlich erhöht, während gleichzeitig mehr Menschen als je zuvor Zugang zu Arbeitsmarktprogrammen und individualisierten Beihilfeprogrammen haben.

## 1 Introduction

Although Germany has a long-standing reputation as a passive welfare state with elaborate schemes of status-protecting income replacement through social insurance in case of unemployment and a full-blown system of active labor market policies, all benefit systems had formal elements of activation and work requirement—but they had not been enforced systematically. In recent years, however, reforms of active and passive labor market policy were implemented in Germany in order to create a more activating labor market and social policy regime and awake dormant activation principles. Changing the system of unemployment insurance benefits and basic income support as well as the repertoire of active labor market policy instruments and making benefit receipt more conditional upon job search and acceptance of job offers was a major issue on the political agenda. This led to a system shift away from “Bismarckian” status-protecting benefits towards a more “Beveridgean” model of income support with strong activation requirements. In the realm of unemployment benefits the dominant regime is no longer a social insurance benefit but a means-tested flat-rate transfer. The reform of the benefit system also involved a major overhaul of the governance of labor market policy and has far-reaching implications for the logic of the German welfare state. All these reforms generated considerable public attention and interest from foreign observers. This article provides an in-depth account of the institutional change, its practical implementation and mid-term outcomes and assesses if the desired economic and societal objectives of activation could be achieved through the adopted reforms.

## 2 The Shift towards Activation

### *The Legacy of a Conservative European Welfare State*

The German welfare state is typically depicted as the prime example of the conservative welfare regime, for which the preservation of social status is central (Esping-Andersen 1990). It has also been prominently characterized as a “frozen welfare state” highly resistant to change (Manow and Seils 2000). Facing a difficult economic environment since the mid-seventies, policy makers and social partners used active and passive labor market policies to reduce labor supply by taking “surplus labor” out of the labor market and shifting the unemployed to benefit schemes and active programs that were not effectively oriented towards swift reintegration into the labor market (Manow and Seils 2000). For some decades, active and passive labor market policies provided a “convenient” and “socially acceptable” way of subsidizing entrepreneurial adjustment to dynamic global markets and help stabilize competitiveness of manufacturing that was at the core of the German employment system (Streeck 1997) while at the same time facilitating a “social policy” approach to unemployment emphasizing income protection and “benevolent” treatment through active policies. Availability of rather generous insurance-based social benefits related to labor market status and skills in the tradition of a “Bismarckian” model helped limiting income inequality and wage dispersion. Rather than creating a flexible and more inclusive labor market, the institutional arrangement of the German labor market of the eighties and nineties was conducive to limiting low-wage employment and wage inequality. This model focusing skilled labor was also stabilized by rather restrictive labor market regulation (Estevez-Abe et al. 2001).

Whereas this institutional pattern helped stabilize the core of the labor market, it also resulted in a strong segmentation of the labor market and high long-term unemployment. However, the German “high equality, low activity” equilibrium (Streeck 2001) resulted in an ever increasing burden of non-wage labor costs as a growing number of benefit recipients in the labor market direct-

ly translated into rising social security contributions and fiscal pressure on the state budget that was used to cover deficits in social insurance. Thus, the sustainability of the German “welfare state without work” (Esping-Andersen 1996) was at risk as it tended to erode its own financial basis in particular facing increasing pressure on wage costs stemming from more intense international competition (Manow and Seils 2000).

### *The old system of unemployment benefits*

Prior to the Hartz reforms that came into force between 2002 and 2005, Germany had a three-tier system of income protection in case of unemployment:

- Unemployment insurance benefit (UB, Arbeitslosengeld) provided earnings-related income replacement for a limited duration of up to 32 months if the unemployed had been in employment covered by social insurance for at least 12 months. Unemployment insurance benefits were funded through employer and employee contributions and administered by the Federal Employment Agency which was also in charge of implementing active labor market policies.
- Unemployment assistance (UA, Arbeitslosenhilfe) was a system of means-tested, but earnings-related benefits for long-term unemployed after the expiry of unemployment insurance benefits. Hence, it provided income support for unemployed that had some prior employment experience but had become long-term unemployed. Unemployment assistance was granted for an unlimited period and funded through the Federal budget, i.e. by general taxation. This scheme was also implemented by the Federal Employment Agency, with recipients of unemployment assistance in principle having access to similar active labor market schemes.
- Social assistance (SA, Sozialhilfe), finally, provided basic income protection on a means-tested and flat-rate basis for all German inhabitants—with or without employment experience—who could not rely on sufficient resources from earned income, other social benefits or family transfers. Thus, social assistance was the major protection system for unem-

ployed with either no employment record or unemployment insurance/unemployment assistance claims that did not match the guaranteed minimum income. Social assistance was funded by the municipalities that were also responsible for reintegrating recipients into the labor market through specific active measures.

In comparison to unemployment assistance, means-testing was harsher in social assistance, moreover, any job was considered acceptable. For labor market integration of employable social assistance recipients, a fairly rudimentary labor market policy, the “Help to Work” scheme, was available. It was operated by the municipalities with a considerable scope of discretion. There was no entitlement to integration measures by the public employment service (PES).

All these systems had formal elements of activation and work requirements, but these provisions were not systematically enforced in practice. For example, the “Help to Work” scheme (Hilfe zur Arbeit) incorporated in the Social Assistance Act (§§ 18 to 20 BSHG) was based on the “rights and obligation” principle. The BSHG nevertheless failed to state specific provisions on the reasonability of job offers. Court rulings have tended to show that a protection of former occupational status no longer exists. Personal grounds are above all seen in age or sickness, while familial grounds mainly take account of a single parent’s care of a child under the age of three. Despite the fact that the law on social assistance called for individual efforts to search for work in order to be able to become independent from public assistance, activating interventions were not implemented systematically. Some local authorities were able to achieve remarkably good results in reintegrating assistance applicants under the “Help to Work” scheme. However, the intensity of activation differed strongly between municipalities, and many local authorities placed social assistance recipients in work opportunities that were covered by social insurance in order to create new entitlements to unemployment insurance benefits. This proved to be an effective way of shifting the burden of transfer payment to unemployment insurance. The fact that the two predecessor schemes of the current Unemployment Benefit II (“Arbeitslosen-

geld II”) were subject to different rules and administered by different bodies hampered efficient activation of recipients.

Suitability criteria in unemployment insurance were also tightened over the nineties. The formal strictness of the unemployment protection regime was increased as legal provisions on benefits being conditional upon willingness to work and accept jobs not equivalent to prior qualification were reformulated in a more restrictive direction with occupational protection being revoked completely in 1997. The main motivation, however, was not effective activation, but short-term fiscal stabilization. At the same time, access to benefits became slightly more difficult, and benefit generosity was reduced marginally. Nevertheless, a rather “permissive” and benefit-centered approach to unemployment was still dominant in practical implementation.

### *The Hartz reforms*

With the number of recipients of unemployment and social assistance benefits steeply rising, largely due to a continuous increase in long-term unemployment, reforming these systems became a priority on the agenda of labor market and social policy. In the late nineties, the problem of fiscal disincentives was more widely discussed, thus paving the way to some pilot projects on joint initiatives of local PES agencies and municipal social assistance offices to reintegrate the long-term unemployed into the labor market (“Mozart initiative”). This was followed by the JobAktiv Act of late 2001 that, for the first time, aimed at a more coherent activation principle in Germany labor market policies. However, the moderate attempt of JobAktiv was superposed by the PES placement scandal and the work of the Hartz Commission, a government-initiated expert committee that presented its report in August 2002. This report formed the base for a package of reforms aiming at activating both short- and long-term unemployed, reforming the PES and the institutional repertoire of active schemes. Finally, with the Fourth Hartz Act (widely known under the label “Hartz IV”) coming into force in January 2005, unemployment assistance and social assistance were replaced by a single means-tested benefit scheme for persons in need and

able to work (Arbeitslosengeld II, UB II) but not entitled to unemployment insurance benefit or after expiry of this contribution-based benefit (Arbeitslosengeld I, UB I).

Besides UB II, the new basic income scheme provides social allowance (Sozialgeld) to persons who live together with needy persons capable of working in a joint household (Bedarfsgemeinschaft)<sup>1</sup>. The recipients of social allowance are normally children below the working age of 15 years. Those incapable of work receive social assistance according to SGB XII which continues to be the responsibility of the municipalities (see table 1).

Hartz IV radically changed the German system of unemployment benefits. The new Unemployment Benefit II scheme has a dual aim: on the one hand it was designed to prevent poverty—but not to secure previous living standards. Thus, for those having received social assistance before, the new legislation actually allows them to receive marginally higher benefits and access to job employment services. For many former recipients of unemployment assistance the level of transfer payment decreased.

Apart from its social policy objective, the aim of this reform was to lower unemployment but also to ease the burden of taxation and non-wage labor costs by reducing benefit dependency. The major lever to achieve this goal was the shortening of individual unemployment spells through accelerated job placement and more coherent activation of the beneficiaries of unemployment insurance benefits and unemployment as well as social assistance. Less generous benefits for long-term unemployed, stricter job suitability criteria and more effective job placement and active labor market schemes were the instruments to achieve this

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<sup>1</sup> The term Bedarfsgemeinschaft includes: the needy persons capable to work; the parents living in the household, or the parent, respectively, of an under-age, unmarried employable child and this parent's partner living in the household; the not permanently separated spouse as partner of the employable person in need of assistance; the person living with the employable person in need of assistance as a cohabitant; the partner not permanently living apart from the employable person in need of assistance; the under-age unmarried children belonging to the household of the aforementioned persons to the extent that they are unable to procure their means of subsistence from their own income or assets.

goal. However, as termination of need is the core objective, there is no formal labor market availability criterion for UB II recipients. But the suitability criterion was further tightened. Benefit recipients can be demanded to take up any job and follow obligations stemming from integration agreements. For activation to become an effective answer to benefit dependency, the labor market, however, must improve its capacities to create jobs (Eichhorst and Konle-Seidl 2006). Therefore part of the Hartz package was devoted to a (limited) flexibilization of the labor market (Jacobi and Kluge 2006, Eichhorst and Kaiser 2006). This was not right at the core of activating labor market policy, but should facilitate it.

**Table 1:** The Old and the New Benefit System

Old System (until 2004)	New System (since 2005)
<i>Arbeitslosengeld</i> (unemployment insurance benefit): funded through contributions, earnings-related, limited duration	<i>Arbeitslosengeld I (UB I)</i> : funded through contributions, earnings-related, limited duration
<i>Arbeitslosenhilfe</i> (earnings-related unemployment assistance): tax-funded, earnings-related, means-tested, infinite duration	<i>Grundsicherung für Arbeitsuchende (Basic income scheme for needy jobseekers)</i> Consisting of <i>Arbeitslosengeld II (UB II)</i> : tax-funded, means-tested, flat rate, after expiry of UB I (and temporary supplement), infinite duration (integration of “Arbeitslosenhilfe” and “Sozialhilfe” for people capable of working ) but stronger principle of activation <i>Sozialgeld</i> (social allowance) especially for kids below the working age of 15 living in a household of an UB II recipient
<i>Sozialhilfe</i> (social assistance): tax-funded, means-tested, flat rate, infinite duration	<i>Grundsicherung für Erwerbsgeminderte und im Alter</i> (social assistance): means-tested, tax-funded for those working age people not capable of working and for needy persons above 65 years



The explicit practical enforcement of “rights and duties”, however, is the core element of the Hartz reforms. The activation strategy is implemented in virtually every element of the labor market policy framework. The Hartz reforms shift priority towards active measures that require proactive behavior of the unemployed and promote their direct integration into regular employment. To this end, the reform re-designed integration subsidies, introduced new forms of wage subsidies, start-up subsidies and jobs with reduced social security contributions.

*The political logic behind the policy shift*

Germany’s rather late, but broad and massive shift to activation or—more precisely—awakening of “dormant” activating principles was the direct result of a long period of reform blockage and postponement in labor market policy. One explanation is German reunification. As a consequence of reunification in Germany, not the restructuring, but the expansion of traditional instruments of active labor market policies, particularly job creation schemes, but also passive income support was on the agenda in the beginning of the 1990s (Manow and Seils 2000). Another explanation refers to the strong role of social partner self-administration in the public employment service (Trampusch 2002) that were interested in controlling resource allocation to favor their clientele, take “surplus labor” out of the labor market and shift it to active and passive labor market policies and other social benefit schemes while deficits in unemployment insurance were covered by the federal government or higher contributions. Labor market policies in Germany helped to create and sustain the illusion that the “implicit contract” of rewarding previous contributions of the unemployed to the German economy—through benefits and labor market measures—was still intact. In fact, this contract had been undermined to a considerable degree for an increasing number of long-term unemployed who, in addition to their often meager Arbeitslosenhilfe, had to rely on Sozialhilfe payments, thus receiving financial support that was only related to need and not to previous labor market achievement.

This resulted in rising non-wage labor costs which in turn hampered employment creation. Despite the fact that rather critical evaluation studies on active labor market policies and employment disincentives in benefit systems had become available in the late 1990s, a more fundamental overhaul of active and passive labor market policies was virtually a non-issue in the Germany political economy until the early years of the current decade. Reforms in this area would have questioned the implicit “social treatment” of unemployment and implied a more prominent role of low-wage employment as a tool of labor market re-entry for the long-term unemployed as well as a more general flexibilization of the labor market.

The Red-Green coalition that came into power in 1998 was divided on this issue, with the major fragmentation between different wings of the social democratic parties. On the one hand, the new government revoked some of the restrictive provisions of the prior Christian-Democratic/Liberal government (i.e. full continuation of payments to sick workers) and tried to stabilize the “social policy” approach to unemployment. On the other hand, it tried to develop a more coherent normative framework for labor market and welfare state reforms referring to the concept of the “activating state” which was mainly inspired by New Labor and “third way” approaches formulated in the United Kingdom (Giddens 1999).

The concept of the “activating state” would have meant focusing public interventions on “enabling” programs that could help individuals take their own responsibility. In labor market policy, this implied stressing the conditionality of benefits upon individual efforts and cooperation, thus emphasizing the fundamental symmetry of “rights and obligations”. As it would also mean a break with the tradition of a status-protecting and occupation-oriented welfare state, this concept met only limited acceptance and strong opposition from major fractions within the Social Democrats. Maybe the best example for this reluctance is the rejection of the alleged “neo-liberal” Schröder/Blair paper in 1999. Hence, activation could not become a more systematic point of reference or an elaborated concept in the early years of the Red-Green coalition.

Reform stalemate could only be overcome in the face of the window of opportunity of the “placement scandal” and the subsequent Hartz report in 2002 with an expert commission legitimizing further reforms of labor market policy and regulation, changing the role of social partner tripartism in the German PES, the Bundesagentur für Arbeit (BA) and national policy-making, thus paving the way for more determined government action (Streeck and Trampusch 2005).

Activation was reintroduced by the report of the Hartz Commission who made references to good practices at the national levels, e.g. models of effective cooperation between BA and municipalities in selected “Mozart” projects, as well as international “best practices” and benchmarking of labor market performance and policies. Hence, the Hartz reforms focus was inspired by activating policies for the unemployed in other European countries that were perceived to be more successful in lowering unemployment such as the United Kingdom, the Netherlands or Denmark (Bruttel and Kemmerling 2006, Eichhorst et al., Fleckenstein 2004).

Government’s willingness to implement the Hartz proposals in a comprehensive way implied further clarification of crucial issues such as the level of the unified benefit for long-term unemployed that was to replace unemployment assistance and social assistance for people capable of working (erwerbsfähige Hilfebedürftige). With the “Agenda 2010” announced in March 2003 in a situation of high and rising unemployment and considerable political pressure it became clear that the government would opt for a flat-rate benefit with about the same level as social assistance thus effectively severing the link with prior earnings. This was to be implemented with the fourth Hartz Act in January 2005. In addition, the government announced shortening unemployment insurance benefit duration for older workers from 32 to 18 months and to cut dismissal protection and other elements of labor market regulation (Jantz 2004).

This sequence of rather “harsh” reforms that were perceived as a break with traditional social policy approach to labor market problems provoked broad public unrest that eventually resulted in a significant decline in political support for the red-green coa-

lition, in particular the Social Democrats, the emergence of a new left-wing party and the electoral defeat of Red-Green coalition in autumn 2005 (Eichhorst and Sesselmeier 2006).<sup>2</sup>

Opposition was strongest in the Eastern part of Germany (Rucht and Yang 2004). There, long-term unemployed could rely on relatively high and unlimited unemployment assistance payments due to widespread full-time employment of both men and women in the former GDR. Hence, abolishing earnings-related benefits, replacing them with flat-rate benefits and introducing a stricter activation policy was perceived as a threat to individual well being in particular given the poor labor market perspectives in East Germany.

Therefore, Hartz IV was perceived as a “social cruelty” that would result in severe benefit cuts, increasing poverty, strict supervision of jobseekers and forcing people in low-wage jobs, thus leading to a growing number of “working poor” and a tacit “Americanization” of the German labor market, something that had to be avoided by any means. Thus, Hartz IV became the symbol for a policy that was seen as a break with the principle of “the social insurance state” of providing status-oriented benefits while imposing only limited demands on unemployed. Even to date, there is no societal consensus on policy objectives in labor market policies. Hence, the paradigm shift to activation is not complete yet. Moreover there is a dominating sense of injustice. It is fair to argue that the broad rejection of the Hartz IV reform is due to a fundamental deficit of legitimating the “hidden” or silent shift from a social insurance state to a welfare state dominated by basic income support and stronger activation.

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<sup>2</sup> This was also due to the fact that Hartz IV led to a change in unemployment statistics. As the reform changed the rules for eligibility criteria for unemployment benefits, requiring all recipients of former social assistance “capable of working at least three hours a day” to register as unemployed, the number of registered unemployed exceeded 5 million for the first time in January 2005. Although this was only a statistical effect and did not mean a substantial increase in non-employment or broad unemployment, it was perceived as a major policy failure and the proof of the fact that the Hartz reforms did not work.

*The Silent Change of the Welfare State Logic: From Bismarck to Beveridge?*

Despite on-going reforms since the mid-1990s, it is frequently argued that the Hartz IV law marks a critical juncture resulting in the departure from a conservative welfare state securing acquired standards of living and a move towards an Anglo-Saxon welfare state relying on means-tested welfare and securing only basic needs. Activation is not an entirely new thing for Germany and has been reinforced step by step even before the Hartz Reforms, but the activation paradigm was not seriously implemented until the Hartz reforms. More specifically, the Hartz IV reform is part of a long-term shift from “Bismarck” to “Beveridge” in that it weakened the principle of status protection and contribution-equivalence in unemployment benefits for the long-term unemployed and strengthened the role of means-tested flat-rate benefits providing a minimum income floor only.<sup>3</sup> At the same time, however, stricter means-testing and flat-rate benefits imply a higher degree of interpersonal redistribution. Table 2 shows the relationship between recipients of contribution-based and means-tested flat-rate benefits in 2005 and 2007.

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<sup>3</sup> This is also true in the public old-age pension regime where the Riester reform implemented in 2001 brought about a departure from the principle of status-preserving public pensions.

**Table 2:** Contribution-based and means-tested unemployment benefits (2005 and 2007), in 1.000

Type of benefit	Total number of benefit recipients	Registered unemployed	Share of registered unemployed in %
<b>2005</b>			
Insurance scheme (UB I)	1.730	2.091	43
Means-tested scheme (UB II)	4.980	2.770	57
Total UB I and UB II	6.710	4.861	100
<b>2007</b>			
Insurance scheme (UB I)	1.079	1.253	33
Means-tested scheme (UB II)	5.277	2.523	67
Total UB I and UB II	6.247	3.776	100

Source: Bundesagentur für Arbeit.

To secure social status and the acquired standard of living, the unemployment benefit and the previous unemployment assistance referred to the former income. The duration of the unemployment benefit varied strongly according to age. Until early 2006 drawing benefits for up to 32 months was possible for older workers, thus stressing a widely perceived “savings account logic” of unemployment insurance. In the old system, a person becoming unemployed was entitled to unemployment insurance benefits for a certain period if he/she had an employment record of at least one year during the past few years. This benefit initially amounted to more than two thirds of the previous income with an in-built ceiling in accordance to the “equivalence principle”, and thus “rewarded” prior earnings and effort. The higher an individual’s achievements during his or her employment career, the higher the benefits. Older workers with a longer employment record could rely on extended unemployment insurance benefits.

When unemployment benefits were exhausted, the unemployed could apply for unemployment assistance which was still related to previous earnings but on a lower level. Although unemployment assistance was tax-funded, it was seen as a prolongation of unemployment insurance benefit (Karl et al. 2002). The “equivalence principle” was complemented by the principle of “occupational protection” that defined the “suitable job” an unemployed person had to accept as more or less adequate to the position held before becoming unemployed. Last but not least, persons relying on unemployment insurance benefits could also benefit from heavy investment in “enabling” active labor market policy schemes. These programs were not primarily used as a work-test but as instruments to stabilize human capital and restore benefit claims.

Hence, removing occupational protection (as early as in 1997), but more specifically, shortening benefit duration in unemployment insurance for older workers and abolishing earnings-related unemployment assistance means a departure from status protection and the strong reliance on the insurance principle and the equivalence of contributions and benefits. Abolishing longer benefit durations for older unemployed and earnings-related unemployment assistance was seen as an “expropriation”. As the reform interfered with widely accepted principles of “social justice” embodied in an insurance-based system, this change was perceived as “unfair” in particular given the fear of increased economic pressure not only due to lower and less sufficient benefits but also due to the announcement of stricter activation and placement even in low-wage jobs. While such prospects are well established and generally accepted in countries like the United States or the UK, they mean an overhaul of established notions of the German social model which strongly rests on what could be called “social security citizenship” (Ludwig-Mayerhofer 2005).<sup>4</sup>

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<sup>4</sup> Moving from extended social insurance through earnings-related benefit both in unemployment insurance and unemployment assistance also means a weakening of the traditional conservative “bread winner” model that was applied not only to the employed but also to the unemployed. The new basic income support does not take into account derived family responsibilities but generated individual entitlement for partners/spouses

This is not to say that means-tested benefits and activation provisions did not exist before, but they have now become the major principle of the German unemployment benefit regime both in terms of claimant figures and normative points of reference.

### **3 Activating Labor Market Policy after Hartz**

#### *The general framework*

The first and foremost objective of activating labor market policy in Germany is the reduction of individual unemployment duration by bringing unemployed persons, in particularly the long-term unemployed, back to work.

The basic principle of activating labor market policy in Germany is “Fördern und Fordern“, i.e. enabling or supporting the jobseekers on the one hand and demanding individual effort on the other. The recent reforms are in fact a recalibration of the Janus-faced nature of the German welfare state emphasizing both the role of demanding provisions (Fordern) and the enabling or empowering elements of social and labor market policy (Fördern). In the past, benefits could be received without meeting activation requirements in practice but rather expecting to be placed in active labor market schemes in a “benevolent” way. While activation principles have been in place for some time under former social assistance and in the well established active labor market policy framework, what is new is a tighter conceptual and practical linking of promoting and demanding elements (Fördern durch Fordern). These general orientations were explicitly fixed in the new SGB II (Second Book of the German Social Security Act, Sozialgesetzbuch II).

The concept of individual “co-production” by needy persons “capable of work” replaces the former paternalistic model. As participation in the labor market is assumed to be the high road to societal integration, taking up work is superior to receiving pas-

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and children, thus furthering individualization of welfare claims and stressing job search requirements for all employable members of a needy household and breaking with a more conservative family model.



sive benefits only. Formal terms defining the basic orientation of German activating labor market policy, however, open up ample space for divergent interpretations that are crucial for actual implementation.

Complementary to activating instruments in a more narrow sense, SGB II comprises enabling schemes such as labor market policy programs (§ 16 (1) SGB II) and other social services like child care provision or help in case of social problems like drug abuse or debts (§ 16 (2) SGB II) that have been conceived in order to facilitate labor market integration of employable benefit recipients, but do not reinforce benefit conditionality.

### *Target Groups*

First and foremost, activating measures address the target group of unemployed persons—both UB I and UB II recipients. To avoid long-term unemployment, which begins after 12 months according to both the German and the European definition, these persons have to register promptly with the local employment offices as soon as unemployment is foreseeable.

The medical definition of “capability of working” (not employability) with three hours a day in the foreseeable future under the usual conditions of the labor market results in a rather broad demarcation of the target groups which exceeds the focus of activation in many other European countries. This contributes to higher figures of open (registered) unemployment while in other countries a narrow definition of employability means fewer people registered as unemployed but assigned to passive schemes such as disability benefits. “Capability of working” (Erwerbsfähigkeit) features prominently as the overall concept of this approach. The individual working ability is evaluated purely from a medical standpoint. It is decided by the institution responsible for the safety net, i.e. usually the local employment office.

Certain sub-groups of persons “capable of working” are exempted from the availability criterion under the unemployment insurance regime (UB I) and the conditional job search requirement under basic income support (UB II). This holds for sick people and for persons that take care of children under the age of

three or care for family members as well as for older persons. However, there is a contradictory approach regarding to older persons with some enabling schemes on the one hand (wage subsidies and wage insurance) and an explicit provision exempting them from the obligation to be available for work. Accordingly, these persons receive public support but are not obliged to seek or accept employment—nor are they recorded as unemployed in the statistics as they are expected to move to the old-age pension system as soon as possible (Eichhorst 2006).

Persons with disabilities form an additional group at the core of the legislator's activating strategy. These persons are not subject to the same requirements as other unemployed persons, in particular their rights to support are less tightly linked to duties. The prime objective since many years, however, is to promote participation in working life. The principle of supporting rehabilitation measures instead of paying passive income support for disabled people is a basic feature of German active labor market policy. Furthermore, access to passive schemes like disability allowance is rather restrictive and not seen as an attractive "escape route" like in most other European countries (Konle-Seidl and Lang 2006).<sup>5</sup>

*Demanding and promoting under SGB III (unemployment insurance)*

The role of demanding and promoting elements (Fördern und Fordern) differ with respect to individual rights and obligations between unemployment insurance (Third Book of the Social Security Act, SGB III) and basic income support (Second Book of the Social Security Act, SGB II).

The claim to unemployment insurance benefit under § 118(1) SGB III arises in the event of unemployment and further vocational training. Workers entitled to this unemployment benefit

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<sup>5</sup> This means that the share of recipients registered as unemployed and included in mandatory job search activities or activation programs is higher in Germany (12.1 percent of working age population) and that of "inactive" recipients of passive welfare benefit schemes (3.5 percent of working age population) lower than in other countries.

must be unemployed and registered with the employment office and must have fulfilled the qualifying period.

Unemployed persons pursuant to § 119(1) SGB III are persons without work, seek to end their unemployment (personal efforts) and are available for the placement efforts of the Employment Agency (availability). Persons are considered to be without work if they do not work at all or if they work less than 15 hours per week. To be available, the unemployed person must be capable of working and be prepared to work, i.e. have the subjective will to work.

Unemployed persons have to devote personal efforts in order to utilize all possibilities available for their occupational integration (§ 119 (4) SGB III). These efforts include the performance of duties set forth in the integration agreement, participation in third-party placement services and the use of self-information facilities provided by the Employment Agencies.

The concept of personal effort bears activating features in that the search for employment is a precondition for the receipt of unemployment benefit. The nearest sanction for lack of personal effort is the imposition of a disqualification period. Unemployed are deemed available for the placement efforts if, inter alia, they are capable of and allowed to exercise an occupation which can be reasonably expected of them under the usual conditions of the labor market to be considered by them, and which is subject to compulsory insurance and comprises a weekly working time of no less than 15 hours. An important criterion of this definition is “suitability”, which is detailed in § 121 SGB III and purports that an unemployed person can be expected to perform all occupations conforming to his or her working capabilities to the extent that general or personal grounds do not oppose the reasonability of such an employment offer.

In contrast to basic income protection, not all jobs are considered suitable for unemployment insurance beneficiaries. There is not only a minimum threshold of 15 hours per week, but also a minimum level of earnings to be achieved that is related to prior wages and to the benefit levels. In earlier times, the protection of an acquired earnings level and occupation was even stronger. But the principle of occupational protection had been eroded to a

considerable degree in 1997 when new legislation stipulated that after six months of unemployment any job was suitable that provides at least earnings equivalent to unemployment compensation.

Nevertheless, until 1998 it was possible to stabilize and renew claims for unemployment insurance benefits through participation in publicly funded training programs and until 2003 in direct public job creation. These options have now been abolished. Additionally, the Hartz legislation strengthened availability criteria by defining removal reasonable and just in case of single unemployed and by shifting the burden of proof in case of rejection of job offers to the unemployed. Last but not least, the cut in maximum benefit duration from 32 to 18 months for unemployed aged 55 and over (effective since 1 February 2006) means that older unemployed move to means-tested basic income support earlier in their unemployment spell.

*Demanding and promoting principles under SGB II (Basic Income Scheme)*

Basic income support for needy jobseekers (Grundsicherung für Arbeitsuchende) has the double aim of

- providing sufficient minimum resources to ensure a decent standard of living in order to avoid poverty and
- ending benefit dependency through reintegration into gainful employment.

Basic income support for jobseekers is awarded under § 7 SGB II to persons who have attained the age of 15 but are still under 65, are capable of gainful employment, in need of assistance and have their customary place of abode in the Federal Republic of Germany.

According to § 1 Abs. 1 SGB II “people capable of working” should overcome need through their own efforts and their own means. An individual is needy if he/she is unable to earn a living for him/herself and for the other family members living together in one household. The individual in question is required to take on an acceptable job and use his own income and (certain) assets as well as that of his/her partner. Legislation on basic income

support (SGB II) pursues foremost social objectives. It provides a needs-oriented income so that all needy persons in Germany have sufficient means of subsistence.

Although basic income support for needy jobseekers is foremost a genuine social policy program to avoid poverty it has a strong focus on the labor market. With Hartz IV, the interface of social and labor market policy has been redefined and the traditional divide between both policy areas eroded. It focuses on need (not on unemployment as such) and on interventions to reduce need—with attempts at labor market integration featuring prominently as a promising way to end benefit dependency.

Thus, the new regime of basic income points at personal responsibility and at enabling and supporting interventions in order to enhance individual capacities to overcome need. Labor market availability and willingness to take up any job—even below wages set by collective agreements or public employment opportunities—are therefore crucial elements of activation addressing recipients of basic income support as long as they are capable of work. At the same time, however, UB II recipients can keep their benefit if they take up low-wage jobs that fit into the earnings disregard clause. The current provision stipulates that the first EUR 100 of monthly earnings are not taken into account when benefits are calculated whereas between EUR 100 and 800 20% remain with the beneficiaries as is true for 10% of earnings between EUR 800 and EUR 1.200 for singles or EUR 1.500 in case of UB II recipients with children.

Pursuant to § 19 SGB II, UB II consists of benefits to secure subsistence, including reasonable costs of accommodation and heating and a fixed-term supplementary allowance under § 24 SGB II to cushion the transition from unemployment insurance to Unemployment Benefit II. It provides two thirds of the difference between UB I and UB II for twelve months and one third for an additional year.

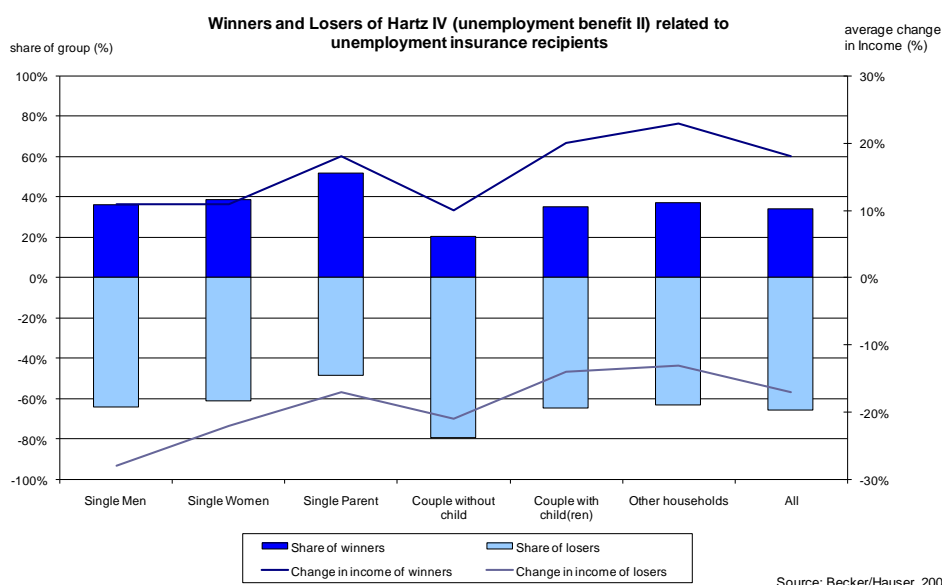
The normal benefit under § 20(2) and (4) SGB II is a lump-sum amount that is supposed to cover all living expenses. From 1 July 2008, this amount has been fixed at a standard rate of EUR 351 throughout the federal territory. Benefits for accommodation

and heating are specified in § 22 SGB II. Their amount is equivalent to the actual expenses, provided these are reasonable.

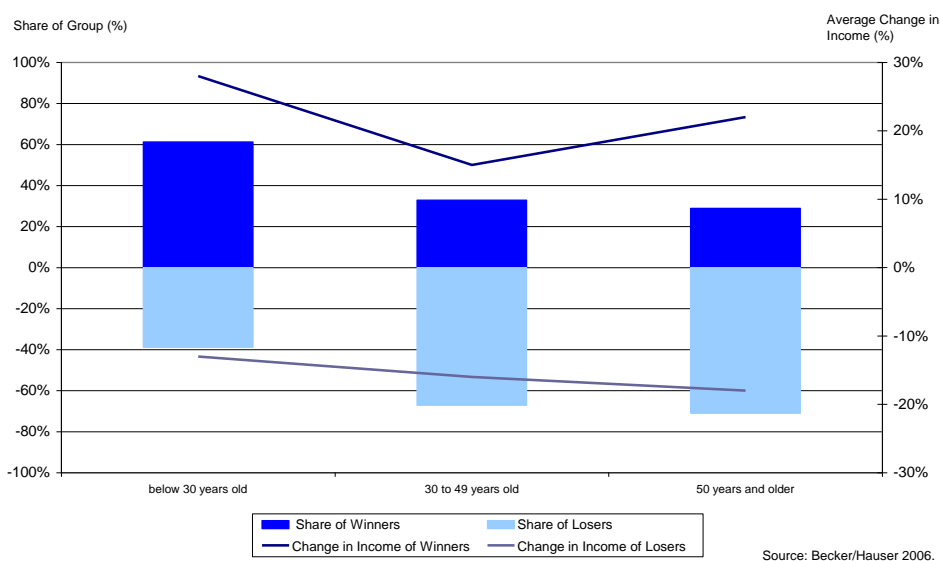
This standard payment is higher than former social assistance (EUR 295 as of July 2004). For children the standard payments are lower. Nevertheless SA benefits included more additional payments than UB II. In comparison to former unemployment assistance (on average EUR 550 in 2003 in Western Germany) UB II is less generous. This should result in pressure on the jobless to take on work. However, it should be taken into account that, whereas the recipients of UB II receive payments for housing and heating, the former UA recipients could only qualify for supplementary housing and social assistance if they fulfilled special conditions.

Hence, contrary to widespread beliefs, the new UB II is not in general lower than prior benefits. This holds for virtually all former social assistance beneficiaries, but also for a relevant share of all former unemployment assistance recipients. Simulation studies show that about one sixth of them lost its benefit entitlement due to the stricter consideration of wealth or earned income. Of the remaining persons with continued benefit claims, about 47 percent receive higher benefits, and about 53 percent have net losses (Blos and Rudolph 2005). Former unemployment assistance beneficiaries are affected unequally, however, with net gains concentrated among the young and the lone parents while older beneficiaries and couples with relatively high benefits under earnings-related unemployment assistance suffered from considerable cuts. This is mainly true for East Germany (65% losers) where long-term unemployed with a substantial employment record in the GDR and subsequent receipt of higher unemployment assistance are now transferred to flat-rate UB II (Becker and Hauser 2006, Blos and Rudolph 2005, see figures 1 and 2).

**Figure 1:** Change in Benefit Levels due to Hartz IV Reform, Former Unemployment Assistance Recipients, by Household Type



**Figure 2:** Change in Benefit Levels due to Hartz IV Reform, Former Unemployment Assistance Recipients, by Age Group



Basic income can also be received in all cases of need where resources from work and other income are not sufficient to pass the threshold income set by law (i.e. additional UB II). Hence, basic income support does not only focus on registered unemployed without entitlements to unemployment insurance benefits,

but also on people in school and training or in dependent employment if they pass the means-test. The same holds for self-employed. In contrast to former social assistance, UB II recipients are covered by both statutory health insurance and old-age pension insurance which also means that self-employed can receive health insurance coverage at a low premium under UB II.

Although the legislator defined the prerequisite for UB II receipt—capability of working—in a legally unequivocal manner, two problematic issues have been quick to emerge: For one thing, unequivocal assignment is not a question of law; rather, whether a person can work for at least three hours daily is a factual problem that is certain to raise dispute. The term “capable of working” is a criterion of delimitation vis-à-vis social assistance, since only persons capable of gainful employment can be expected to earn their living consistently and primarily through their own work. Consequently, there is a need for the various benefit institutions to reach a uniform decision on this issue. The essential aim of consistently placing persons able to work for at least three hours a day and also members of their *Bedarfgemeinschaft* under a single regime (either SGB II or SGB XII) has been judicially confirmed, and the relevant decisions have found approval in the literature (Berlit 2005, Luthé 2005).

In January 2005, more than 90 percent of former social assistance have been assessed as “capable of working” and consequently transferred from municipal responsibility to the new basic income support scheme financed out of taxes at the Federal level. However, first analyses by the BA regarding the structure of long-term unemployed recipients of UB II show that about half of all UB II beneficiaries have a considerable distance to the labor market. This holds in particular for long-term unemployed without vocational training, over 50 years of age, with severe health problems or a migration background especially in regions with high unemployment. About 400.000 to 600.000 people assessed as capable of working obviously have severe barriers to labor market integration.



*The Personal Integration Agreement*

The results of an individual profiling process at the employment offices are set out in a binding integration agreement. This written agreement states both the services that will be provided to the job seeker as well as the job seeker's obligation regarding job search activities and program participation, where required. An unemployed individual will be threatened by sanctions if he or she deviates from the integration agreement or does not cooperate appropriately.

Integration agreements pursuant to § 35(4) SGB III for UB I recipients are not a precondition for participating in active measures. Rather they are regarded as an instrument for improving the placement procedure. Under the insurance scheme integration agreements have a limited significance. They are linked only to active measures, but not to passive benefit receipt. The agreement therefore cannot be used to sanction unemployed persons. As a consequence, integration agreements are scarcely applied within the legal ambit of SGB III. The agreement's mere restriction to the acquisition of more comprehensive information for the unilateral decision on active employment promotion measures fails to do adequate justice to the potential inherent in agreed strategies. In contrast to integration agreements for UB II claimants, the merits of negotiated strategies under the insurance scheme mainly lie in the psychological sphere.

In contrast to the insurance scheme personal agreements for UB II claimants are mandatory pursuant to §§ 2(1) sent. 2 and 15 SGB II. The two parts have to conclude an integration agreement stipulating the necessary services and obligations. This duty is not a duty in the legal sense, but a so-called incidental obligation, meaning its fulfillment is not legally enforceable. But it is indirectly "compelled" via the imposition of a financial sanction. Jobseekers face financial disadvantages if they refuse to enter into an integration agreement (§ 31(1) SGB II).

*Sanctions*

According to § 144 SGB III benefit receipt could be suspended temporarily if a UB I recipient

- refuses suitable work or a suitable activation measure
- resigns work without good reason or
- shows insufficient effort to look for a new job
- fails to notify in the case of dismissal to the employment office.

The sanction consists in the imposition of a disqualification period of normally 12 weeks.

A key element has been introduced through a reversal of the onus of proof in respect of the “good reason” which can justify a disqualification period. Now it is the unemployed person who must prove the facts within his or her sphere of activity and scope of responsibility—and not the administrative authority, who only bears the burden of proof under the general rules of evidence.

In contrast to unemployment insurance, however, basic income support (UB II) cannot be suspended completely in case of lack of willingness to work or to participate in reintegration programs, but only reduced to a certain extent as minimum resources needed for physical existence cannot be withdrawn even if the behavior of the recipient violates general principles of activation. In extreme cases, benefits in kind can replace cash benefits.

The sanction regulation under § 31(1) sent. 1 no. 1c SGB II implies that the duty to take up reasonable work is not a legal duty, but a mere incidental obligation. This is because the regulation makes clear that work need not actually be taken up for the receipt of benefits under SGB II, but that the refusal to accept reasonable work only has financial consequences for the job-seeker. The subsequent provisions of § 31 SGB II moreover do not entail a complete denial of all benefits under SGB II in case of the beneficiary’s persisting unwillingness to work, but instead specify the sanctions to be adopted.

The possible curtailment of UB II and its ultimate withdrawal as provided under § 31 SGB II, constitute important enforcement measures. UB II recipients are obliged to accept any offer to suitable work. The definition of suitable work was broadened. Both the beneficiary’s refusal to conclude an integration agreement and his or her non-compliance with agreed duties, but also the

rejection of a reasonable job offer, an immediate offer or a public employment opportunity without a valid reason lead to a 30 percent reduction of benefits upon first breach of duty. A second breach of duty incurs a 60 percent reduction, followed by the complete withdrawal of benefit if a renewed breach occurs within a year. To ensure the constitutionally guaranteed subsistence minimum, the provision of in-kind benefits is left to the duty-bound discretion of the institution granting basic security—§ 31(3) SGB II (Wunder and Diehm 2006). These refined sanctioning provisions addressing UB II claimants are a result of legal fine-tuning effective as of August 2006 and January 2007 after an unexpected increase in numbers of beneficiaries. This also led to stricter sanctioning clauses for beneficiaries under 25 that stipulated that after the first incidence of misconduct, benefits can be restricted to benefits in kind. However, the duration of sanctions can be reduced from 12 to 6 weeks.

#### *Activation Measures for UB I recipients*

Active employment promotion include a variety of measures stipulated under § 3(1) SGB III. Examples of active employment measures are: counseling and career guidance, job placement, job creation schemes, wage subsidies, training measures to improve integration prospects, and the defrayal of retraining costs during participation in further vocational training.

In the early days of labor market policies, as expressed in the Federal Employment Promotion Act (*Arbeitsförderungsgesetz*) of 1969, not only the unemployed but also persons with insufficient training were entitled to long-range training measures, receiving generous support during these measures and even for six months afterwards if they did not immediately find a job. Thus, active labor market policies offered possibilities of upgrading the labor force, both to the benefit of the individual (upwards mobility) and the collective (maintaining a well-trained labor force). Soon after the first labor market crisis in the mid-1970s, the entitlements of the individuals to training measures—and to the accompanying payments—were severely curtailed.

With the Hartz reforms a number of new instruments were created that aim at a more effective re-integration of the unemployed although they are not “activating” in a narrow sense, i.e. used to enforce benefit conditionality. These innovative instruments comprise different forms of flexible and subsidized employment apart from “classical” employer-oriented wage subsidies:

- temporary agency work for the unemployment provided by specific agencies associated with the PES (*Personal-Service-Agenturen*),
- part-time work up to EUR 400 per month exempt from employees’ contributions to social insurance and taxes (*Minijobs*) replacing older models of minor employment (*geringfügige Beschäftigung*) with a lower earnings threshold,
- jobs between EUR 400 and 800 per month with employees’ social insurance contributions increasing proportionally with earnings (*Midijobs*),
- start-up grants for small business providing subsidies for up to three years (*Ich-AG* or “Me Inc.”).<sup>6</sup>

Additionally, preventive measures like “job-to-job placement” have been enforced. Pursuant to § 37b SGB III, persons whose employment or training relationship is due to end are obliged to report personally as jobseekers to the local employment office no later than three months prior to the termination of that relationship. Non-compliance with this reporting obligation entails a disqualification period of one week. It is hoped that early reporting will permit the Employment Agencies to become active faster and thus more successfully, than in the past. The financial loss set by law for late reporting has met opposition and has therefore become a matter for the courts.<sup>7</sup> In the last instance, the Federal Social Court (Bundessozialgericht) came to the conclusion that

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<sup>6</sup> This was replaced by a new and integrated start-up allowance as of mid-2006.

<sup>7</sup> Despite the meanwhile mitigated version of the sanction regulation, court rulings remain relevant: BSG (Federal Social Court), judgment of 25 May 2005, SGB 2006, 49 ff.; BSG, judgment of 18 Aug. 2005.

unemployment insurance benefits could only be reduced on account of belated reporting if the jobseeker was to blame for this.

#### *Activation Measures for UB II recipients*

Provision of services is based on individual need for assistance. UB II recipients are no longer excluded from most of the instruments of ALMP provided by SGB III. The implementing institutions (Arbeitsgemeinschaften, ARGEn, i.e. joint bodies of federal PES and municipal welfare offices, or, as in some districts, opting-out municipalities, Optionskommunen) are in principle entitled, as set forth in § 16(1) SGB II, to apply all the instruments available for UB I recipients by reference to the relevant provisions of SGB III. Moreover, SGB II has introduced additional measures which have been designed specifically for welfare recipients and their particular barriers to employment like debt, abuse of alcohol or other drugs, socio-psychological counseling and child care services stipulated in § 16(2) SGB II or a start-up allowance pursuant to § 29 SGB II. The promotion of reintegration measures is regulated in § 14 SGB II, meaning the institutions responsible for providing basic security to jobseekers primarily become active with the aim of reintegrating needy persons capable of working into the labor market.

In a recent amendment by 20 July 2006, § 15a SGB II now provides that persons capable of working who within the past two years have not received cash benefits under either SGB II or SGB III are immediately to be offered benefits for integration into work upon applying for benefits pursuant to SGB II. This “immediate offer” of integration services is to avoid the need of assistance or at least prevent long spells of such need and to test the applicant’s readiness to accept employment.

If needy persons capable of working find no job, public employment opportunities are to be created on their behalf (§ 16(3) SGB II). Prerequisites governing the admissibility of job opportunities are not to be discussed further here. Important, rather, is how the legislator’s conceptions are put into practice. The legislative intent was that the provision of time-limited job opportunities (so-called “One-Euro-Jobs”) would avoid the emergence of a

subsidized, state-financed “third” labor market, as was the case with the largely unsuccessful public job creation measures in the 1990s. Activation programs should be applied only if they avoid, eliminate, shorten or reduce benefit dependency through integration into a regular job.

The activating effect of One-Euro-Jobs is seen in re-acustoming jobless persons to activities with a steady work rhythm, punctuality, and so forth, and, hence, to improve their integration prospects (“work-pedagogic objective”) (Bieritz-Harder 2005). The foremost aim is always to achieve integration into the regular labor market, possibly also to regain fully-fledged employment in the wake of such job opportunities. The approach of regarding these additional jobs as a quid pro quo for the receipt of Unemployment Benefit II does not conform to the enacted text, nor can this be inferred from the judgments so far delivered in respect of § 16(3) SGB II.

#### *Implementation and outcomes so far*

The Hartz reform package not only changed the benefit and activation regime, it also created new implementation structures with the ARGE and opting-out municipalities.<sup>8</sup> After more than three years of actual activation practice under the new regime, one can assess the effectiveness of the reforms and their overall outcomes. As shown above, the curtailment of social insurance benefits meant a major structural change regarding the composition of the benefit recipients. In summer 2008, about three quarters are under UB II. At the same time, the change in policy orientation and governance led to a strong decline in participation and expenditure for traditional active labor market schemes, such as training and direct job creation, whereas start-up grants expanded significantly. Between 2002 and 2007 expenditure for active schemes went down from 22.1 billion EUR to 15.2 billion EUR. Hence, the shift towards activation by way of more demanding interventions was associated with a decline in active labor market

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<sup>8</sup> The ARGE structure has been ruled unconstitutional by the Federal Constitutional Court in late 2007 so that a new legal basis for cooperation between federal PES and the municipal level.

policy expenditure, not with an increase. With regard to UB recipients, One-Euro-Jobs are by far the most important scheme, as figure 3 shows. They have virtually replaced other forms of direct job creation.

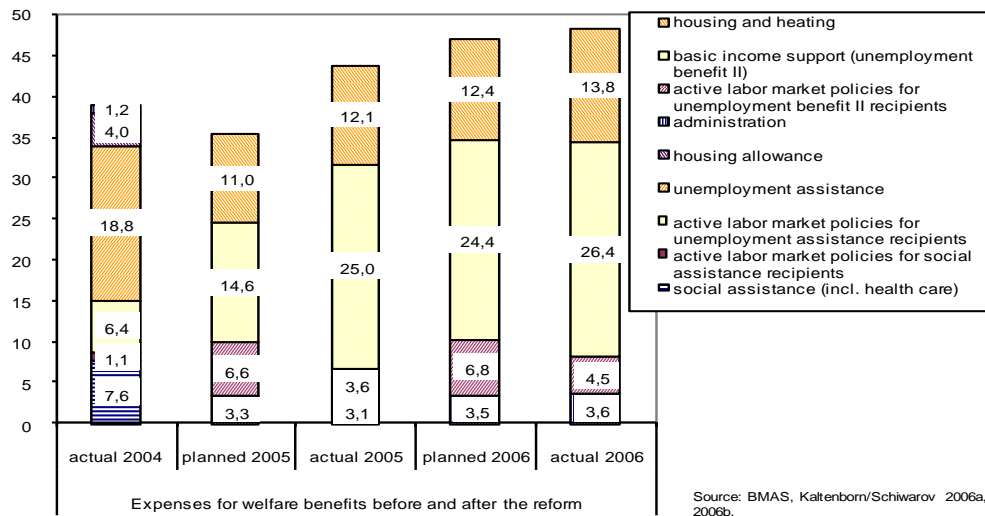
**Figure 3:** Activating Interventions under SGB II, 2005 to 2007



Source: BA Statistics.

In terms of overall expenditure, however, the decline of benefit expenditure and active schemes for UB I claimants was offset by increases in UB II expenditure, i.e. by a shift from contribution-based to tax-funded benefits (see figure 4).

**Figure 4:** Expenditure for Active and Passive Labor Market Policies in Assistance Schemes Before and After the Reform



The number of beneficiaries and the expenditure data are only rough approximations of the reform effects. In terms of evaluation of individual labor market integration, available evidence suggests that the labor market policy instruments only show mixed effects with broad similarities across UB I and UB II activation. There seem to be positive effects of subsidization, sanctioning and support self-employment at least in the short run whereas some evidence suggests positive long-term effects of training (Bernhard et al. 2008, Eichhorst and Zimmermann 2007).

One-Euro-Jobs are less promising. This scheme is also a good example to demonstrate the still insufficient implementation of the Fördern und Fordern principles of activation. On the one hand, these jobs have been designed to promote the employability of unemployed persons with a bad prognosis for a quick integration into the regular labor market. On the other hand, they serve as a work-test for individuals with good chances but low search efforts. However, results from a survey of case managers carried out in fall 2005 show that One-Euro-Jobs are offered mostly on a voluntary basis, i.e. on a consensual basis. Case managers see their prime objective in re-establishing or stabilizing employability and in strengthening societal integration



through structuring daily life, improved self-confidence and additional resources for debt redemption. Immediate reintegration into the labor market is not a principle objective of this scheme in their view (Wolff and Hohmeyer 2006). Nevertheless, the use and purpose of the One-Euro-Jobs is still highly controversial. In a recent report, the Federal Audit Court (Bundesrechnungshof) found out that about two thirds of these public employment opportunities do not meet the legal requirements of “public interest” and “additionality”. Using a fixed-effects panel-estimation of the years 2004 and 2005 on the substitution of regular jobs, the analysis shows that One-Euro-Jobs tend to have negative effects in Eastern Germany, but no corresponding negative effect could be identified in Western Germany (Hohendanner 2007). The Federal Audit Court also continues to criticize the implementation of Hartz IV by point out at the fact that activating interventions start too late to prevent long-term benefit receipt.

At the same time, however, the shift to activation was associated with a decline in reservation wages of German unemployed. Unemployed now accept lower wages (Kettner and Rebien 2007, Schneider 2008), and persons threatened by unemployment take the eventual receipt of a means-test basic income benefit into account and intensify job search. This has contributed to more employment-intensive economic growth during the recent upswing. In this respect, Hartz IV contributed to making the German labor market more flexible. From a critical perspective, some observers point at the growth of low-wage jobs and benefit recipients who enter the labor market only at the margin and do not earn enough to leave the benefit system completely (Brenke and Ziemendorff 2008). Although the majority of these 1.3 million “Aufstocker” are part-time workers and the full-time employees in need of additional benefit top-up tend to live in large households, there is an issue of sustainability of labor market integration. Many low-skilled benefit recipients find it difficult to achieve earnings that help them out of benefit receipt. In a broader sense, the growth of low-wage sector contributes to fears of downward mobility and income erosion of the middle class expressed in survey data (Grabka and Frick 2008). Empirical evidence also shows that upward mobility is rather limited in

Germany (Schank et al. 2008). Hartz IV has become a major point of reference not only for the unemployed, but also for the labor force in more general terms.

#### **4 Conclusion: Germany on the Way to a Means-Tested Welfare State?**

Germany embarked on the shift towards activation much later than its European neighbors, but this policy change was in many respects more fundamental and comprehensive as it implied a major break with the welfare state tradition which had been characterized by the social insurance logic of a “Bismarckian” system. Passive, status protecting benefits had been used in the past to buffer economic adjustment. Against this background, policy change from status and occupational orientation in the benefit regime to basic income support for the long-term unemployed in combination with the stricter formulation and potential enforcement of “dormant” demanding elements is a major element of “path departure” and recalibration of rights and obligations in the German welfare state. This also implied a major overhaul of active labor market policy schemes and governance. But the shift towards activation is not just a “technical” issue and an example of implementing New Public Management principles in Germany.

The late, but fundamental change in Germany is most notable in comparison with other European countries such as the UK, Denmark, the Netherlands or Sweden as the German approach to activation is relatively broad and ambitious as “capability of working” is defined mainly in a medical sense so that the number of people to be activated is much higher than elsewhere, in particular given the fact that alternative escape routes do not play a prominent role in Germany these days (i.e. disability benefits) or are being closed (e.g. early retirement). This dramatically increases transparency regarding non-employment and leads to high open (registered) unemployment at the beginning of the activation of the long-term unemployed with the Hartz IV reform.

Contrary to widespread perceptions, however, stronger activation is not associated with a general decline in benefit levels—even not for the long-term unemployed—as Hartz IV is not only activation, but also a social policy reform widening access to benefits and assistance. Rather the severance of the link between benefits for the long-term unemployed and prior earnings changed the perception of benefit generosity. There is some evidence that this—in conjunction with more demanding interventions by administrative bodies—leads to lower acceptance wages and stronger job search effort due to increased fears of downward mobility in case of longer unemployment spells.

This has more fundamental consequences as it signals the departure from status protection and a “benevolent” welfare state to a more basic, means-tested system of social protection and stricter “workfare” although these very principles had been in place before. This is not only a result of the abolition of earnings-related unemployment assistance but also due to the associated cut in maximum duration of unemployment insurance benefits for older workers. In empirical terms this becomes evident with respect to the diminishing role of contribution-based and earnings-related unemployment insurance benefits relative to the number of beneficiaries of means-tested basic income schemes. Hence, both in terms of claimant numbers and expected benefit levels, basic income support is now the dominant regime and major point of reference for the unemployed in Germany.

Basic income for jobseekers, but also means-tested earnings top-up for low-wage earners is now by far the more important benefit scheme than unemployment insurance for short-term unemployed with sufficient prior employment record. This new arrangements questions the status of lifetime achievement and occupational orientation that was characteristic for the German model of industrial production in the past. On the one hand, this may reduce incentives to pursue professional careers as acquired rights in the social insurance system depreciate more quickly than in the past, and after (accelerated) expiry of unemployment insurance benefits, virtually all jobs are suitable. On the other hand, however, reduced benefit generosity in case of long-term unemployment and even the threat of being transferred to means-

tested flat-rate basic income may lead to higher individual effort in order not to lose track of the regular labor market and raise individual job search intensity in case of unemployment. This may even have positive effects on human capital investment. Anyway, the reform reinforces individual responsibility and reduces the possibility to rely on status-oriented benefits and human capital enhancing labor market policies.

Given this broad paradigm shift, acceptance deficits come as no surprise. Cuts in UB I duration, replacing earnings-related unemployment assistance with a flat-rate benefit for the long-term unemployed and fears of “enforced” low-wage employment as a result of stricter activation motivated major public unrest before and after the Hartz IV reform came into effect. However, despite a broad public controversy, the long-term implications of this institutional change remain rather implicit. Part of the acceptance deficit can be explained by the lack of a general normative framework developed in order to explain the necessity of these changes and to emphasize the potential of this reform. This may also be partly responsible for reluctant implementation in practice as the implicit normative assumptions are not shared by all actors charged with implementation.

The difficulties experienced with the politics and the implementation of activation in Germany points at more fundamental issues as both policy makers and the general public are very reluctant with regard to a complementary liberalization of the labor market and higher wage dispersion which would help strengthen the supply of entry jobs for the activated. The concept of “work first” may be embodied in current German legislation, yet the idea of “any job is better than no job” still raises widespread opposition. Hence, the question whether a higher degree of inequality is inevitable in the general labor market in order to overcome benefit dependency is still unsolved. Being accustomed to a “high equality, low activity” arrangement, activation of the long-term unemployed and the low-skilled implies a major shift of paradigm as there is now a combination of less equality, but higher activity although this is probably not a stable new equilibrium yet.

With regard to the foreseeable future, the German activation regime will most probably be subject to further, sometimes contradictory modification. One more coherent policy solution implying a general lowering of basic income is virtually ruled out, therefore there is no prominent role for strong in-work benefits (see e.g. Sachverständigenrat 2006). This is also true for a bold flexibilization of the labor market which would be complementary to this approach inspired by the Anglo-Saxon experience. Both the public and the policy makers are highly reserved with regard to these issues. Activation will most probably remain in place as the major principle of unemployment protection, but strong social justice considerations already led to stabilizing wages through introducing a general statutory minimum wage or extending collectively agreed sectoral minimum wages even if this might be detrimental to the labor market integration of the long-term unemployed. Policy makers currently aim at “softening” activation policies. UB I has been prolonged again for the older unemployed in order to restore “social justice”, and some tend to resort to a more limited definition of “capability of working”, to liberalizing access to disability pensions and continuing old-age part-time work and assigning part of the hard-to-place to public sector employment where some new models of direct public job creation or heavily subsidized jobs have already been introduced. These policy corrections reflect the fact that the German labor force and the electorate feel uneasy about the consequences of activation on the dynamics of the labor market. Yet, opening up new exit routes from the labor market is in stark opposition to tackling the major barriers to sustainable employment experienced in activation of long-term inactive and low-skilled benefit recipients, namely early activation associated with basic training and continuous education to ensure employability and make upward mobility a real option.

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