
Financial incentives within social assistance: Comparing current strategies in the U.S. and Germany

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Abstract

In this paper we rule out general financial incentives such as the negative income tax or a U.S.-American Earned Income Tax Credit for feasible implementation and the improvement of employment in German social assistance. Instead we provide a description of alternative targeted financial incentive experiments in both the U.S. and Germany designed to encourage employment among social assistance recipients. The programs are the German Einstiegsgeld in Baden-Württemberg and Hessen, and in the U.S. the Minnesota Family Investment Program and the Wisconsin New Hope program. In describing evaluations of the programs we explore what one country could learn from another.

Introduction

In light of the current unstable situation of German social assistance and the pressure on the German welfare state to introduce changes to its system, we present a thought-provoking comparison of U.S. and German financial incentive programs. It is not our intent to present a 'best practice' solution for the creation of jobs and the prevention of poverty for either Germany or the U.S.. However, it is our intent to present a comparison of these programs in a way that might provide learning aspects for each country. While a specific program comparison needs careful analysis because of the varying social, economic and historical conditions which frame each country, we are convinced that in the wake of the restructuring of social assistance schemes in both countries, there is much to be gained by this useful exercise.

As Josef Schmid has remarked in his introduction to this volume, innovations on the local level can provide us much information about the transformations of welfare states. Indeed, we have found that the local logic at the community level are somewhat similar when we examine targeted financial incentives in the U.S. and Germany. With these observations we hope then to provide a fresh view of welfare state comparison and welfare state development.

In light of the changes occurring in the German welfare state, we first describe the overall reforms in social assistance during the 1990s. Then we argue that general labor market incentives such as the negative income tax or the Earned Income Tax Credit (EITC) are not feasible in Germany due to its narrow income distribution and the incompatibility of broad ideological factors that make a consensus among policy makers extremely difficult. Instead, we consider carefully targeted programs with generous incentives as more easily compared among the two welfare states. We outline experiments currently taking place in Germany which are helping to remodel its social assistance programs, and compare more advanced reform experimentation in the United States. We provide an economic view of the newly created targeted financial incentive programs and experiments in Germany under the growing pressures of rising costs for social assistance, high unemployment and social assistance 'traps' that make it more difficult for recipients to leave social assistance. In the conclusion, we provide experience from financial incentive efforts in the United States to

suggest possible answers or provide a contrast to questions of German experimentation and to discuss possible consequences of borrowing policy.

German Social Assistance and its reforms in the 1990s

German social assistance is pretty much unified at the federal level, and yet recently, there have been some changes on the national level which have created the framework for innovative programs within local levels of government (see Schridde in this volume). In this section we briefly describe these reform measures and in the subsequent section, we illustrate the discussions of general labor market strategies for German social assistance that followed these national reforms. We use the word social assistance to refer to the German 'Hilfe zum Lebensunterhalt'. Not included in this term is the coverage provided from 'Hilfe in besonderen Lebenslagen', which mostly for ill, disabled or very old people.

The last decade has shown little economic improvement in Germany and this one situation has probably stimulated considerable pressure on social assistance and unemployment insurance during the 1990s (Sturm 1996). The German economic downturn in the early nineties led to higher unemployment and consequently increased social assistance expenditures. For example, costs for 'Hilfe zum Lebensunterhalt', only one part of social assistance, went from □ 2,736 million in 1983 to □ 6,972 million in 1993 (Wenzel 1995). These rising expenditures were primarily due to the increased number of recipients (not because of increased benefits) and they were probably the reason for increased pressure on the government to institute reforms. Others like Robert Henry Cox (also in this volume) argue that liberalizing trends have been observed in most welfare states (Cox 1999) and Germany is not excluded: "social assistance is becoming more residual, pension schemes are becoming more contributory, and active labor market policies are transforming the passive character of social insurance" (Cox 1999: 11). Indeed, it has been reasoned that liberalizing trends are more easily adopted by conservative countries like Germany than coordinated market logics are adopted by liberal organized systems (Hall and Soskice 2001; Soskice 2001).

Whatever its causes, the German reforms of social assistance in the 1990s have taken an unmistakable turn. Generous unemployment benefits were first restricted by reduction of time limits, with the result that many recipients slipped from the unemployment rolls to the public assistance rolls. In 1990 the measurement of welfare assistance was reformulated. The Statistik-Modell replaced the 'Warenkorb-Methode' which led to a reduction of welfare payments. According to the Federal Social Assistance Act (Bundessozialhilfegesetz) the state was responsible for providing unconditional universal social security to its citizens, but in the 1990s work and social assistance became more interdependent. In 1993 the law 'Gesetz zur Umsetzung des Föderalen Konsolidierungsprogramms' introduced penalties when social recipients refused to work. It stated that a social assistance office not only 'could' reduce payments, but 'should'. A year later, the law 'Zweites Gesetz zur Umsetzung des Spar-, Konsolidierungs- und Wachstumsprogramms' reemphasized that willingness to work was now a requirement for social assistance. This law gave the social assistance offices an option to create job opportunities for their social assistance recipients to find permanent work or to test their willingness to work (§20, Abs. 1 BSHG).

During the mid 1990s social assistance was no longer just a rehabilitation program but developed into a mechanism for controlling willingness to work (Herweg 1999). In July 1996, powers were given to the welfare office that made them responsible for penalizing refusals to take up offered work. When welfare recipients did not take up work, the welfare offices were told that they 'must' reduce payments (§§18-20, 25 BSHG).

A reformulation of the ideas of social assistance in the reforms was also incorporated as justification in the ideologies already present. A main principle in German social assistance is the 'subsidiarity principle': people are required to rely on themselves and their family before the state intervenes. This has been interpreted as the duty of each recipient of social assistance to look for and accept any job that is available. The subsidiarity principle has also been used to serve as a rationale for major reductions in social assistance payments for Germans who are additionally earning an income.

Working while still on social assistance is not encouraged in Germany. A social assistance recipient has to become fully independent of social assistance before she can improve her situation through

employment. A recipient of German social assistance receives about □ 283 a month plus individual housing costs. In 1998 the total average social assistance for single recipients in Germany was about □ 564, while two parent families with two children received about □ 1,333. These amounts included housing costs of □ 231 for a single person and □ 410 for a family with two children, which need to be paid out of social assistance (Statistisches Bundesamt 1999b, 39). If recipients get a job, they can keep their new net earnings up to □ 71 a month. For any extra □ more than □ 71 that they receive in the labor market, their social assistance is reduced by 44 Cents. If the recipient earns more than □ 71 despite the marginal deduction (or tax) rate of 85 %, the maximum amount that can be gained by the recipient is □ 142 per month. Additional net income is deducted in full from the individual social assistance. The recipients cannot improve their financial situation by more than □ 142 (□ 71) if they (do not) accept a marginal deduction rate on net earnings of 85 % (These rates vary slightly according to region and district).

Recent German discussions about reform alternatives have centered around this social assistance 'trap' which reduces individual incentives to work, along with the issues of high unemployment and the increased costs of social assistance. Just as in the United States, German discussions have revolved around similar arguments that 'work does not pay for recipients of social assistance'. There has been a debate as to whether the majority of recipients who are on social assistance and want gainful employment do not have an opportunity for substantial improvements of their own financial situation. For these people the temptation could be too strong to improve their own financial situation by working in the shadow economy.

In 1997-1998 among all 2.9 million recipients of social assistance some 1.2 million were estimated to be employable, but only 133,000 were working at least in a part-time job. Furthermore, 44,000 people were taking part in educational and training programs (Statistisches Bundesamt 1999a: 14; Statistisches Bundesamt 1999b: 7). These unemployment rates have made policy makers desperate to find new solutions, and look at other countries' policies. Financial incentive solutions are being considered in Germany in order to increase labor market participation of people receiving German social assistance and lower German tax burdens. The consequences of these arguments are examined in the following sections.

Discussions of general labor market incentives in Germany

To address a lack of incentives to enter the labor market, several alternative proposals for general labor market incentives have been discussed in political circles. These include the negative income tax, a German variant of the US- American Earned Income Tax Credit, and improving general labor market incentives for recipients of social assistance.

General negative income tax

Negative income taxes are government benefits dependent on income and citizenship and provided through the tax system. In the early 1990s Germany began a very broad discussion regarding negative income taxes with a variety of proposals, estimations and simulations. German Liberal Democrats (F.D.P.) tried hard to push for a kind of general negative income tax which they called 'Bürgergeld' ('citizen's money'). The implementation of different variants of a negative income tax has also been discussed in other German parties (Scharpf 1993; Hochmuth/Klee/Volkert 1995). For politicians and economists favoring a German general negative income tax there were many goals involved. It was expected that a negative income tax could increase work incentives for people with low wages, lead to positive employment effects, reduce the shadow economy, lower the complexity of the German tax and transfer system, and reduce administrative costs (Volkert 1999: 239 ff). This general negative income reform was doomed to fall victim to a lack of consensus, as there were many goals wrapped up in a very new ideological direction for the welfare state; and, as Josef Schmid's analysis of policy borrowing would predict, it was not very likely to become concrete policy (1999).

Indeed, controversy over the negative income tax erupted between far reaching expectations of policy makers and a number of studies that showed fundamental problems with the outlined concept. A commission of experts ('Expertenkommission Alternative Steuer- und Transfersysteme' 1996) had the task of evaluating the German prerequisites and the existing studies for such a concept in order to

decide whether a negative income tax could be a promising alternative to reform the German tax and transfer system.

Apart from conceptual problems in the proposals it was shown that a 50 % negative income tax would have to distribute transfers to an additional 10 million employees who did not get transfers before (Spermann 1996). Spermann documents that this is because the grant break even level (and probably the amount where taxation starts) would rise substantially. (The total sum of German employees is about 36 million; ca. 27 million people work in jobs with full social security coverage). For the new recipients income and substitution effects would cause disincentives and reduce employment even if elasticity of labor supply in the relevant German income section can be shown to be almost zero (for men) or at most very low (for women). These negative employment effects would counteract the incentives and expected positive employment effects for unemployed people, and lead to an unknown total employment effect.

A general incentive program would not be economically feasible in Germany because the income distribution is very narrow. Unlike in a liberal welfare state model, the implementation of a negative income tax in Germany would lead to a high number of additional people who would be entitled to transfers. This would cause substantial additional costs in Germany, whereas wide income distribution in the U.S. would not cause such high additional welfare expenditures. Depending on the concrete concept, cost estimations for a 50 % negative income tax varied between additional net costs of at least \square 20.5 billion up to \square 138.5 billion in Germany. Even with a less generous negative income tax rate (with transfer reductions of 66%) additional net costs would have reached \square 9 billion, an amount that was higher than the total sum spent for social assistance (Hilfe zum Lebensunterhalt) (Becker 1996; Statistisches Bundesamt 1998, 4). If a comparable less generous variant (with transfer reductions of 70 %) were financed by taxes, marginal income tax rates would have to be increased by eight percentage points. These developments would have been contrary to optimal taxation and would lead to high additional costs with at least uncertain employment effects.

Unlike in the U.S., where negative income taxes were created to correct low wages and insufficient exemptions, a negative income tax in Germany would be established with current tariffs, which are set high

enough to prevent a massive working poor problem. The Experten-Kommission (1996) advised against the plans of a general negative income tax but nevertheless the general discussion of policy reform remained, and there were recommendations to look at additional policy reforms for social assistance. While in the 1970s there was less stress on either the stick or the carrot in Germany (Leibfried 1978), the discussion of a negative income tax today is reflective of more interest in promoting self-initiatives for social assistance recipients in combating their unemployment. Indeed, the conceptualization of the meaning of social (assistance) policies in Germany has undergone considerable change.

Debates about a U.S.-American EITC for Germany

While German policy makers were discussing a negative income tax, they also started to pay attention to the United States' Earned Income Tax Credit (EITC). This is a tax benefit not based on citizenship rights, but on working status. Since studies showed that these U.S.-American employment-conditional tax credits have some positive effects on labor supply (particularly among single mothers) (Eissa/Liebman 1993; Meyer/Rosenbaum 1998), the question arose as to whether such a concept could be a promising way to strengthen work incentives in German social assistance (Sinn 1999; Wilke 1999).

The OECD (1997, 74 f.) has approximated the U.S.-American EITC for Germany, giving a credit of 25 per cent of gross earnings up to one third of median earnings. They modeled a plateau between one third and half of the average production worker's earnings and a phase-out at 20 per cent of gross earnings. Among the currently employed Germans, 29 per cent of those affected would be in the phase-in region with falling marginal effective tax rates (METRs), 21 per cent in the plateau region (constant METRs) and 50 per cent in the phase-out region (increasing METRs).

For those Germans already employed before the reform the incentive effects will reduce overall labor supply. If unemployed people found jobs at a low wage, like the earnings of the lowest decile, replacement rates would fall significantly for 234,000 workers. Those unemployed Germans would have much stronger incentives to find a job. However, 200,000 people without jobs would face lower incentives, because their spouses would be eligible for the benefit if they did not

work, but not if they did. The higher the assumed wage of those entering employment, the more the disincentive effect would dominate the incentive effect.

Similar to negative tax credits, a U.S.-American EITC is problematic for German policy borrowing because of its different welfare state type. A general policy like this would likely clash with the corporatistic-conservative welfare state policies already in place. From an economic viewpoint, the main difference between the U.S. and the German situation is again the narrower earnings distribution in Germany. This would make many more people eligible for the credit and most of them would find themselves in the phase-out region with high METRs. Therefore disincentives for those already working would be more serious than in the United States. Furthermore a German EITC would be much more expensive than in the United States, if it had a similar structure relative to median earnings. The OECD estimated the costs of such a German EITC to be \square 6 billion (1997).

Recent proposals in Germany

Reforms and simulations of their effects have not been lacking in the German welfare changes this past decade. Three additional proposals have been publicized that would lead to general financial incentives in Germany: one from the German Federal Ministry for Health, another reform from the German Association of Employers, and finally, a related concept simulated by Buslei/Steiner (1999). All three plans focus on general financial incentives and have not proven very cost-effective in the evaluations.

The German Federal Ministry for Health, which has been responsible for social assistance, designed a general work incentive program in 1997. The amount of disposable income including labor market earnings for recipients of social assistance would vary according to the type of household (single, couple, number of children) and the characteristics of the job type (precarious or with full social security). Recipients of social assistance who were entering a job (with full social security) would be allowed to keep approximately \square 83 (with a precarious job this amount would drop to \square 41.53) plus \square 11 per child and month without deductions. A family with two children who received a sum of social assistance payments of about \square 1,333 per month in 1998 (Statistisches Bundesamt 1999b, 39) would be allowed to keep \square 105.23

of their labor market earnings per month (instead of □ 69.23 in the status quo) without any deductions. However, for earnings beyond that threshold only 10 % (instead of 15 % in the status quo) would be disposable to the recipients of social assistance. Thus 90 per cent of the additional earnings would be deducted from social assistance.

Based on a micro econometric model and data from the labor market in Sachsen-Anhalt (East Germany), Trabert et al. (1998) estimated the employment effects and costs of such a reform: There was a calculated increased labor supply among the group of unemployed recipients of social assistance which led to an additional labor supply of 540 people among the 7,121 for whom data had been available. 120 people might find a job which would lead to cost reductions of more than three quarters of a million □ per year. Recipients of social assistance who are already working would be entitled to keep more of their earnings and cause additional costs of about □ 1 million. New recipients of social assistance who had already been working and were not eligible before the reform would cause additional costs of □ 2.2 million. Despite, on balance, positive labor market effects, Trabert et al. (1998) points out that additional costs for people who are already working substantially exceed the savings from additional employment. Also, Kaltenborn (1998) estimates a very limited positive employment effect for this program in Germany. For example, using micro data from the German Socio-Economic Panel he estimated that in 1995 only 900 additional people would have entered the labor market and the costs of the Federal plans would have reached □ 256 million.

A similar plan (to what the German Federal Ministry for Health had proposed) was published by the German Association of Employers (BDA) and also analyzed by Kaltenborn (1998). The plan was to replace the original 85-100 % reductions of wages of social assistance recipients to a lower percent of reductions in earnings, i.e. a rate of 70-90 %. Due to the slightly higher incentives, Kaltenborn's simulations show a positive employment effect of 3,800 persons in East and West Germany, which is a little higher than that of the Ministry of Health. However, the estimated costs necessary to achieve that limited employment effect reach □ 1.3 billion. Buslei/Steiner (1999) worked with simulations for a third concept that promotes a deduction of earnings from social assistance which begins with 70 % deductions rising gradually to 100 % (starting above an amount of □ 69 per month that is free of deductions). The positive employment effects are similar to those estimated by

Kaltenborn and reach a maximum employment effect of 10,000 persons. Unfortunately Buslei/Steiner have not calculated the financial costs of their models.

These recent simulations demonstrate that if they are to be adopted in Germany, general financial incentives have to be limited in order to avoid high financial as well as substantial deadweight costs in Germany. Therefore, we concentrate the rest of the paper on programs that incorporate incentives to a target group of unemployed, which would most likely appeal to German policy makers who are interested in looking at reforms that improve employment but do not excessively increase costs. These policies of targeted labor market incentives are more likely to be integrated into the current welfare state reforms (than the above-mentioned proposals) because they incorporate the present liberalizing reforms of Germany but account for some existing welfare state structures. Whether they are to be advocated or what effects they might have on other reforms is discussed in our conclusion.

Targeted Labor Market Incentives in Germany and the U.S.

The concept of a targeted negative income tax is currently being implemented in experiments in the German states of Baden-Württemberg and Hessen. U.S.-American states have had experience with similar social assistance reforms for a slightly longer period of time. We present the German experiments in light of some central issues and then compare results with studies of two U.S.-American programs. A discussion of general questions follows at the end of this section.

Einstiegsgeld: a targeted negative income tax in Germany

In 1998, the German government approved a waiver which allowed all German Bundesländer (individual German states) to ignore some existing social assistance regulations for a limited period of four years and experiment with stronger employment incentives than which had been previously available. Contingent on this waiver was an experimental targeted negative income tax that was started in Baden-Württemberg in 1999 called the 'Einstiegsgeld' (translated as 'money for reentry' [into the workforce]). This concept was designed by an

economic academic, Alexander Spermann, along with the research center Institut für Angewandte Wirtschaftsforschung (IAW) (Spermann 1996, 1998, 1999) and is currently being tested and evaluated in 17 German cities and districts.

Experiments are parts of three comparable projects in different German regions. The first project has been called 'Einstiegsgeld in Baden-Württemberg' (1999-2002) and takes place in the cities of Freiburg, Karlsruhe and Mannheim and in the rural districts Alb-Donau, Boeblingen, Esslingen, Rhein-Neckar, Tuebingen and Waldshut. The second project 'Hessischer Kombilohn' (1999-2001) is being planned in the cities of Frankfurt/Main, Kassel, Offenbach and Ruesselsheim and in the rural districts Fulda, Kassel and Odenwald. Both projects are based on Spermann's design. In the districts of Rhein-Neckar and Tuebingen programs are exclusively for single mothers. A third project Bergstraesser Modell (2000-2002) is a combination of slightly more financial incentives for recipients of social assistance and social security subsidies for employers. All three projects are planned and evaluated by the Institute for Applied Economic Research Tuebingen.

Unlike the previous above-mentioned reforms, the Einstiegsgeld program emphasized the following three elements:

The first significant element of the Einstiegsgeld experiment is the presence of a target group: Only recipients of social assistance who have not been working for at least a year are eligible to participate in the program. Thus, experiments target long-term unemployed as well as single mothers who are reentering the labor market after the German three year social assistance allowance for new mothers.

A second criteria for the Einstiegsgeld program is an improved financial incentive in comparison to reforms mentioned earlier: Here attempts were made to substantially improve financial incentives for participants who find a job on their own. In this case, \square 70 of the individual earnings are always free of any deductions. If the recipient earns more, 50 % of gross income remains free of deductions (instead of the status quo of 15 % of net income). To benefit from the improved financial incentives, recipients have to continue to be eligible for social assistance even while earning labor market incomes.

A third characteristic of the *Einstiegsgeld* experimentation is its limited time period approach: Each recipient receives financial incentives for a limited period. The better financial incentives are limited for the most part for one or two years in order to avoid long-term violations of horizontal equity and to encourage participants to leave the low-income sector and become wholly independent of social assistance.

Not only is the *Einstiegsgeld* extraordinary in "targeting" groups for financial incentives in a German context, but it is also unique in the research techniques of evaluating a study with control groups. The cities of Freiburg and Mannheim and the rural districts of Böblingen and Tübingen decided to establish experimental and control groups. Based on these decisions most of the cities and districts in Hessen could be convinced to introduce control groups as well. There are about 1,500 households in the program group in Baden-Württemberg and the same number of households in the control group. In two other districts with about 1,000 households the effects will be evaluated with econometric matching procedures. For the project 'Hessischer Kombilohn' similar sizes of program and control groups have been planned.

Results from evaluations of the '*Einstiegsgeld*' are expected to show increased labor supply due to its incentives and its targeted nature. The program should also result in fewer deadweight losses and disincentives than general labor supply incentives. This is the case because, firstly, there are no 'new' recipients of social assistance since only long-term unemployed are eligible. Second, there are no added costs because the gainfully employed recipients of social assistance who are not members of the target group are not eligible for the income tax. Third, the job-seeking long-term unemployed are reported to have very limited access to the primary labor market and a targeted income tax would in this way provide special help for these participants. The *Einstiegsgeld* researchers are still evaluating if this program might provide a combination of higher labor market participation and public savings, minus the additional costs of the incentives.

In the case that these benefits are proven to be realistic, and if this experiment is made into standard policy, the economic and political consequences to the German welfare state would be striking. Comparisons to the U.S. are presented in the following two studies, and "practical" policy problems are discussed in the follow-up.

Experiences with targeted programs in the U.S.

Just as Germany could be said to be experiencing a liberalization of the welfare state and social assistance, the United States has incredibly altered its welfare system. With similar justifications in terms of rising costs of social assistance, long-term dependency, long-term unemployment, and work disincentives, the U.S. federal government approved "waivers" in the early 1990s that allowed states to ignore some rules and change some practices of social assistance. Two states introduced programs that are directly relevant for a German Einstiegsgehalt comparison: Wisconsin and Minnesota. These programs were instrumental in providing research material and were also the impetus for the welfare reforms of 1996 that created the Temporary Assistance to Needy Families (TANF) program. Many researchers and government officials view these programs as successfully encouraging work by providing monthly cash payments to supplement the earnings of low-income workers.

Minnesota Family Investment Program (MFIP)

The Minnesota Family Investment Program (MFIP) began in 1994 and has been well documented in studies from Miller et al. (1997) and Berlin (2000)- on which we have based this section. MFIP combines financial incentives to encourage and support work, and mandatory participation in employment-focused services for long-term welfare recipients. MFIP's rules ensure that families are always financially better off working than not working. The benefits provide larger work incentives for part-time than full-time work. Recipients can continue to receive supplemental benefits until their income reaches approximately 145 percent of the U.S. poverty level. (For example, in 1997 the U.S. poverty threshold for a family of three was \$12,802; the threshold was \$16,400 for a family of four. The median income for a family of three was \$46,783; for a family of four it was \$53,350). For recipients who work, their welfare grant is 20% higher than the regular grant, and benefits are only reduced by 62 cents for every dollar instead of the dollar-for-dollar reduction under Minnesota's regular program. In addition, MFIP requires single parents who have been on welfare for two years or more to develop and follow a plan for self-sufficiency. Two-parent families that have received welfare for 6 of the past 12 months are also required to participate. Long-term recipients had to work at

least 30 hours per week or participate in other work preparation or training programs to receive the supplemental benefits.

The crucial factors for the success of MFIP were that it covered child care, transportation, and work-related expenses for program participants. Finding decent, affordable child care is often a large barrier for welfare recipients in the United States (and also in Germany). Findings from the MFIP program suggest that the strong economy in Minnesota made it easier for people to go to work.

Applicants for the regular welfare program, Aid to Families with Dependent Children (AFDC), were randomly assigned to the control AFDC group or to the experimental MFIP group. Approximately 15,000 families were randomly assigned between April 1994 and April 1996. Each family in the sample was followed for three years.

Results based on the 4th, 5th, and 6th quarters after random assignment (one year to eighteen months) show substantial differences between the experimental and control groups. The employment rate was 12 to 17 percent higher for the experimental group, and earnings were \$150 to \$264 higher, per quarter. Because benefits were also higher, total income was \$261 to \$402 higher for the program group. These results were all statistically significant at the 5 percent level or higher. Although it had significant effects, a program such as MFIP will not solve all problems. About half of all MFIP program group members did not work during the follow-up period.

MFIP results were even stronger for some specific subgroups, particularly single parents in urban areas who were long-term recipients. For these participants, the proportion employed was higher (52% vs. 38% for the control group). Family income was 13% higher, earnings were 27% higher, poverty was 16% lower, and welfare payments were 8% higher. Although 16% less of the program group was in poverty, 71% of the families in the MFIP group were still poor - thus although MFIP may make people better off when they work, it did not dramatically improve the financial situation. Results for participants in rural areas were less impressive, perhaps because the labor market was generally less favorable.

The MFIP experiment included a group that received financial incentives, but for whom work was not mandatory. Comparing the

outcomes between this group and the experimental group shows that both the carrot of extra benefits and the stick of mandatory work requirements contributed to the increase in work. For example, in the 5th quarter, employment was 15% higher for the full-MFIP group, and 7% higher for the incentives only group, suggesting that roughly 8% of the impact was due to the mandatory requirements. Regarding earnings, the incentives-only program had little or no impact on earnings.

In contrast, the MFIP program for new applicants did not require people to work full time or participate in other work-readiness activities. The program for applicants was not as successful in increasing work or earnings.

Work effort and earnings have increased among the program participants. Unlike earlier welfare to work programs that reduced benefits as earnings increased, total income for the program participants has also increased under MFIP. Yet these results are costly, since welfare receipt and total benefits paid have increased under the program. It remains to be seen whether the cost increases are temporary ones that allow people to transition into the permanent labor market, or whether poverty and welfare dependence will rise again once the program ends.

Wisconsin New Hope

The New Hope Project is a community-initiated, work-based program similar to the German programs mentioned but with an antipoverty goal. Studies from Bos et al. (1999) and Brock et al. (1997) document this program well: It operated in two low-income areas in Milwaukee, Wisconsin from August, 1994 through December, 1998. New Hope enrolled adults who lived in one of the two targeted areas who planned to work at least 30 hours per week and had income at or below 150% of the U.S. federal poverty level. These adults were provided with job search assistance, including access to paid community service jobs, an earnings supplement, affordable health insurance, and subsidized child care. In the United States, unlike in Germany, lack of access to health insurance is often a large barrier to leaving welfare, since welfare recipients are covered by Medicaid, the public health program for low-income Americans.

Unlike MFIP, people in New Hope had voluntarily applied to participate, so New Hope participants might be more likely and motivated to work. 1,362 adults applied to New Hope. They were randomly assigned to a New Hope program group or a control group. There were 678 adults in the program group. Participants had to work at least 30 hours per week to receive New Hope's benefits. They could be eligible for up to three years. The benefits were phased out such that a participant always experienced at least a \$.30 rise in total income for each \$1 increase in earnings (total tax rate no higher than 70%).

There were two main difficulties for the experiment that might have reduced success rates: the economy and lack of education. Although the Milwaukee economy in general was doing quite well during the program period, the two neighborhoods in the experiment had high levels of unemployment. Forty-three percent of the sample lacked a high school diploma or its equivalent. Many participants reported an additional positive effect: the help and encouragement offered by their project representative was as important as the financial benefits offered by the program.

If participants could not find full-time work after searching for eight weeks, they could interview for a community service job that pays the minimum wage. Participants could work in community service jobs for a total of 12 months over a three-year period. Each position lasted a maximum of six months, and participants could work in two community service jobs (for a total of 12 months). Participants in community service jobs (but not regular jobs) could also attend up to 10 hours of school or training each week and get paid for this time, as long as they also worked at least 30 hours in their work assignments.

The results currently available are for people who participated in New Hope for two years. 1,086 sample members completed the two-year follow-up survey, which included such information as hours of work and monthly changes in employment status. The results show that New Hope increased employment and earnings for sample members who were not already employed full time at random assignment. The increases were largest during the first year of follow-up and were largely driven by people using New Hope's community service jobs. New Hope did observe some reductions in work effort, mainly by people who were working more than 40 hours per week reducing their hours.

For the overall sample, the program group had higher levels of employment than the control group by between 4 and 11 percentage points in each of the eight follow-up quarters. Community service jobs played an important role, because in every quarter, fewer program group members than controls were employed in unsubsidized jobs. Thirty-two percent of all participants used a community service job at any time during the two-year follow-up period. If employment and earnings from community service jobs are excluded, the differences between the control group and program group are no longer statistically significant. Program group members had an "ever-employed" rate that was 5.5 percentage points higher than control group members. Earnings for program members were only significantly greater in the first year (by \$583). Yet due to the EITC and the New Hope earnings supplements, the poverty rate for program members was between 5.6 and 7.8 percentage points lower than for the control group. Like MFIP, however, New Hope was no panacea: between 66 and 74 percent of the program group was in poverty during the two years.

New Hope's impacts were strongest for people who were not already employed full-time at random assignment. Within this group, the results were strongest for people who had one of the following potential barriers to work: low level of education, responsibility for young children, an arrest record, lack of recent job experience, and having been fired from one's last job. The differences between the program and control group were statistically significant for the group with one potential barrier, and almost never statistically significant for those with no barriers or more than one barrier. New Hope program members who were AFDC recipients (the U.S. welfare program for single parents) worked significantly more quarters than their similar control group members.

New Hope was an expensive program. Program services for the two years cost \$9,056 per program group member. 26.2% of the total was for child care subsidies, which were the most expensive component of the program (but also perhaps the most important for enabling people to work). The program was more cost effective for people who were not employed full-time at random assignment. Since Germany's experiment is for the long-term unemployed, it is likely to have results more similar to those for people who were not employed full-time at random assignment. The earnings supplement was \$126 per month for

those receiving it, 10% of the total cost. Community service job wages accounted for 10.4 percent of total program costs. As with MFIP, it is easier to measure the short-term costs of the program than to measure any long-term benefits. It remains to be seen whether the increased work experience of the New Hope program members will translate into more work, higher earnings, and less welfare dependence in the future. Final results will be available at the end of 2001.

A discussion of German and U.S. experiments in comparison

Because U.S. and German experiments are fairly new, not all answers are available for each country about the economic value and effectiveness of these types of targeted financial tax incentives in current social assistance reform. More advanced results from the U.S. experiments could provide preliminary answers to some German questions, if a satisfactory methodological comparison is conducted. The consequences of 'borrowing' some of the policy features could in effect suggest other issues the German experiments may want to consider in more detail.

The examples of MFIP, New Hope and the Einstiegs geld have shown differences but similarities: in Germany as well as in the United States lack of education and child care for gainfully employed single mothers are very important for the integration of recipients of social assistance into the labor market. Both countries can therefore learn from each other's concepts which tackle these commonly-shared problems. A crucial prerequisite is that not only general features – like the EITC – but also smaller experiments like MFIP, New Hope in the United States and the Targeted Negative Income Tax (Einstiegs geld) in Germany are made transparent to researchers in both countries, and researchers should have the possibility to meet and communicate in order to further develop such similar strategies.

Some preliminary data from the MFIP and New Hope programs provide material for discussion for some economic questions in the German experiments. We have listed a few of the following:

Can targeted incentive programs increase employment in Germany? Or is the lack of employment opportunities the dominant problem for the target group?

The financial incentive programs for recipients of social assistance have proven to be a way to improve labor market participation in the United States, even if the labor market economic situation was unfavorable. It is important to note, however, that in the cases where economic downturn in U.S. areas was present, it was the extra provision of community service jobs which provided job opportunities.

According to German case studies, the lack of employment opportunities was not a problem that made incentive programs ineffectual (Kirchmann/Spermann/Volkert 2000). In the first three months despite a very problematic labor market more than 100 people in the Baden-Württemberg experiment started to work. For example, in Mannheim, the city with the highest unemployment rate in Baden-Württemberg, 30 households (out of 500 households in the experimental group) had started a job during the first three months. It is important to remember that the target group is a group of long-term unemployed and long-term beneficiaries of social assistance who are thus likely to have more difficulties with labor market integration than the average recipients of social assistance. In many cases, it was often the local social assistance administration that was influential in supporting the Einstiegs geld and thereby promoting its success.

Can people use stronger labor market incentives to substantially increase their income?

MFIP and New Hope indicate that higher employment due to more financial incentives may also increase the income of people living with social assistance, although much of the short-term income increase came from higher benefits. U.S. incentive programs are very often motivated as remedies against the phenomenon of the working poor. Today, poverty among workers is less of an issue in Germany. Instead, poverty in Germany is often combined with very low labor market participation. The above mentioned U.S. program effects on poverty might be of special concern because they could increase employment by using productivity-oriented wages, which might cause a new low-wage sector in Germany (Sachverständigenrat 1999/2000; Arbeitsgruppe Benchmarking 1999). Political consequences of programs that encourage work for those who are still on social assistance (i.e., work that does not pay enough to bring a recipient out of social assistance) could be speculatively used to provide a cushion for the general

lowering of wage tariffs or the creation of "Billigjobs" in the German sector.

Are there specific subgroups among the target groups who benefit significantly more than others?

Interestingly, single mothers in both the U.S. and Germany benefit more than other target groups in financial incentive programs. MFIP and New Hope - as well as other U.S. labor market incentive experiments - have shown that single mothers are often the main beneficiaries of incentive programs. Similarly, in the German Einstiegs geld experiment single mothers are using the programs significantly more than other groups of recipients. In the city of Mannheim 40 % of all single mothers in the program group were working after 6 months.

Since most U.S. programs are targeted on single mothers, it could be helpful to discuss experiences and strategies in both countries in order to ensure access to child care which is of crucial importance for the remarkable number of single mothers among the recipients of social assistance in both countries. For example, in 1998 1,286,900 households received social assistance in Germany. Among them were 332,965 single mothers and 10,399 single fathers with children not older than 17 years. More than every fourth recipient of German social assistance is a single parent – a share which has increasingly reached even higher levels in some German districts. In Germany, women are encouraged not to work for the first three years of the child's life and yet single mothers are the first to start working. If incentive programs become routine in Germany and if high demand from single mothers remains, social assistance offices would need to focus more on operating capacities for finding child care.

Do traditional welfare to work and other subsidized work activities as well as training and qualification programs conflict with financial incentives or can there be a mutual benefit?

Recent experiments like MFIP and New Hope have shown the need for education and the importance of training measures for recipients of social assistance. This seems to be a conceptual limit for any incentive-oriented program in the United States as well as in Germany. The German 'Einstiegs geld in Baden-Wuerttemberg' is

confronted with the fact that among those recipients in Baden-Wuerttemberg whose educational level was known two of three recipients had not more than a lower secondary school leaving certificate. 12 % did not have any school leaving certificate, 52 % had a lower secondary school leaving certificate. The majority (52 %) of recipients had no occupational training (Kirchmann/Volkert 2000).

Financial incentives for recipients of social assistance have the greatest probability for success when they target people who are relatively close to the labor market and do not suffer from special problems such as a severe lack of education, psychic problems, diseases or drug addiction. Therefore incentive programs can only work as a complementary element to programs like training and other measures that make recipients ready to enter the official labor market.

Furthermore, experiences from MFIP and New Hope would suggest that if Germany incorporates such programs, it may need to consider an optimal combination of community service jobs and incentive programs directed to its particular labor market. Beginning with German welfare reform in 1996, communities have more possibilities to create subsidized work programs. Kirchmann/Klee (1999) show that the number of these programs has increased substantially and can be found in a wide range of jobs. Meanwhile about 300,000 Germans are employed in such programs. An optimal combination of community service jobs and labor market incentives, however, in terms of 'best practices' might be useful to discuss individually in light of German and American welfare states and the specific social policies that interrelate with such programs.

Do mandatory work requirements (which have played a dominant role in German social assistance during the last decade) and the proposed labor market incentives conflict or complement each other within social assistance policies?

A major objection to financial incentives in German social assistance is the assumption that offering a "carrot" to the recipients who are willing to work might be redundant within the German social assistance strategy. This has always relied on recipients having their own motivation to leave welfare ranks and recently has relied heavily on 'sticks' like mandatory work and penalties. Since the introduction of welfare reforms in the 1990s, recipients of social assistance are

obligated to work and are 'punished' if they refuse to work; thus, many question giving recipients additional benefits to do what they are expected to do - i.e., work. The early results of MFIP indicate that additional employment is substantially higher in Minnesota when carrot and stick are used together. Adding a carrot to the newly implemented stick of German social assistance may therefore be (easily) justified by policy makers for social assistance recipients and their successful labor market integration.

Since the German welfare state is corporatistic and has a more centralized decision-making administration, the social assistance administration does not have the same room that U.S.-American states have in carrying out experiments- especially when it comes to 'carrots' and 'sticks'. However, changes in the 1990s have caused the Bundesländer (the individual states) in Germany to pursue labor market strategies. These German provinces have more possibilities, and some desire to make more changes in the labor market strategies that might correspond more to a carrot or a stick model, or a combination of both. Politicians in Hessen have recently advocated more 'sticks' in combination with programs like the Einstiegsgehalt - these restrictions would equal the sort of reductions that are experienced in the US, when participants do not work full-time. In Baden-Württemberg, however, where the Einstiegsgehalt is more established, these incentives on their own are viewed by the social minister as a successful experiment on its own (Dubyk 2001).

Since the reforms, German states have developed an individual approach to labor market strategies, which will probably influence further reforms in social assistance. As Blancke and Schmid explain, 'Push' strategies, for example, have been developed in Nordrhein-Westfalen and the majority of eastern states which provide an active labor market and community service jobs. A 'Pull' strategy like Baden-Württemberg's and Bayern's provides financial incentives and less welfare to work/active labor market provisions. Hessen is somewhat in the middle between Pull strategies and 'Stay' strategies (as in most of the western and northern states with social-political traditions) where a high volume of active market strategies are followed but are less explicitly linked with the business community (Blancke and Schmid 2000).

Will new recipients not take up employment until they qualify for target group incentives?

Another open question for German researchers of the Einstiegs geld was if programs that targeted long-term unemployed recipients would cause new recipients to wait until they qualify as long-term unemployed and thus become a member of the target-group for financial incentive programs. U.S. experience from the MFIP project indicates that this has not happened in that context; however, similar analyses are being carried out in Germany, which is (up until recently) not characteristic of social assistance administrative practices.

Conclusion

While fundamental differences make it impossible to 'copy' general concepts like the U.S.-American EITC or introduce a negative income tax for the German situation, we argue that close attention needs to be given to smaller policy programs on the local level for beneficial comparisons. Evaluations are of interest for both countries and helpful for identifying potential impacts of similar programs in the other country.

Some unexpected surprises were learned by making such a comparison of targeted financial incentives between the U.S. and Germany. First of all, there were commonalities among the MFIP, New Hope, and Einstiegs geld programs in the high numbers of single parents, even though Einstiegs geld projects (with the exception of two) did not target single mothers. Indeed, when one considers the recommodification logic of both welfare states for (poor) single mothers, the situation is remarkably similar: There is a withdrawal of single mothers from the labor market, a spell of social assistance for 2-3 years and finally an obligation for workforce reentry. Then, it should not be surprising that single mothers are willing and able to become recommodified and need an extra boost, which in the case of these experiments, came from targeted financial incentives and the availability of child care.

Comparisons with U.S. models were informative for German experiments. A factor which German researchers did not consider, but with which they were able to increase their knowledge, was a decreased incentive based on household labor market incomes and a possible

effect on marriage rates in U.S. experiments (For example, MFIP found slightly lower rates of marriage dissolution among the control group). These results are perhaps significant for looking at effects in a strong bread-winner model like Germany (Lewis/Ostner 1995). Other results were perhaps not so surprising but were effective in the work incentive programs. 'Soft' factors such as reduced stigmatizing effects and improved self-help or motivation were part of U.S. evaluations and were thought to be very significant in helping the long-term German unemployed to find work (Kirchmann/ Spermann/Volkert 2000) Another emphasis of the U.S. experiments was testing for fraud and abuse, whereas German social assistance (which was typical of its welfare state history) had not fully accounted for how the new programs could be controlled efficiently.

Within these sorts of strategies of job activation/recommodification in the form of financial incentives, some of the U.S. American and German experiments were somewhat similar, but the surrounding structural characteristics, like the amount of services remained the same. Indeed, these characteristics are also important to discuss. If some reforms are successful, do other reforms need to follow or be modified to make the situation even better? Disincentives to enter the labor market that clash with the Einstiegsgeld in Germany might be caused by factors such as high effective tax rates, high social security contributions plus cuts in social benefits. Some factors which could be of importance such as the increasing reduction of social assistance with rising labor market incomes and cuts in social payments (housing subsidies etc.) or the additional burden caused by social security contributions have been documented in the U.S. Current Einstiegsgeld experiments in Germany have tried to avoid additional burdens caused by cuts in other social payments like housing subsidies ('Wohngeld').

One policy that is being considered to complement the Einstiegsgeld is the 'Mainzer Modell' which finances social security subsidies in order to develop stronger incentives for people with low incomes to take jobs which are fully liable to social security. The 'Mainzer Modell' is designed to subsidize/increase the net pay of employees, thereby motivating people to work in regular jobs. The Einstiegsgeld might benefit from additional incentives for jobs with full social security coverage while the 'Mainzer Modell' programs could use an incentive program like the Einstiegsgeld. The interaction of both approaches is documented by the fact that some recipients of

Einstiegsgeld have already changed their marginal part-time jobs with weak and incomplete social security ('geringfügige Beschäftigung') into part-time jobs with full social security coverage. Without such a compatible program, an existing lack of incentives due to high social assistance reduction rates could prevent recipients of social assistance from working more time in secure jobs because the Einstiegsgeld targets potentially low-income groups and the Mainzer Model might not reach these groups (Kirchmann/Spermann/Volkert 2000).

Some U.S. findings may be useful for German reforms and some may not be. Our conclusion is that Germany has undergone transformations to adopt decentralizing policies which can be seen on the local level (although by U.S. standards these reforms have been small). For example, targeted groups for German social policy are less typical of a corporatistic-conservative welfare state, and the presence of control groups are very much against the grain of solidarity in this type of welfare state. The change however, could just be viewed alongside work requirements and mechanisms for categorizing and controlling welfare recipients which have also been instrumental in altering the face of the German welfare state. While social assistance is still considered a right and poverty prevention is desirable, changes in the concept of redistribution are also apparent. No longer is social assistance just a way to cover life risks for unemployment, old age, etc.; but it emphasizes the recipient's own responsibility for his or her situation and an obligation to work.

From the experiments in the U.S., potential dangers can be detected for German programs. Some of these changes could be seen as detrimental to the German welfare state, as politician's advocating for the creation of more jobs by a reduction of wage level tariffs ('Billigjobs'). Some reforms such as a negative income tax could then be speculatively used to provide a cushion for the general lowering of wage tariffs. Also, arguments about social assistance have become more punitive in recent German debates. In comparison to the U.S., German policies are less punitive and are often, as the Einstiegsgeld was, introduced with reasoning that emphasized better living conditions (and employment). These discussions, however, are also changing course, so that the Einstiegsgeld, which emphasizes incentives or carrots, has been discussed in relation to creating more punitive measures for those who do not work full-time (Dubyk 2001).

The U.S. reforms were introduced under the pressure that social assistance was wasting money, and radical reforms incorporated time-limits, leaving those unable to work unacknowledged. While the U.S. has accounted little for those on social assistance who are not able to work, the German welfare state has up until now always acknowledged that there are some people who are unable to work. German social assistance has accounted for people with considerable problems in finding and maintaining a job and the state provides additional help (by subsidized work, training, individual programs etc.). It is obvious that competitive recipients and single mothers who have adequate child care and few financial burdens will fare the best in such competitive financial incentive programs and yet there will be others who are not able to participate in such incentives.

When it comes to considering policy adoption- which is a question posed by policy comparative research, historical and institutional structures needs to be accounted for. According to Josef Schmid, when considering policy adoption for another country, two aspects need to be more closely evaluated for its successful transfer (Schmid 1999): Firstly, social and economic political problem solving is easier to transfer onto countries that have similar welfare state forms; Secondly a differentiation must be made between the levels of the problem-solving for each policy objective. Germany and the U.S. have wide differences in values, political assumptions/processes, labor markets and income distributions as well as a substantial variations in poverty and unemployment rates. Negative income taxes and an German EITC were broad ideological goals in the policy discussions and since such policies would be borrowed from a very different welfare state (the US), one could predict that these had very little promise for a German consensus.

Yet, local financial incentive reform trends have been very apparent in both Germany and the U.S. Goals have differed to some degree but their similarities have been remarkable (Germany's dominant goals of financial incentive programs are to improve employment while the U.S. concentrated both on employment and on redistributive objectives). Although largely ignored, such policies in comparison can successfully illustrate the welfare state transformations which each country has been undergoing. In comparing these reforms and their legitimation within related policies, initial insights can

provide a broader understanding of the welfare state and its proper role in securing and providing for the well-being of its population is possible.

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