

Hartz IV – The German “Word of the Year 2004” and the Country’s Hope to overcome its Problem of Unemployment

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ABSTRACT: When the centre-left government came into power in Germany in 1998, a core promise of the new Chancellor, Schroeder, was to reduce the lack of jobs and to increase welfare. Facing persistently increasing unemployment rates from then on, the government finally launched “Hartz IV” in 2004; the largest social reform project in the history of the Federal Republic. This reform, that took effect at the beginning of 2005, aims to increase employment in Europe’s biggest but slowest growing economy, whilst avoiding the financial collapse of its social systems. Its main aim is to strengthen individual responsibility whilst lowering transfers for those unemployed individuals that are capable of work. Therefore, it is also the most disputed reform of the German social welfare system. By characterising effects and defects of the German welfare system, we identify some of the most important obstacles facing higher employment. We provide an outline of the government’s endeavours to handle the problem of unemployment and of the main changes in the country’s laws of social contributions. Particular focus is given to the newly established unemployment benefit II and to the “reasonableness” of work, which reflects a new social valuation of labour. To conclude, potential welfare and employment effects under the new system are discussed.

KEYWORDS: Welfare, Unemployment, Poverty.

JEL-CLASSIFICATION: I38, J64

Introduction

“Hartz IV” is the title of the most disputed reform of the German social welfare system and is the largest social reform project in the history of the Federal Republic. Facing the highest rate of unemployment since the foundation of the Republic, this reform aims to increase employment in Europe’s biggest, but slowest growing economy, whilst avoiding the financial collapse of its social systems. At its core is the guideline of strengthening individual responsibility together with lowering transfers for those unemployed individuals that are capable of work. Enacted by the centre-left government as part of its more comprehensive reform “Agenda 2010”, “Hartz IV” has provoked large-scale anti-demonstrations in 2004. These manifestations, which predominated in East Germany (where the unemployment rate is higher than in West Germany), were called “*Montagsdemonstrationen*” and by this were a reminder of the demonstrations in 1989 in the former GDR where the people successfully opposed the communist regime. The political discussion lasted for almost the entire year 2004 and the term “Hartz IV” was finally chosen as the German “word of the year 2004” (Gesellschaft fuer deutsche Sprache, 2005). But what are the determinants of Germany’s labour market disaster; what lies at the heart of the reforms; and will such reforms improve the situation?

This article surveys the most important obstacles to higher employment. It provides an outline of the government’s endeavours to handle the problem of unemployment and of the main changes in the country’s laws of social contributions. Particular focus is given to the newly established unemployment benefit II (*Arbeitslosengeld II*) that will be compared with the social assistance. As an area of special interest the questions of “reasonableness” of work and the social valuation of labour will also be dealt with. To conclude, potential welfare and employment effects are discussed.

Effects and defects of the extensive German welfare state

Until the end of 2004 three different benefit systems for productive but unemployed persons existed at the same time: 1. the unemployment benefit (*Arbeitslosengeld*): payment within the unemployment insurance, which is contribution-financed, time restricted and related to the last wage received; 2. the unemployment assistance (*Arbeitslosenhilfe*): a tax-financed benefit, restricted to the needy and related to the last wage, granted after the unemployment benefit has expired; 3. the social assistance (*Sozialhilfe*) as the ultimate “social net”, protecting against any kind of risk in life.

This design of the welfare state showed obvious defects. *De jure* the receipt of the unemployment assistance is restricted to disadvantaged people (§ 190 (1) no. 5 *Sozialgesetzbuch*

III). But since the expenditure of the monitoring institution – the Federal Employment Services (*Bundesagentur für Arbeit*) – is reimbursed by the federal government, there is a clear problem of incentives for an appropriate audit of individual eligibility. Moreover, the existence of two social systems present at the same time both conditioned on the neediness of people, namely unemployment and social assistance, is economically hard to justify: parallel structures are costly, especially since both kinds of assistance can be received contemporaneously. A crucial aspect was pointed out by the Academic Advisory Council at the German Federal Ministry of Economics and Labour (2002, p. 13). The Council argued that the level of public transfers has the character of a wage floor and will have a distorting effect on wage negotiations. The mechanism is as follows: Public transfers are only granted if the recipient is unemployed, but are routinely cancelled if he takes up a job. Hence, granting a transfer is equivalent to offering a state-provided alternative income. In order to motivate a rational, jobless benefit-recipient to take up a job, the transfer income marks the minimum amount which must be earned in the labour force. Of course this reasoning, which assumes that every individual that accepts a job with a wage below the public transfer is irrational, might be criticised for not considering the social psychological dimension of unemployment. As early as in 1938, first studies revealed that the loss of employment might initiate a process of emotional destruction driven by fear, depressions, inferiority complexes or the loss of social relations (Eisenberger and Lazarsfeld, 1938). A decreasing labour productivity resulting from personal sadness must also be taken into consideration (Darity and Goldsmith, 1996, p. 122). However, the allocation of transfers as outlined above, definitely does not contribute to reduce the lack of jobs. In this context further insights into the misleading incentives of the German welfare system can be gained from a comparison of the unemployment assistance and the social assistance with a disposable market income, respectively. *De lege lata* the old unemployment assistance was at most only 57 percent of the last earned income. But taking into account other transfers such as accommodation allowances (*Wohngeld*) or child benefit (*Kindergeld*), the income of other members of the household, taxes, social welfare contributions, and permissible supplementary income, the effective rate was about 80 percent and for a single parent even between 90 and 95 percent of his former net income (Breyer et al., 2004, p. 32). An interesting variable is the difference between the disposable market income and the social assistance with regard to different types of households. Given in percentages this variable explains how much lower the appropriate social assistance compared to the achievable market income is. In 2000, for a married couple without children in West Germany this difference was 53,7 percent. By contrast, the difference for a West German couple with three children was about

15,3 percent and for a comparable East German family it was only 11,5 percent (Engels, 2001, p. 58). At least for the latter the monetary incentive to start working is rather low. A further issue is the effect of the transfer recipient's supplementary income on the granted assistance. Generally, one can state that this extra income is subject to a withdrawal rate of 100 percent, meaning that the more willing a recipient is to undertake illicit work, the lower the incentive for the recipient to look for a regular job will be.

During the last decades, persistently high unemployment rates have produced a lot of theoretical and empirical research. Among the established "stylised facts" is the finding, that unemployment rates in most industrialized countries tend to be higher at the bottom of the income scale than at the top.

Table 1 Standardised Unemployment Rates EU 15

	2001	2002	2003
Belgium	6.7	7.3	7.9
Denmark	4.3	4.6	5.6
Germany	7.8	8.7	9.6
Greece	10.4	10.0	9.3
Spain	10.6	11.3	11.3
France	8.4	8.9	9.4
Ireland	3.9	4.3	4.6
Italy	9.4	9.0	8.6
Luxemburg	2.1	2.8	3.7
Netherlands	2.5	2.7	3.8
Austria	3.6	4.2	4.3
Portugal	4.0	5.0	6.2
Finland	9.1	9.1	9.0
Sweden	4.9	4.9	5.6
UK	5.0	5.1	5.0

Source: Adapted from OECD (2004, p. 16).

Table 2 Standardised Unemployment Rates EU 15 for low qualified people

	2001	2002	2003
Belgium	10.8	11.2	11.6
Denmark	6.3	7.0	8.9
Germany	11.5	13.3	15.7
Greece	8.7	8.1	7.3
Spain	11.5	12.3	12.7
France	13.2	12.9	12.1
Ireland	6.5	6.8	7.0
Italy	11.0	10.6	10.5
Luxemburg	2.5	4.6	4.0
Netherlands	3.0	3.7	--
Austria	6.2	5.8	7.9
Portugal	3.9	4.4	6.1
Finland	17.5	18.8	18.3
Sweden	7.8	7.8	8.6
UK	8.9	9.7	8.9

Source: Adapted from Eurostat (2005).

Table 1 shows the total unemployment rates of the EU 15 countries between the years 2001 and 2003, and table 2 reveals the unemployment rates for low qualified people for the same states.¹ During the 1990ies about 50 percent of the jobless people in West Germany did not have a completed apprenticeship (Federal Employment Services, 2001, p. 197). The relatively higher unemployment rates of the less qualified cannot be explained by wage rigidities alone, unless one offers a compelling reason as to why such rigidities should be more pronounced in the case of the less qualified. Therefore an alternative explanation preserves, that the welfare state itself induces high unemployment at the bottom of the income scale in granting a basic allowance to every unemployed person in need. The wage is economically a price for labour

¹ Persons whose highest level of education comprises of the levels 0-2 according to the International Standard Classification of Education – 1997 (ISCED), i.e. pre-primary, primary and lower secondary education.

and works as a mechanism to equalize the supply and the demand for work. However, the total rate of German unemployment, exceeded only by Spain in the EU 15, reveals that payments in line with market requirements are not possible anymore: the wage is overloaded with the aim to ensure a humane existence for everybody. A pointed conclusion is that it is the welfare state itself which provoked unemployment; thus there exists a forceful admonition to reform it!

The government's endeavours to overcome the unemployment

The aim of the reforms launched by the social-democrats/green-government since 2003, is to avoid the financial collapse of Germany's social systems. The persistently high unemployment rates of the last years as shown in Table 1 have especially put pressure on the German government. This pressure has two dimensions, namely a political and financial one. It was the Chancellor's promise to reduce the rate of unemployment substantially after taking over the government in 1998. Gerhard Schroeder literally stated: "Either we manage to reverse the trend of growing unemployment and to reduce it within the next four years ... or we do not deserve being re-elected"(Schroeder, 1998). With an unemployment rate of 8.1 percent in early 2002 he ran the risk of being reminded on this very statement. Moreover, the unemployment problem is a financial burden for the public budget since the generous welfare system, though partly organised as insurance, requires vast public aids.

Facing the federal elections in autumn 2002, in February of that year the federal government set up a commission to elaborate suggestions on how to change the German welfare state in order to sustain its stability also in the 21st century. Headed by the personnel director of Volkswagen, Peter Hartz, the public coined the term "Hartz-commission". In August 2002, this commission presented its report "Modern Services at the Labour Market" (*„Moderne Dienstleistungen am Arbeitsmarkt“*) (Hartz-Commission, 2002). Split up into four bills, the most important is the fourth part of the „Hartz-reform“, with the official title "Fourth Law for modern services at the labour market" (*„Viertes Gesetz für moderne Dienstleistungen am Arbeitsmarkt“*), or in short "Hartz IV". It adds a new Book II to the Social Code which has as its core the basic social security for job-seekers.

In his government statement, "Agenda-Speech", at the German Bundestag on March 14th 2003 Chancellor Schroeder emphasised the intention and direction of the government's social and labour market reforms: "We will reduce state benefits, encourage personal responsibility, and ask for more personal contribution" (Schroeder, 2003, p. 8, translation). Instead of the usual explanations for the lack of jobs, such as laboursaving technical progress or the interna-

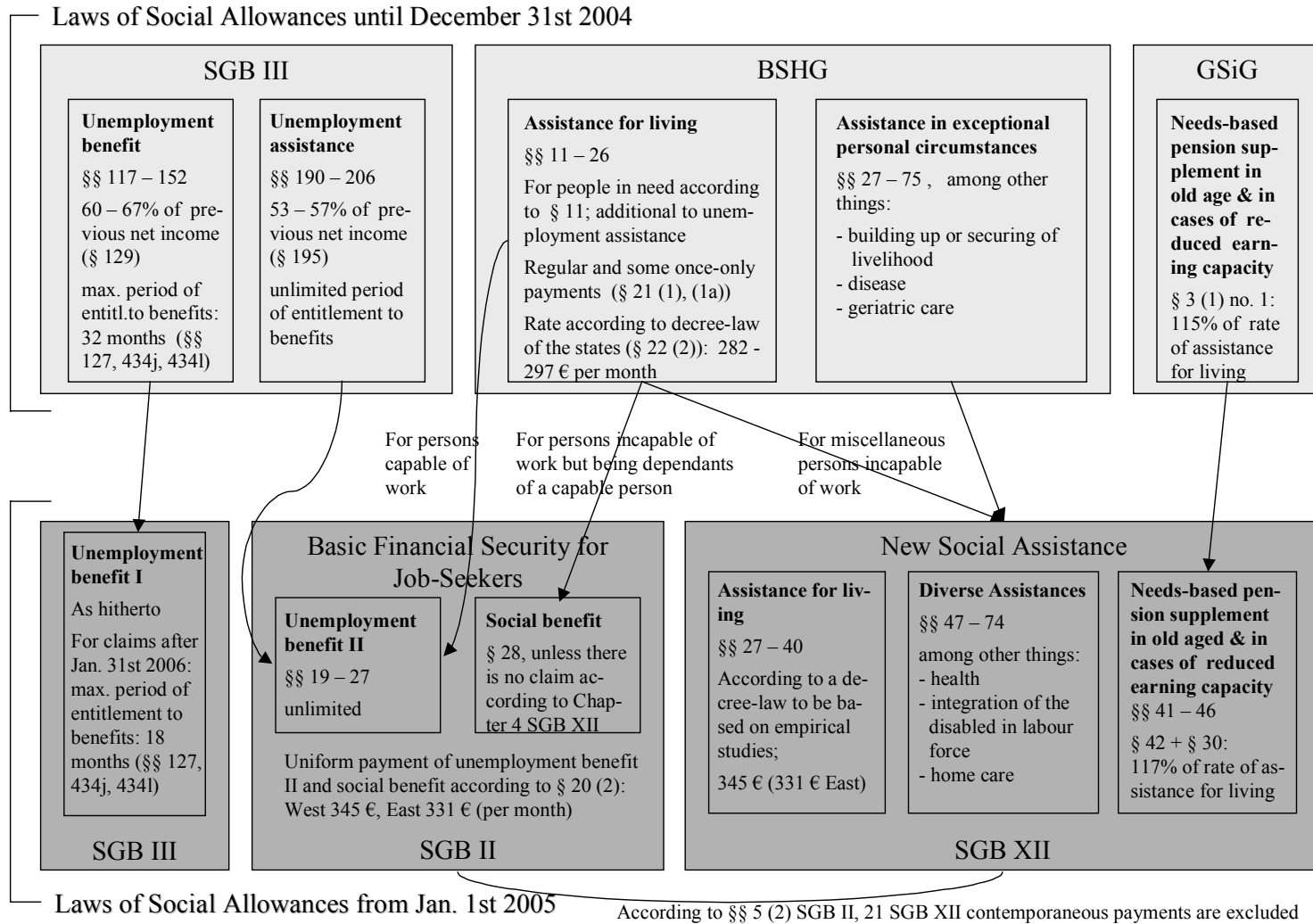
tionalisation of the markets, he stated structural causes as restraints for employment in Germany. Under the proverbial motto “Courage for changes“ the Chancellor outlined several projects that caused heavy protests in late 2004, even among his own fellow party members. Starting with the provocative question “Are our social succours really succours for those in need?“ (Schroeder, 2003, p. 22, translation), Schroeder announced, that “... we will merge unemployment and social assistance on a uniform level ... that will usually correspond to the level of the social assistance“ (Schroeder, 2003, p. 22, translation). Combined with a lowering of the withdrawal rate “ ... we point the way to the future for those persons in our society that have been without a job for more than twelve months“ (Schroeder, 2003, p. 23, translation). With the Agenda 2010 – aiming for the year of 2010, but with no reform being related to this specific year – that has been asserted against many resistances, structural restraints of employments shall be relieved step by step in order to solve the country’s occupation problem. There is a widely held belief that “all who are able to work, should work” and that basic allowances should be confined to truly needy persons. As a characteristic principle one might consider the title of Chapter 1 of the new Book II of the Social Code (*SGB II*): Promote and Push (*Fördern und Fordern*).

Unemployment benefit I, unemployment benefit II and a new social assistance

Until the end of the year 2004 transfer payments for unemployed people were granted according to Book III of the Social Code (*Sozialgesetzbuch III (SGB III)*), social assistance was provided according to the Federal Social Assistance Act (*Bundessozialhilfegesetz (BSHG)*) and a needs-based pension supplement in old age and in cases of long-term reduced earning capacity was given according to the Minimum Income Act (*Grundsicherungsgesetz (GSiG)*).

With regard to the unemployment benefit I, firstly it has to be mentioned that since January 1st 2004 the maximum period of entitlement to this benefit is 32 months just transitionally. For claims after January 31st 2006 (according to §§ 434j (3) and 434l SGB III) the entitlement generally lasts for a maximum of 12 months, and for persons older than 55 years, a maximum of 18 months.

The crucial change as of January 1st 2005 was the creation of Book II of the Social Code (*SGB II*), and Book XII of the Social Code (*SGB XII*). Generally spoken, persons in need who are capable of work receive benefits according to SGB II; whereas those that are incapable are assessed by SGB XII. The figure below reveals the decisive judicial changes with respect to the affected groups of individuals.



Source: Adapted from Lohse (2004, p. 578).

Figure 1: Changes in the German Laws of Social Allowances

Since the beginning of 2005 people between 15 and 65 that are capable of work, but needy², can receive the new unemployment benefit II (*Arbeitslosengeld II (ALG II)*). The usual unemployment assistance was abolished at the turn of the year 2004/2005. Hence, thereby recipients of the old unemployment assistance and recipients of the social assistance that are capable of work are treated in the same way. However, since any income from the recipients' partner will be considered under the new law, not all recipients of the former unemployment assistance will be entitled to the new unemployment benefit II. The recipient's dependants nowadays are entitled to the new social benefit (*Sozialgeld*), as long as they live with the recipient together in a so called community of needy persons (*Bedarfsgemeinschaft*) and are themselves not capable of work. These two payments, unemployment benefit II and social benefit, are part of public welfare and are thought to cover the expenses for living. As they are tax-financed the monthly rate of 345 € in West Germany (331 € East Germany) is orientated towards the requirements of the needy persons, but not on their last wage as was done under the old system.

But the unemployment benefit II, the social benefit and any additional requirements according to § 21 SGB II are just one part of the more comprehensive "Basic financial security for job-seekers". § 1 (1), Sentence 1 SGB II reveals that this basic financial security does not aim at an alimentionation of its recipients, but is intended to encourage their personal responsibility: "The basic financial security for job-seekers shall strengthen the personal responsibility of needy persons that are capable of work ... and shall contribute to covering costs of living by own resources and vigours, independently of the basic security" (translated by the author).

In the context of the law „*Gesetz zur Einordnung des Sozialhilferechts in das Sozialgesetzbuch*“, a new social assistance, codified in Book XII of the Social Code (*SGB XII*), was established on January 1st 2005. It is the duty of the social assistance "to allow the entitled persons to bear a dignified life" (§ 1 Sentence 1 SGB XII) (translated by the author). As the lowest net of the social security, and likewise the core of the new social assistance, the assistance for living (*Hilfe zum Lebensunterhalt*, Chapter 3 SGB XII) serves for those persons in need that do not receive benefits from elsewhere. This assistance is granted to people within employable age who temporarily are not participating in the labour force (e.g. those with long-term illnesses) and people that are disabled or in need of care; in short: persons incapable of work.

² § 8 (1) SGB II defines all persons as capable of work who in the foreseeable future due to illness or disability are not unable to work at least three hours per day under the regular conditions of the general labour market. And according to § 9 (1) SGB II needy are persons that can not earn their living and the living of their dependants on their own.

The monthly rate of the assistance of living in West Germany is 345 € (331 € East Germany); a special decree-law allows the states a slight deviation (Bundesrats-Drucksache, 2004).

It is of no coincidence, that the new social assistance and the unemployment benefit II are on the same level. In fact, this was politically intended – see the explanations about Chancellor Schroeder's agenda speech above. And § 20 (4) Sentence 2 SGB II certifies the instruction to assess the level of the unemployment benefit II in correspondence to the level of the assistance for living according to § 28 (3) Sentence 5 SGB II.

At first sight the amount of 345 € commencing at the beginning of 2005 seems to be a socio-political benefaction because the level of the old assistance for living was between 282 € and 297 € per month depending on the recipient's home state. However, it must be taken into account that in the sense of the reform, to encourage personal responsibility and autonomy, the new rate is not due to an augmentation but to an integration of formerly once-only payments (like e.g. for clothing). In the context of the old assistance, the Federal Ministry of Health and Social Security calculated an average requirement for living for a single person in West Germany in 2003 of 342 € (295 € monthly rate (average) plus 47 € once-only payments; without costs for dwellings) (Federal Ministry of Health and Social Security, 2004, p. 723). An indisputable positive side effect of this consolidation into a lump sum is the increase of efficiency due to an administrative simplification. Thereby, intending a re-vitalisation of the idea of a market economy, the self responsibility has been enforced.

The “reasonableness” of work

There has hardly been any aspect of the social welfare reform that has been criticised as vehemently as the alleged extremely unsocial merger of the former unemployment and social assistance for persons capable of work to the new unemployment benefit II. The continuously repeated reproach is that somebody who became unemployed but who had previously worked would drop in the social destitution after the expiration of his entitlement to the unemployment benefit I: Whereas former unemployment assistance amounted to an average of 515 € (average assistance for a male recipient; Federal Employment Services, 2004a, p. 72), the new unemployment benefit II is just 345 €. Defendants of the new system argue that for assessing a tax-financed social transfer the history of the recipient's work life must be irrelevant. Although a fundamental change in the interpretation of an equitable welfare state is linked to the introduction of the unemployment benefit II (away from the comprehensive and accommodative welfare state towards a system that restricts benefits to people in need that are required to

take care of their own future) there has been hardly any judgement about the arguments sketched above.

A first insight as to whether the same level for unemployment benefit II and new social assistance might be economically justifiable is provided by Homburg and Lohse (2004). Within an optimal taxation framework in the style of Mirrlees (1971) they analyse the possible conditioning of the entitlement to benefits on the capability of working in the context of the transition to the new laws of social contributions. Their focus of interest is the characterisation of tax-transfer-systems under the governmental knowledge about the persons' productivities which is named "partial information". Thus, a tax-transfer-system is optimal in such a way, that public transfers for needy persons who are incapable of working have to be assessed at a higher level than the transfers for those capable of working (Homburg and Lohse, 2004, p. 4). For society, the latter cause costs not only in terms of the transfers granted to them, but also in terms of potential, but not produced output due to their unemployment. Hence their economic costs to the society are much higher than those caused by persons incapable of work. But keeping the rate of 345 € equal it seems rather doubtful whether the new system of benefits is economically optimal.

The regulations about the "reasonableness" of work for employable individuals (§ 10 SGB II) and the resulting consequences in case of a refusal of a job (§ 31 SGB II) have been and are still an issue of intensive controversies. According to these new legal requirements almost any work is reasonable (§ 10 (1) 1st clause SGB II), and it is especially not unreasonable if the former job differs from the potentially new one (§ 10 (2) no. 1 SGB II) or the place of work is more distant than the former one (§ 10 (2) no. 3 SGB II). If the recipient of unemployment benefit II refuses to accept or to continue a new job, his transfer of 345 € will be cut initially by 30 percent (§ 31 (1) no. 1c) SGB II). In case of a repeated breach of duty he faces further reductions (§ 31 (3) Sentence 1 SGB II) until, finally, all payments are substituted by in-kind transfers. Taking into account the expected growth of a sector of low wages in the near future, most of the unemployed are probably facing the following situation: either they accept any job offered or they accept substantial reductions in their transfers. Thus, the final level of transfers for recipients of the unemployment benefit II will be de facto lower than the social assistance. An economic justification for this has been outlined above in the context of optimal taxation theory. Hence, the regulations about the reasonableness of work as stated in SGB II are an economic necessity because theory requires an optimal welfare system to grant higher transfers to persons incapable than to those capable of work. The reason why the legislator did not directly enact differentiated rates for these two groups of persons by specifying

the assistance for living (as part of the social assistance) higher than the unemployment benefit II, but has announced a uniform 345 € transfer, is certainly the political enforceability of the reforms.

The social valuation of labour

The government's reform takes account of the taxpayers' acceptance of funding transfers if they see the recipients 'earning' them. It is for this reason, that for unemployed recipients any job is reasonable. However, as Bradbury points out (2004, p. 315), this popular attitude can be underpinned by some normative rationales for labour to be valued *per se*. In this context the focus is on the paternalist and the reciprocity concept. Regarding the former, recipients are required to undertake employment activities, and this compulsion is not only in the society's, but also in the individual's own interest. Mead, the main founder of this concept (1992 and 1997), argues that transfer recipients have a desire to work, but can not turn this wish into practice (1997, p. 5). Similar arguments can be found from Yeatman e.g. (2000). In contrast, disagreeing on these parallel interests leads to a policy of obligation or reciprocity: those that are able to work should work or at least search actively for a job in order to be entitled to transfers, or, to put it briefly with the words of Anthony Giddens: 'No rights without responsibility' (1998).

Considering the recent debates about social reforms in diverse countries one can see a trend of moving from the paternalistic to the reciprocity concept (Bradbury, 2004). The discussion about the 'third way' and the 'new deal' in the United Kingdom, the principle of 'mutual obligation' in Australia or US-president Clinton's 'Personal Responsibility and Work Opportunity Reconciliation Act' of 1996 are some examples. This idea of the reinforcement of the work ethic can also be seen with the German 'Hartz IV' reform.

Welfare and employment effects

For the first time, politics has chosen a possibly effective approach to get out of the dilemma of the two competing socio-political goals; namely the struggle against poverty on the one hand and the strengthening of the self-help through taking up a job on the other hand (Gueron, 1990, p. 80). This has been carried out through the differentiation between transfer recipients capable and incapable of work and their respective treatment.

However, in reflection of the outlined differences of payments, one can conjecture that problems might arise concerning another issue: the control of being capable to work or not. As persons that are incapable receive higher public transfers than those that are capable but sim-

ply unemployed the institution that has to carry out the assessment faces high social pressure. This institution takes responsibility for the financial scarcity that results from the decision to declare someone capable instead of incapable. Given the harsh treatment of the productive poor, i.e. the unemployed persons that are capable of work, these may be apt to become incapable. Consequences such as drinking or drug addiction come into mind.

With a current unemployment of almost 4.5 Mio. people³ a central question in public discussion is: Even if all efforts to carry out the reforms of increasing efficiency and optimising incentives for unemployed to take up a job again are successful, where will suitable places of employment for such a huge number of people be found? An honest answer to this is simple: at the moment they are non-existent. First, because of a non-competitive wage for low-qualified (i.e. low-productivity) individuals, their remuneration would be too expensive. Second, because of the high state-offered “alternative incomes“ (i.e. social benefits) there is no demand for such a kind of job. But, and this is the crucial point, this situation will just remain for a limited transitional time. Since the beginning of 2005 when the reforms explained above came into force, jobs especially in the sector of low wages can be offered now thanks to lower costs. And as the entitlements to benefits have become more modest for many recipients, such jobs will also be requested. Estimations of the potential additional labour force give the number of employable persons in such a new low wage sector at a figure of around 2.2 (Kaltenborn, 2001; Raffelhüschen, 2001) up to 4.3 Mio (Riphahn et al., 1999).

There are considerations among some members of the government to establish a statutory minimum wage. However, a minimum wage would conflict with the objectives of the social and labour market reform and therefore would be counterproductive. Even the Deutsche Bundesbank emphasizes that “wages should primarily perform a steering function on the labour market and not be used for social policy aims through legislative interventions” (Deutsche Bundesbank, 2004, p. 57).

Some people argue that with the introduction of the unemployment benefit II, a kind of wage dumping will be initiated since unemployed people are forced to accept any job no matter at what wage, solely in order to keep their benefits. The fact that in the future more people will work in jobs with low incomes cannot be denied. But this is exactly what the reform aims for: the creation of a low wage sector in which low skilled people, who are presently disproportionately unemployed, can find a job. This reflects the mental change that underlies the reform of the welfare state. Instead of cementing the jobless person’s faineance through the sponsor-

³ For the month December 2004 the Federal Employment Services announced the number of 4.464.200 persons as jobless. This corresponds to a EU-standardised unemployment rate of 10.0%. Federal Employment Services, 2004b, p. 3.

ing of society, any recipient of transfers is forced to come up with some service in return. To overcome the potential problem of neediness when entering the job market with a very low wage, § 29 SGB II enforces a public supplementary payment (*Einstiegsgeld*) that can be received in order to support oneself on a real job. Moreover, it strengthens the self-confidence of a jobless person to give him the opportunity to work again, i.e. to generate his own income. In this context it can be related to Thomas Aquinas who postulated as early as in the 13th century: work is inherently good.

However, it is far from being obvious that the reforms carried out will have such a positive effect on employment since it is necessary to reduce the lack of jobs significantly and for a long period of time. In early 2005 the unemployment rate will rise instead of fall. This is due to a kind of statistical effect. Under the new legislation all people that are capable of work but without a job have to register as unemployed whereas in former times for recipients of social assistance such a registration was not necessary. The Institute for Employment Research (*Institut für Arbeitsmarkt- und Berufsforschung (IAB)*), being the Federal Employment Services' research institution, forecasts the number of people affected by this measure at approximately 300,000 (2004, p.5). In late 2004 some economists even feared an unemployment figure of more than 5 Mio. for mid 2005 (Weinert and Wohlers, 2004, p. 794) – unfortunately their estimations were correct as early as in January 2005 when the Federal Employment Service announced the figure to be at 5,037,000 (2005).

The high withdrawal rates for additional income were and are still a crucial problem. Although in the Chancellor's Agenda-Speech the rates were explicitly mentioned as central obstacles for more employment, they have de facto not been lowered, which in turn has the probable consequence that unemployment is unlikely to drop (Breyer, 2003). Moreover, by differentiating between income from a regular job on the first labour market on which the high rates have to be applied, and income from doing community services (so called 1-Euro-jobs) for which lower rates hold, a bias towards jobs in the second labour market has been enforced.

A further slackening of the dismissals protection would have to flank the reform of the welfare system. In the context of the „*Gesetz zu Reformen am Arbeitsmarkt*“ politicians just agreed to a minimal consensus in 2003. So the government is still called upon to take additional measures to a more flexible labour market. The employment protection legislation has a considerable impact on firms' recruitment policy and is thereby one of the most important obstacles for more employment.

Moreover, it would have been desirable if in the course of the reform process one had also dealt with the politically critical issue of free collective bargaining in order to allow for more flexible wage structures and labour relations. As far as a spreading of the wage structure depending on abilities is concerned, Siebert stated in 1995: “A major condition for more jobs on the lower steps of the productivity stairs in Germany is a stronger differentiation of the wages ... It must be also possible to expand wages downwards” (Siebert, 1995, p. 242, translated). An analysis by Fitzenberger and Franz (1998, p. 63) substantiates that this is the only promising way to reduce unemployment among low qualified persons. For the social partners this means a commitment to effectuate such differentiations in order to enable a higher employment, especially in the range of low standard wages.

Unfortunately, the postponement of the reduction of the maximum period of entitlement to unemployment benefit I that will take place as from 2006, is opposed to an early job miracle. In line with international studies (Atkinson and Micklewright, 1991), empirical surveys for Germany also show evidence for a significant positive relation between the period of receiving unemployment benefits and the duration of unemployment (e.g. Hunt, 1995 or Tatsiramos, 2004). An immediate reduction of the maximum period of entitlement would have been conducive to the German problem of unemployment. To quote the Deutsche Bundesbank: ”This should likewise boost the incentive to find a job” (2004, p. 55). Waiting until 2006 to carry out this part of the reform will result in accepting a delay in the melioration at the labour market.

Conclusion

The reforms in the course of “Hartz IV“ indeed mark a social political awakening. The guideline is to strengthen the personal individual responsibility and therefore to exempt the individual from his immaturity decreed by the welfare state. It allows him to take personal actions not only for his own, but also for society’s sake – in the best Adam Smith’s tradition. The clear classification of the transfers, social benefit for persons incapable of work and unemployment benefit II for persons capable of work, deserves plaudit. The massive lowering of the level of public transfers for capable persons – from the former generous unemployment assistance to the unemployment benefit II – may be a monetary break in individual cases. However, there is no lack of an economic reasoning for this measure. As derived from the optimal taxation theory, anything other than a level of transfers for unemployed, but capable persons which is lower than for unemployed and incapable persons would be sub optimal. The reproach of an “unsocial reform” counts for nothing: “Hartz IV” ensures that the state takes

care of the most disadvantaged, i.e. the persons incapable of work. Thereby, a de facto lowering of the lower bound for wages has been realised. Unfortunately, the removal of the central obstacle for more employment, the high withdrawal rates, have not been realised— maybe, it has simply been forgotten.

It will be destructive if another bugbear of the labour market comes true: the statutory minimum wage. By this, the mechanism of the wage as a market price for labour would definitely result in its death – along with the vanishing hope for a sustainable reduction of the unemployment. Only if the labour market can be called a “market“ in the economic sense, there is a chance for more employment in Germany. Maybe the selection of “Hartz IV” as the most prominent word in 2004 helps to realise this.

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