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The European Social Model in an age of crisis and austerity: the case of Germany

1. Introduction

In comparative research on welfare states, the German social model is regarded as the archetype of the conservative welfare state which seeks, through its social security arrangements, to maintain differences in status and, through its strong adherence to Christian social teaching, to support traditional family forms with a single male breadwinner (Esping-Andersen 1990). In contrast to the predominantly tax-funded, universalist Scandinavian social model, it is more strongly based on social insurance schemes which, in the Bismarckian tradition, provide cover only for dependent employees. Thus access to insurance benefits, as well as the level and quality thereof, depend on a worker’s position in the labour market. Wives and children are insured through the gainfully employed husband, although that particular provision was not introduced until long after Bismarck. Self-employed workers are dependent either on occupational insurance systems, which are found mainly in the liberal professions (medicine, law etc.) with their own regulatory bodies, or on self-provision, the family or basic social protection.

However, the social insurance schemes constitute only a part of the German social model. Other central pillars of the model are the wage system, codetermination at establishment and company level, universal, needs-dependent social assistance and basic social protection, family policy and the public service, with its social services organised primarily at local government level. Additionally, there is a complex system of fiscal equalisation between the Länder and municipalities with unequal economic power in order to ensure similar living conditions in all parts of the country.

The extent to which the welfare state helps to avoid, mitigate or compensate for social problems in various stages of the life course can be understood only by examining how these various elements of the German social model interact with each other. In combination with an inclusive wage system, social insurance schemes give rise to only slight differences in status and make an important contribution to the reduction of poverty. By the mid-1990s, what was then an inclusive wage system had led to the establishment of a middle class which, by international standards, was broadly based, with low levels of income inequality, and whose living standards were guaranteed by social insurance schemes that paid benefits even during long periods of illness and unemployment and in old age.

It is on the basis of these institutional complementarities that, in contradistinction to Esping-Andersen, whose criticism of the espousal of the single male breadwinner model I share however, I would like to describe the German social model of the post-war period as an inclusive Bismarckian welfare state. Among dependent employees, the only separate system is that for career public servants (Beamte). By virtue of this universality, the social insurance
schemes offer protection against risks to the vast majority of the population, right up to the upper middle classes. The broad protection afforded by the German welfare state also explains its high level of acceptance among the population. Because of the considerable potential for conflict, most of the major social reforms have been introduced by agreement among the major parties.

In contrast to many other European countries, German has not really experienced a dismantling of its welfare state, either in the years following the financial crisis of 2008 or, further back, in the two decades before the financial crisis. Rather, social benefits have been subjected to a combination of cutbacks, development and reorganisation. On the one hand, important new benefits have been agreed, such as the introduction of long-term care insurance and, following the Swedish model, the so-called parental allowance (Elterngeld). Moreover, during the financial crisis and despite a drastic decline in output, job losses have been kept to a minimum through a combination of active labour market policy and a revival of social dialogue between the state and the social partners. On the other hand, there have also been drastic cuts, particularly in old-age and unemployment insurance, and the labour market has been extensively deregulated as a result of the so-called Hartz Acts. Moreover, the hitherto inclusive wage system has been eroded by the deregulation of product markets, the privatisation of public companies and services and changed behaviour on the part of employers and employers’ associations, which have increasingly been taking advantage of opportunities to withdraw from social dialogue and collective wage bargaining in firms and industries in which trade unions are weak. And increasing pay inequality has significantly weakened the positive complementarities between the various elements of the German social model (Hall/Soskice 2001: 17). Widening income differentials in the employment system have led perforce to a differentiation of income-dependent social benefits, particularly pensions and support for the unemployed. Since the state is at the same time increasingly having to top up low wages and social insurance benefits, demands for minimum levels of protection in both the employment system and the social system are coming increasingly to the fore.

As a result of the cumulative effects of the changes in the social and wage system, there has been a shift away from the inclusive Bismarckian model towards a dualistic social model or an increasingly exclusive Bismarckian model. The advantages of the old model still apply to what is still, by international standards, a broad middle segment, but one that has, nevertheless, contracted somewhat compared with the early 1990s. Consequently, a growing segment of the population is dependent on the basic social protection systems, in which benefits are granted only according to need. In view of the current inflationary use of the term ‘dualisation’, which tends to conceal the still considerable differences between countries in income distribution and risk of poverty, it will be essential to describe precisely the various aspects of this risk.

The paper is structured as follows. In section 2, the development of the German social model in the post-war period is outlined. This is followed by an analysis of the social budget and the funding thereof (section 3). In the next section, the principal pillars of the German social model and the changes they have undergone in the past 20 years are analysed. This section 4 begins with an analysis of the labour market reforms (Hartz Acts), the related shift within the
German wage system towards an exclusive model with a large low-wage sector and the introduction of industry minimum wages. This is followed by a description of the changes in old age protection, which range from the abolition of early retirement, via reductions in the standard pension level and the introduction of a private, fully funded pension scheme to the raising of the pension age to 67 (section 5). Subsequent sections examine the changes in German family policy (section 6) and health insurance (section 7) and the introduction of the long-term care insurance scheme (section 8). In section 9, the mechanisms and effects of the regional fiscal equalisation system are examined, together with the role of the social insurance schemes in regional equalisation. The analysis is extended by means of two case studies. In the first, the object of investigation is the German ‘labour market miracle’ in the financial crisis, which became possible only through a revival of the traditional German social dialogue between the social partners and the federal government (section 10). In the second, the question of the social system’s role in preventing poverty despite the rapid rise in low-wage work is examined (section 11).

2. The construction of the welfare state after the Second World War

The foundations of the German social insurance system were laid by Bismarck between 1883 and 1889, during which time health, accident and old age insurance schemes were introduced. However, benefits levels at that time were still very low. After the First World War, free collective bargaining was recognised for the first time, albeit with statutory dispute resolution, and codetermination in the workplace was institutionalised with the establishment of works councils. This period also saw the establishment of national poor relief (1924), which replaced the largely municipal poor relief schemes, and of the national unemployment insurance scheme (1927), which took over from the numerous local benefit or mutual aid societies, most of them run by trade unions.

These measures laid down the basic structures of the future social model. However, it was not until after the Second World War that the welfare state actually began to be developed. It was only then that levels of benefits and universality were attained that justified the use of the epithet ‘inclusive’. The social benefit ratio, which in 1913 was only 3.1% and in 1938 6.0% of GNP (Teppe 1977: 195), rose by 1950 to 19%, since the massive socio-political problems that arose in the aftermath of the war, such as forced displacements, homelessness, inability to work, unemployment etc., were much more extensively alleviated than after the First World War. Despite extensive development of the welfare state, the social benefit ratio rose to only 23.3% by 1970, since high growth rates led to disproportionate increases in receipts and the decline in unemployment led to a reduction in expenditure on unemployment benefits. This changed with the first oil crisis in 1974. Unemployment increased and the social benefit ratio rose to 28.8%. The first expenditure reduction measures, which included cuts in unemployment benefits and subsistence payments for unemployed individuals on further training programmes, led to a reduction in the ratio to 25.8% by 1990. By 2003, however, following German unification, the integration of the East German population into the West German social system and the persistently high levels of unemployment engendered by unification, the ratio had reached a record high of 32.9%. In the lengthy boom that lasted until
the financial crisis, the social benefit ratio fell to under 30%, but by 2009, in the wake of the financial crisis, it had risen again to the 2003 level.

The development of the welfare state in the Federal Republic’s post-war order was also reflected in the legal system. When the Basic Constitutional Law (Grundgesetz) came into force in 1949, the so-called ‘welfare state principle’ was enshrined in the constitution, with Germany being described as a ‘democratic and social federal state’ (Article 20, para. 1 GG). Basic social rights were also enshrined in the constitution, including the inviolability of human dignity and the state’s obligation to eliminate unequal treatment, protect the family and ensure equality of living conditions in the various regions of the country. It is true that the commitment to the welfare state and the other basic values remained unspecified with regard to content, but they have often served as reference points in key judgments delivered by the Constitutional Court and place limits on attempts to cut back the welfare state (Bäcker et al. 2010a: 72). In 2010, the Federal Constitutional Court pronounced that the benefit rates and calculation methods used in the administration of social assistance and basic social protection for the unemployed breached the commitment to the welfare state and human dignity and were therefore unconstitutional. A transparent process had to be established for recalculating the benefit rates, which rose slightly as a result. On this and many other socio-political issues, the Constitutional Court has developed into the key actor in decisions on the direction of social policy.

The most important pillars of the German social model developed in the post-war period up to unification as outlined below:

- The 1949 Collective Bargaining Act guaranteed the autonomy of the parties to collective bargaining in wage setting and the determination of many other labour standards, such as working time, without statutory dispute resolution. The establishment of strong unified trade unions at industry level enabled effective use to be made of this autonomy.
- The 1951 Dismissal Protection Act, the 1969 Statutory Sick Pay Act and other items of labour legislation improved the protection afforded to employees. The legislation often followed in the wake of pilot agreements concluded between unions and employers in individual industries, as was the case with the Statutory Sick Pay Act, for example.
- In 1957, the uprateable pension was introduced; from now on, pensions were uprated automatically in line with the general evolution of wages.
- Financial transfers to families were extended in 1954, when the Child Allowance Act came into force, and again in 1958 with the introduction of the income splitting tax law for married couples. Prior to this, the Constitutional Court had declared the joint taxation of married couples to be unconstitutional because it infringed the commitment to protect the family, since married couples had to pay higher rates of tax than unmarried couples.
In 1961, several pieces of legislation on public relief were brought together in the Federal Social Assistance Act. Since many of the earlier municipal public relief schemes had been transferred into the social insurance schemes, the new social assistance system was to focus on providing assistance for individuals in particular life situations, such as those needing care or suffering from a handicap or even large families with low incomes. The paternalistic term ‘public relief’ was replaced by the term ‘social assistance’, which was intended to make independent living possible. Because full employment had been achieved, widespread indigence as a consequence of unemployment was no longer seen as a problem.

Active labour market policy was established in 1969 with the passing of the so-called Employment Promotion Act, which introduced a number of new labour market instruments, such as the systematic promotion of further vocational training for unemployed individuals. The Act was subsequently amended almost every year in order to adapt it to changes in the financial situation and to new labour market problems, as well as the differing views of successive governments.

The goal, enshrined in the Constitution, of ensuring that all parts of the country enjoyed the similar living conditions required that a system of fiscal equalisation between the Länder be put in place. When the Federal Republic of Germany was founded, the various political parties were agreed that the Länder and the federal government should have equal rights and be financially independent of each other. The aim was to avoid a concentration of financial sovereignty either in the Länder, as was the case in the principalities of the German Empire (from 1871 onwards), which made the central state nothing more than a boarder in its own territory, or in the central state, as was the case in the Weimar Republic, which made the Länder boarders in their turn. The 1949 fiscal equalisation mechanism and the reforms of 1955 and 1969 created a unified taxation system in which the central state and the Länder were entitled to fixed shares of income, corporation and sales tax. In addition, a fiscal equalisation mechanism between the rich and poor Länder was put in place.

Some of the basic pillars of the post-war German social model are the result of sometimes intense social disputes. This is particularly true of codetermination at establishment and company level and some of the collectively labour standards, such as the 35-hour week in the metal and engineering industry. However, the disputes ended with social compromises that became accepted over the years, which Dahrendorf saw as one of the strengths of the ‘institutionalisation of class conflict’ (Dahrendorf 1957).

Even though the development of the welfare state did not follow a master plan but happened only through consensus, a number of overarching basic principles underpinning the German social model can be identified. The first to be cited is the principle of subsidiarity, according to which the central state intervenes only when subordinate social units, such as the individual, family or parties to collective bargaining, cannot help themselves. The second, which became established with the 1957 pension reform, is the principle of safeguarding existing living standards, according to which the cash benefits paid in the event of unemployment, retirement and illness are linked to the previous level of earnings. The third is the principle that living conditions should be the same across the country. This was ensured
not solely by means of the fiscal equalisation system but also through collective bargaining policy which, despite the existence of regional bargaining in many industries, did not permit large regional wage differences to develop, and through regional equalisation based on the social insurance schemes, which became increasingly important following unification. The fourth and final principle is that of equal pay for equal work in the same establishment, which well before the EU directives determined the pay of foreign workers, women (albeit only from the end of the 1960 onwards) and fixed-term and part-time employees. However, in contrast to the Scandinavian countries, with their solidaristic wage policies, the equal pay principle was not applied across establishments, which meant that the large differences in pay between industries were maintained.

3. **Structure and funding of the social budget**

The German social insurance schemes are funded on a pay-as-you-go basis and have only a liquidity reserve to smooth out short-term fluctuations. They are operated according to the parity principle, with employers and employees each paying the same percentage of gross pay as contributions. Only the accident insurance and bankruptcy non-payment schemes are funded solely by a levy on employers. The second major source of funding is government subsidies paid for out of taxation. The needs-based basic social protection, social benefits for career public servants and the considerable subsidies for the expenditure incurred by the social insurance schemes not covered by contributions are all funded out of taxation. In this latter case, the expenditure largely concerns derived benefits paid to family members, such as health insurance benefits paid to spouses not liable to pay contributions and children, as well as surviving dependants’ pensions.

As a result of the extension of social insurance benefits in the post-war period and the increases in average contributions for employees and employers from 26.5% of gross pay in 1970 to up to 42.1% in 2003 (Bäcker et al. 2010a: 125), a large share of the social budget was funded by social insurance contributions. In 1991, 70.3% of the social budget was funded in this way. However, this figure includes, under the heading of ‘imputed social contributions’, statutory benefits provided by employers, such as sick pay, and voluntary employer benefits, such as company pensions. Even without these ‘imputed contributions’, social insurance contributions still accounted for significantly more than 50% of receipts. Since 1995, there has been a clear decline in employers’ contributions, which has been offset by a slight rise in the contributions paid by the individuals insured and, above all, by an increase in the state’s contribution (Table 1). The reduction in the employers’ share is explained by a partial departure from the parity principle and a reduction in the voluntary social benefits paid by employers in many sectors.

The increase in the share of funding out of central government taxation has brought the funding of the German welfare state somewhat closer to that of the Scandinavian welfare states, although the share of taxation in total receipts in Sweden in 2007 was still considerably higher, at 47.3% (European Commission 2010).

Compared with private insurance schemes, the social insurance system is very efficiently organised. For a social benefit ratio of 29.9%, administrative costs in 2011 were just 1.1% of
GNP. The largest share of expenditure (excluding administrative costs), at 40.2%, goes on payments to pensioners and their surviving dependants. The second largest share, at 33%, is accounted for by healthcare benefits, including nursing care, followed by benefits for children, incapacity and unemployment.

A number of important items of social expenditure are not included in the social budget. One such is the income splitting arrangement for married couples, which offers considerable tax benefits that are not included in the social budget among the benefits paid to married couples. In 2009, the tax reliefs obtained through income splitting totalled 27 billion euros, or 1.1% of GNP. Another is expenditure by companies on hours not worked by reason of paid absence due to leave or public holidays, which within the EU are an important element of the social model by virtue of the right to paid public holidays and a minimum leave entitlement of 20 days per year. The significance of these rights becomes fully evident only through comparison with countries that do not have them, such as the USA.

There have been considerable shifts in expenditure since 1991. The improvement in the employment situation, combined with cuts in benefits, has led to considerable reductions in expenditure on unemployment. Expenditure on healthcare benefits has risen, not least because of the introduction of a long-term care insurance scheme. Expenditure on surviving dependants’ pensions has also fallen, not only as a result of cuts to benefits but also because of improved pension arrangements due to longer employment histories among the succeeding cohorts (particularly women), while expenditure on pensions for insured individuals has risen because of demographic changes. From a European comparative perspective, the most untypical change is undoubtedly the reduction in expenditure on unemployment during and after the financial crisis due to the exceptional employment situation in the German labour market since 2008.
Table 1: Benefits and funding of the German social budget - structure in %

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<td>39.9</td>
<td>38.0</td>
<td>35.1</td>
<td>33.7</td>
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<td>-actual contributions</td>
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<td>27.5</td>
<td>26.0</td>
<td>24.5</td>
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<td>-imputed contributions</td>
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<td>12.5</td>
<td>12.0</td>
<td>10.6</td>
<td>10.4</td>
<td>10.0</td>
<td>9.9</td>
</tr>
<tr>
<td>by insured individuals</td>
<td>28.1</td>
<td>28.7</td>
<td>27.6</td>
<td>27.8</td>
<td>29.0</td>
<td>28.6</td>
<td>29.7</td>
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<td>-employees</td>
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<td>23.5</td>
<td>22.6</td>
<td>21.9</td>
<td>21.8</td>
<td>21.5</td>
<td>22.3</td>
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<td>-self-employed persons</td>
<td>1.1</td>
<td>1.3</td>
<td>1.2</td>
<td>1.4</td>
<td>1.8</td>
<td>1.7</td>
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<td>-own contributions by benefit recipients</td>
<td>2.1</td>
<td>2.3</td>
<td>2.5</td>
<td>2.9</td>
<td>3.7</td>
<td>3.6</td>
<td>3.7</td>
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<tr>
<td>-Other</td>
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<td>1.6</td>
<td>1.3</td>
<td>1.6</td>
<td>1.7</td>
<td>1.7</td>
<td>2.0</td>
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<td>State subsidies</td>
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<td>28.7</td>
<td>32.1</td>
<td>35.1</td>
<td>35.5</td>
<td>36.7</td>
<td>35.2</td>
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<tr>
<td>Other receipts</td>
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<td>2.7</td>
<td>2.3</td>
<td>2.0</td>
<td>1.8</td>
<td>1.8</td>
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<td>Healthcare</td>
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<td>31</td>
<td>29.4</td>
<td>28.5</td>
<td>32.1</td>
<td>32.2</td>
<td>33</td>
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<td>Incapacity</td>
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<td>9.2</td>
<td>8.4</td>
<td>8.4</td>
<td>8.1</td>
<td>8.2</td>
<td>8.3</td>
</tr>
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<td>Old age</td>
<td>30.3</td>
<td>31</td>
<td>32.8</td>
<td>34.4</td>
<td>33.1</td>
<td>33</td>
<td>33.2</td>
</tr>
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<td>Surviving dependants</td>
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<td>10.2</td>
<td>8.9</td>
<td>8.1</td>
<td>7.3</td>
<td>7.2</td>
<td>7.2</td>
</tr>
<tr>
<td>Children</td>
<td>7.7</td>
<td>6.9</td>
<td>10.2</td>
<td>9.8</td>
<td>9.8</td>
<td>10.2</td>
<td>10.5</td>
</tr>
<tr>
<td>Spouses</td>
<td>1.0</td>
<td>0.9</td>
<td>0.8</td>
<td>0.6</td>
<td>0.3</td>
<td>0.3</td>
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<tr>
<td>Maternity</td>
<td>0.4</td>
<td>0.3</td>
<td>0.3</td>
<td>0.4</td>
<td>0.4</td>
<td>0.3</td>
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<tr>
<td>Unemployment</td>
<td>8.4</td>
<td>8.5</td>
<td>7.5</td>
<td>7.3</td>
<td>6.3</td>
<td>5.8</td>
<td>4.7</td>
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<tr>
<td>Housing</td>
<td>1.0</td>
<td>1</td>
<td>1.1</td>
<td>2.1</td>
<td>2.1</td>
<td>2.1</td>
<td>2.0</td>
</tr>
<tr>
<td>General living assistance</td>
<td>0.4</td>
<td>0.9</td>
<td>0.5</td>
<td>0.6</td>
<td>0.6</td>
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1) Excluding administrative and other costs
From 2009 including private health insurance
Status as at May 2012
P: provisional, s: estimated
Source: BMAS 2012: 14

4. Labour market policy, low pay and industry minimum wages

4.1 The Hartz Acts

The impetus for the Hartz Acts was the alleged inefficiency of the then Federal Employment Service as a placement service. The Federal Government appointed an expert commission chaired by the then industrial relations director at Volkswagen AG, Peter Hartz. In August 2002, Hartz presented his report to the then Federal Chancellor, Gerhard Schröder, with the words: ‘Today is a good day for the unemployed. In two years we will reduce the unemployment count by 2.5 million.'
The Hartz Report’s core message was that a new balance should be found between ‘rights and responsibilities’, between the ‘carrot’ and the ‘stick’. The function of labour market policy was to maintain, improve or even forge individuals’ employability through measures adapted to their personal circumstances and potential. To this end, a higher level of support was needed from the labour market authorities, who in the past had simply given up on the majority of unemployed individuals, not least because of an inadequate number of placement staff. In return, however, unemployed individuals were to be required to take part in labour market policy measures and actively seek work (Hartz-Kommission 2002: 45ff).

The key message proclaimed by the Hartz Commission was a radical simplification of the bureaucracy the unemployed had to deal with. Jobcentres were to be created that would be one-stop shops and considerably improve the job placement service. Up to that point, responsibility had been divided between two institutions: the Federal Employment Service for unemployment benefit and unemployment assistance and the local authorities for social assistance. This led to function overlaps, since the local authorities also tried to place their benefit recipients in work in order to save money. Additionally, unemployment benefit and assistance could be supplemented by social assistance if the two combined fell below the level of social assistance.

The aim was to keep the bureaucracy away from the unemployed themselves and banish it to the back office, to simplify the organisation and, in return, to improve the counselling and labour market instruments. There was to be no change to the material benefits to which the unemployed were entitled and the three support payments were to be retained. The first of these was the income-related unemployment insurance benefit (unemployment benefit), paid at 63% to 68% of the previous income, the second, also income-related but means-tested, was unemployment assistance, paid to the long-term unemployed at 53% to 58% of the previous income, and the third was social assistance, a means-tested benefit paid to all the long-term unemployed not in receipt of either of the other two benefits. While entitlement to unemployment benefit was time limited, unemployment assistance could, in theory, be paid until pension age, providing previously well-paid unemployed individuals with a standard of living above that possible on social assistance.

The first draft of the Hartz Acts in fact provided for the establishment of one-stop centres for all unemployed individuals, where all benefits and services could be provided in one place. After the vote in parliament, with the conservative majority in the lower house, nothing (!) remained of this idea. The unexpected result was that in the end, instead of two administrative regimes responsible for three different support payments, there were now four administrative regimes with two support payments (Figure 1). The income-related unemployment assistance was abolished and merged with social assistance to form the new unemployment benefit II, a flat-rate basic subsistence benefit that was no longer income-related. This marked a break with the principle of maintaining living standards. Unemployed individuals with no entitlement to unemployment benefit I or whose entitlement had been exhausted were all treated the same, regardless of whether they had been in gainful employment for many years.

Unemployment benefit II is now known in common parlance as ‘Hartz IV’, since it was introduced in the fourth Hartz Act. The unemployment insurance benefit, the new
unemployment benefit I, was administered by the new Federal Employment Service, now renamed the Federal Employment Agency. On the other hand, three different organisational forms have developed in the job centres for the long-term unemployed on unemployment benefit II. In 2005, 334 local authorities established joint agencies with the local office of the Federal Employment Agency. In 69 places, the local authorities have assumed sole responsibility and receive the tax-funded unemployment benefit II from the Federal Employment Agency as well as the resources for active labour market policy for the long-term unemployed. In 21 cases, the local authorities and the Federal Employment Agency could not agree to adopt one or other of these two models and continued to carry out their functions separately as they had previously.

**Figure 1: Administrative regime and support measures for the unemployed (before 2003) and after the Hartz Acts (from 2004 onwards)**

<table>
<thead>
<tr>
<th>Administrative regime</th>
<th>Support measures</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>passive measures</td>
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<tr>
<td><strong>Before 2003</strong></td>
<td></td>
</tr>
<tr>
<td>1. Federal Employment Service</td>
<td>Unemployment benefit</td>
</tr>
<tr>
<td>2. Local authority social welfare departments</td>
<td>Unemployment assistance</td>
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<td></td>
<td></td>
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<tr>
<td><strong>From 2005 onwards</strong></td>
<td></td>
</tr>
<tr>
<td>1. Federal Employment Agency</td>
<td>Unemployment benefit I</td>
</tr>
<tr>
<td>2a. Joint Jobcentres Local authorities with sole administrative responsibility</td>
<td>Unemployment benefit II</td>
</tr>
<tr>
<td>2b.</td>
<td></td>
</tr>
<tr>
<td>2c. Separate responsibilities</td>
<td>Unemployment benefit II</td>
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<td></td>
<td>Federal Employment Agency</td>
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<td></td>
<td>Special support measures</td>
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*Source: Own compilation*

In 2007, the Federal Constitutional Court declared the joint Jobcentres (2a in Figure 1) in part unconstitutional. In the Court’s view, they constituted an intrusion into the administrative autonomy of the local authorities that was not provided for in the Basic Law. In 2010 the constitution was amended and the Jobcentres brought into compliance with the Basic Law. More local authorities were given an opportunity to set up their own funding bodies, of which 41 authorities took advantage. Since the original number had shrunk to 67 as a result of territorial amalgamations the number of local authorities with sole administrative responsibility rose to 118. At the same time, the separate responsibilities option (2c in Figure 1) was abolished.
Besides the abolition of unemployment assistance, there were also significant reductions in the level of material support, particularly in the case of unemployment benefit I. The maximum length of entitlement to unemployment benefit, which was 12 months but for older workers over 50 between 14 and 32 months depending on age, was reduced to between 15 and 18 months for the over-50s. At the same time, the reasonableness criteria for accepting job offers were tightened. The long-term unemployed now have to accept any job offer paying up to 30% of the customary local wage. Other key measures were the deregulation of temporary agency work and so-called mini-jobs. In the case of temporary agency work, the time limit on the loaning of workers to any one company was completely abolished and derogations from the equal pay rule were permitted in collective agreements. Up to a certain earnings threshold, mini-jobs are exempt from income tax and social insurance contributions. The consequence of this is that married individuals employed in mini-jobs continue to benefit from health insurance at no cost via their spouses and also retain all the tax reliefs granted under the splitting arrangements. The earnings threshold for mini-jobs was raised from 325 to 400 euros per month, the upper limit of 15 hours per week was abolished and workers already in employment were allowed to take mini-jobs as second jobs. In addition, a number of new labour market instruments were introduced, such as training vouchers in place of the previously direct organisation and promotion of further training measures and the so-called Ich-AG, a grant available to individuals planning to become self-employed.

Furthermore, a very broad definition of fitness for work was introduced for those seeking to claim unemployment benefit II. Thus anyone who can work three hours daily is regarded as fit for work. In many other countries, individuals with such a limited capacity for work are regarded as unfit for work. In this way, some people who are actually unfit for work are being pushed into the Hartz IV system. The local authorities welcomed this change, since it helps them reduce expenditure on social assistance. In addition, all individuals in a household who are fit for work now have to be actively seeking work. If a male single breadwinner whose wife does not work loses his job, his wife must now also look for work even though for many years she has only been a housewife. This threatens to undermine the traditional family model for the long-term unemployed, while for those in employment that model is still generously supported by means of the splitting arrangements for income tax assessment, derived social insurance entitlements and the exemption from tax and social insurance contributions for those taking mini-jobs. For the poorer segment of the population, the traditional German family model has been revoked by the obligation placed on the unemployed to seek work.

By making these considerable reductions in the material support available to the unemployed and deregulating temporary agency work and mini-jobs, the legislative process gave rise to a second new labour market policy paradigm, which played only a secondary role in the Hartz Report itself and might be described as ‘placement in work at any cost’. The social protection previously available to the unemployed and the protective provisions regulating precarious employment forms were regarded as crucial obstacles to employment. There were actually enough jobs, it was argued, but they could not be filled because of the excessive demands made by the unemployed. Consequently, the unemployed would have to lower their expectations. The function of labour market policy was to place the unemployed in these jobs.
by using a combination of positive incentives (‘carrot’) and tough sanctions (‘stick’). In this connection, a debate was soon initiated on the introduction of a minimum wage. It was decided not to go down that path, since a low-wage sector was regarded as indispensable. In September 2012, at the annual conference of the Association for Social Policy, the conference of German economists, Gerhard Schröder declared that the government of the day had wanted to create a low-wage sector so that even low-skilled workers would have a chance in the labour market.

4.2 The effects of the Hartz Acts

Together with the introduction of the minimum wage in the UK, the Hartz Acts are one of the most intensively evaluated social reforms. However, some of the evaluations commissioned by the government began too early. They were unable to reach any definite conclusions since the effect of the new instruments was impossible to discern in the chaos of the reorganisation, which it is difficult to underestimate. After the Hartz Acts came into force at the beginning of 2004, just one year remained to prepare for the reorganisation. Many millions of benefit recipients had to be assigned to the new systems and it is estimated that almost 200,000 employees in the Federal Labour Agency and the local authorities were involved and assigned to new organisational structures and duties (Adamy 2012).

Most of the evaluation studies, including all those commissioned by the federal government, have investigated only the effects of different aspects of the extensive organisational reforms and of individual labour market policy instruments. As far as the available data allowed, these studies combined qualitative methods (case studies and expert interviews) with quantitative econometric approaches using control groups, in which the effects on a treatment group were compared with control groups. However, little serious attention was paid to the macro-economic effects.

The most important results of the evaluation can be summarised as follows:

- The number of transfer recipients increased significantly. At the end of 2004, 4.88 million people were drawing social or unemployment assistance; at the beginning of 2005, the number of people in receipt of the new basic social protection rose to 6.12 million. Family members of previous recipients of social assistance and unemployment assistance accounted for the largest increase (Kaltenborn/Schiwarow 2006). Furthermore, the estimated number of unregistered cases fell, since the term Unemployment Benefit II is less discriminatory than social or unemployment assistance. It suggests an entitlement rather than a welfare benefit. Barriers were broken down as a result and take-up of the benefit increased, with fewer people feeling ashamed to apply for it. In subsequent years, the expansion of the low-wage sector and of mini-jobs offering only limited hours has led to an increase in the number of workers who top up their low incomes with unemployment benefit II. The share of such claimants rose from 23.1% of benefit recipients in 2007 to 28.7% in 2010 (Figure 2).

- Those affected by benefit reductions were mainly previous recipients of unemployment assistance and older unemployed individuals, who were also affected
by the cut in the period of entitlement to unemployment benefit. The position of single parents and people who had not previously applied for benefits improved (Brussig/Knuth 2011: 11).

Figure 2: Employees in receipt of unemployment benefit II 2007-2010

Source: Bundesagentur für Arbeit 2011a

- Because of the broad definition of fitness for work and the merging of unemployment and social assistance, the number of registered unemployed people also rose. It was calculated that the Hartz Acts led to an increase of 350,000 in the unemployment count (BA 2006: 63). Thus anyone who can work three hours a day is regarded as fit for work. In many other countries, such individuals would be regarded as unfit for work. As a result, some individuals who are actually not fit for work are forced into the system. This has made it exceptionally difficult to improve the placement success rates.

- As a result of the increase in the number of benefit recipients, costs exploded. Expenditure on labour market policy was 27 billion euros in 2002 and has now risen to 46 billion. This cost explosion had not been planned. On the contrary: it had been assumed that the unemployment count and hence expenditure on labour market policy would fall rapidly. What is actually surprising is that both government and opposition accepted it without demur. Above all, employers, who are actually pushing for reductions in social expenditure, kept quiet, since the abolition of unemployment assistance and the deregulation of temporary agency work and mini-jobs have helped them reduce wage costs.
Another unplanned consequence is that the unemployment insurance system is disproportionately small, while the unemployment benefit II system is excessively large. Of the 2.9 million people who were unemployed in May 2013, 0.9 million (32%) were registered for unemployment insurance and 2 million for basic social protection (Hartz IV). Including family members and those unfit for work, around 6.2 million people are receiving support through the basic social protection system. Despite the massive economic upturn since 2005, the number of benefit recipients has remained largely constant.

Support for the unemployed has slowly improved in recent years. Before 2003, there were 250 unemployed individuals for every 1 member of staff in job centres. This ratio has now been reduced for young people to 1:75 but for adults it is still 1:150. Processes have also been reorganised. The unemployment insurance scheme in particular is now a very modern operation with lean, efficient organisational structures.

The evaluations have not produced any unambiguous findings on the core element of the Hartz philosophy, namely improvement of the job placement service. Consequently, we still to this day do not know whether the core objective of the Hartz Acts, improvement of the job placement services, has actually been achieved. The evaluations show that many unemployed individuals have received no advice or not entered into a jobseeker’s agreement (Bäcker/Bosch/Weinkopf 2011). The fall in the unemployment count since 2005 has largely been among those drawing unemployment benefit I.

The vouchers for further training or private job placement services that were introduced in the Hartz Acts have proved to be a failure. The long-term unemployed are often unable to make use of the vouchers because in most cases they do not know which training providers or placement agencies might be able to help them. A voucher system assumes customer sovereignty, a condition that unfortunately is not met among the bulk of the long-term unemployed population. Moreover, the new ‘work first’ philosophy that is now applied to unemployment benefits I and II has led to a massive decline in support for longer-term further training measures leading to a vocational qualification. Before the Hartz Acts, the prevailing view was that more should be invested in the unemployed (‘train first’) (Bosch 2012).

Fear of a descent into the Hartz IV system has increased among the unemployed and increased their readiness to make concessions. Firms are now able to fill poorly paid positions more easily (Kettner/Rebien 2007).

Outflows from unemployment have increased significantly since 2005. However, since inflows into unemployment have increased at the same time, despite the economic upturn, flows between employment and unemployment have increased. Figure 3 shows the outflow rates (dark curve) and inflow rates (light curve). The reason for the increased flow in the economic upturn since 2005 is the increased use of fixed-term contracts and temporary agency work, which often lead only to short periods of employment.
The two deregulated employment forms, temporary agency work and mini-jobs, have gained considerably in importance. The number of temporary agency workers rose from 300,000 in 2003 to around 900,000 in 2011, while over the same period the number of people employed in mini-jobs rose from around 5.5 million to 7.5 million. The number of people taking mini-jobs as a second job rose particularly sharply (from around 1.3 million in 2003 to around 2.6 million in 2011). Both employment forms are overwhelmingly poorly paid. Among workers in mini-jobs, the share of low-wage workers in 2010 was 86% and among temporary agency workers around two thirds, both far in excess of the average of 22%. The high share of low-wage work among workers in mini-jobs can be explained primarily by the fact that, in contravention of the European Guideline on the equal treatment of part-time employees, such workers are generally paid lower rates than other part-timers. As far as temporary agency workers are concerned, the equal pay principle has been abrogated by collective agreements that amount to wage dumping concluded by the employer-friendly Christian trade union that has virtually no members. The special status of these two employment forms is evidenced by the fact that the trade unions have not succeeded, even in firms that adhere to collective agreements, in negotiating better terms for these workers than those that prevail in firms not bound by collective agreements (Figure 4).
The most contentious effects of the Hartz Acts are those on employment levels. The legislation came into force just as Germany was coming out of a deep recession. In the subsequent upturn, there was a sharp cyclical increase in employment. If the Hartz Acts did indeed influence this positive employment trend, then either the upturn must have been more employment–intensive as a result of better matching processes or the upturn was accelerated by the Hartz Acts. Horn/Herzog-Stein (2012) have compared the employment intensity of three economic cycles (199Q1 – 2001, Q1, 2005/Q2 – 2008/Q1 and 2009/Q2 until the current end point). In the first upturn, employment intensity (i.e. the percentage increase in the level of gainful employment when GDP rises by 1%) was 0.43% and in the two subsequent upturns it was just 0.35% and 0.39% respectively. Thus in fact the employment dynamic tended to weaken after the Hartz Acts. The two upturns after they came into force were almost wholly driven by exports. However, German exports are themselves driven mainly by a high degree of specialisation and innovation and have only limited price elasticity. The Hartz Acts had a damping effect on the evolution of wages; this effect was concentrated primarily in the service sector and ruined domestic demand but had little effect on the export economy.

Thus the reasons for the favourable evolution of employment in Germany in recent years are not to be found in the Hartz Acts. They are the result of German manufacturing industry’s specialisation, over many years, in high-quality products, driven by a rapid pace of innovation, above-average investment in R&D and a good vocational training system. Moreover, the German product portfolio, with its emphasis on capital goods and cars, was well matched to the sharply increasing demand from the BRICS and other developing countries, which meant that the German economy was not wholly dependent on the European market. The Hartz Acts enabled the country, even in the strong upturn of 2005 to 2008, to continue its policy of internal devaluation within the Eurozone by means of below-average wage increases and unit wage costs relative to other Eurozone countries (Stein/ Stephan/ Zwiener 2012). Since domestic demand and, consequently, imports as well did not keep pace with the growth in exports, trade imbalances within the Eurozone increased which is one of the principal reasons for the Euro crisis. Thus the impact of the Hartz Acts has a European dimension. In particular, this policy cannot be applied at will to other countries, since only by abolishing the laws of mathematics would it be possible for all countries to have export surpluses.

4.3 Low wages and minimum wages

Since the end of the 1990s, German wages have risen less than those in the rest of the EU. One principal reason for this is the rapid expansion of the low-wage sector, which was under way before the Hartz Acts. The share of low-wage workers rose from 17.7% in 1995 to 23.1% of all workers in 2010. The number of low-wage workers increased from 5.6 million in 1995 to 7.9 million in 2010. One particularity of the German low-wage sector is its marked downward dispersion, since there is no effective lower limit to prevent very low wages. In 2010, 6.8 million workers were paid less than the minimum wage of 8.50 euros demanded by the German Trade Union Federation, while 2.5 million actually earned less than 6.00 euros per hour (Kalina/Weinkopf 2012).
Virtually all the growth in absolute terms took place in West Germany, i.e. in areas protected by high levels of adherence to collective agreements. Examination of the evolution of the inflation-adjusted wage distribution since 1995 shows that the concentration of wages around the mid-point of the wage distribution is crumbling and many previously well-paid activities are sliding downwards (Figure 4). Low-wage work is not equally distributed among all employees. In 2010, those particularly affected by low wages were younger employees under 25 (50.8%), those on fixed-term contracts (45.7%), those without vocational training (39.3%), women (30.0%) and foreigners (31.9%) (Table 1). The incidence of low-wage work has increased most strongly since 1995 among young workers under 25 (+15.9 percentage points), employees on fixed-term contracts (+18.8 percentage points) and foreigners (+13.4 percentage points). Because of the variable size of these employee categories, a distinction must be made between the impact on individuals and the composition of the low-wage working population. Thus in 2010, 30% of female employees were paid low wages, but they accounted for almost two thirds (63.7%) of all low-paid workers (Table 2). One particularity of the German low-wage sector is the low share of employees without a vocational qualification. Around 80% of people in the sector have a vocational or higher education qualification. The Hartz Acts’ aim of improving the employment chances of low-skill workers has not been fulfilled.

**Figure: 4: Distribution of hourly pay, Germany, adjusted for inflation (base = 1995)**

Source: SOEP 2012, calculations by the IAQ, Thorsten Kalina
The expansion of the low-wage sector began around 10 years before the Hartz Acts. The causes were changes in the behaviour of employers, who took advantage of high unemployment to quit employers’ associations and cease to be bound by collective agreements, and the opening up of many previously public services (post, railways, local transport etc.) to private providers who were not bound by collective agreement and competed with state-owned companies by engaging in wage dumping.

The Hartz Acts did not set this process in motion but, as already noted, prevented low-wage work from being reduced in the strong upturn from 2005 onwards. The most important influence in this regard was exerted by the two employment forms deregulated in the Hartz Acts, which are overwhelmingly badly paid. Among employees in mini-jobs, the share of low-wage workers was 86% in 2010 (Table 2); according to another survey, it was around two thirds for temporary agency workers. The high share of low-wage work among mini-jobbers can be explained primarily by the fact that employees in these jobs are generally, and in contravention of the European guideline on the equal treatment of part-time workers, paid less than other part-timers. As far as temporary agency workers are concerned, the equal pay principle has been abrogated by collective agreements that amount to wage dumping concluded by the employer-friendly Christian trade union that has virtually no members. The special status of these two employment forms is evidenced by the fact that the trade unions have not succeeded, even in firms that adhere to collective agreements, in negotiating better terms for these workers than those that prevail in firms not bound by collective agreements (Figure 5).

<table>
<thead>
<tr>
<th>Category</th>
<th>Share of LW workers in category</th>
<th>Share in LW sector</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1995</td>
<td>2010</td>
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<tr>
<td>Qualification</td>
<td></td>
<td></td>
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<tr>
<td>No vocational qualification</td>
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<td>Vocational qualification</td>
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<td>24.7</td>
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<td>HE qualification</td>
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<td>10.9</td>
</tr>
<tr>
<td>Gender</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Men</td>
<td>10.8</td>
<td>16.7</td>
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</tr>
<tr>
<td>Age</td>
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<tr>
<td>Under 25</td>
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<td>25 – 34</td>
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<td>23.6</td>
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<td>35 – 44</td>
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<td>Foreign</td>
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<tr>
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<td>Open-ended</td>
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<td>Full-time</td>
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<td>15.5</td>
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<tr>
<td>Part-time (liable for social insurance contributions)</td>
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<td>26.6</td>
</tr>
<tr>
<td>Mini-job</td>
<td>77.1</td>
<td>86.1</td>
</tr>
</tbody>
</table>

* < two thirds of the median hourly rate of pay

Source: SOEP 2010, calculations by the IAQ (Thorsten Kalina)
The increase in low-wage work was supposed to make it easier for unemployed individuals to enter the labour market and to improve the employment chances of low-skill workers. In the mid-1990s, the German labour market was still being praised by the OECD for the good opportunities for advancement it offered low earners. That has now fundamentally changed. More recent investigations show that low-wage work is becoming increasingly entrenched. Kalina (2012) shows that the chances of advancement declined over the long period between 1975/6 and 2005/6. Mosthaf et al. (2011) note that only about one in every seven full-time workers who were low paid in 1998/9 was able to leave the low-wage sector by 2007.

**Figure 5: Median gross hourly earnings by employment form and adherence to collective agreements 2010***

![Median gross hourly earnings by employment form and adherence to collective agreements 2010](image)

* Employees in firms with 10 or more employees aged between 15 and 65, in sectors B to S (WZ 2008), excluding trainees and partial retirement for older workers.

**Source:** DESTATIS, Niedriglohn und Beschäftigung 2012: 19

In 1995, the wage distribution still followed a Gaussian normal distribution, with a strong middle segment; by 2010, however, the distribution curve had shifted significantly to the left (Figure 4). Incomes for a growing share of the population remain below the level of basic social protection and those affected claim unemployment benefit II. As the low-wage sector becomes increasingly entrenched and the chances of advancement decline, pensions will in turn become lower (section 5), so that the German social system will increasingly lose its inclusiveness.

Coverage by collective agreement, which was around 80% prior to 1990, had declined by 2010 to 60% in West Germany and to 48% in East Germany. Autonomous wage-setting by the social partners is obviously no longer functioning. In many small and medium-sized enterprises and service industries, wages are determined unilaterally by firms, since collective agreements are not in force and works councils have not been set up. As a result, the trade
unions have reconsidered their rejection of state intervention in the wage-setting process and since the Hartz Acts have been campaigning for the introduction of minimum wages. Industry minimum wages have now been agreed with employers’ associations in 12 industries and have been declared generally binding by the Federal Government. The minimum wages range from 12.60 euros in further training in North Rhine-Westphalia to 7.00 euros in laundries in East Germany. In some industries a second minimum wage has been agreed for skilled workers, ranging from 13.70 euros in the main construction trade in West Germany to 9.00 in the cleaning industry in East Germany. The effects of minimum wages on pay levels and employment have been investigated in eight industries, in some cases using a difference in differences estimation. No negative employment effects were observed (Bosch/Weinkopf 2012). However, a trend change towards a reduction in low-wage employment has not yet been instigated since the largest low-wage sectors, such as retailing and hotels and catering, do not have industry minimum wages. Attempts to introduce a national minimum wage and reform the Collective Bargaining Act to make it easier to declare industry agreements generally binding have so far been dashed on the rocks of federal government opposition.

5. Old age insurance

The vast majority of the population is insured through the statutory old-age insurance scheme. The only group exempt from contributing to the statutory scheme are career public servants (Beamte), whose pensions are funded directly from the federal government budget. Apart from a few particular groups, self-employed workers are not insured through the statutory system and have to make private provision for themselves. Farmers and certain other groups have special funded occupational schemes. For the liberal professions with their own regulatory bodies (doctors, pharmacists, architects etc.), membership of a pension scheme organised at the level of the individual federal state (Land) is compulsory. There are also company pension schemes, although these cover only a section of the labour force.

The overwhelming importance of the statutory old age insurance scheme is reflected in the fact that 66% of all expenditure on old-age benefits is made from the statutory scheme. If the pensions of career public servants, the public service supplementary pension and the farmers’ old age insurance scheme are also included, then the pay-as-you-go public pension schemes account for 81% of expenditure. The funded systems account for 19% of expenditure, with life insurance accounting for 10%, company pension schemes for 8% and the pension schemes for the liberal professions 1% (Bäcker et al. 2010b: 392).

The level of pensions is not calculated on the basis of the absolute level of earned income and contributions paid. The decisive factor, rather, is the relative level compared to average earnings over the entire working life, which determines the position in the ‘pension hierarchy’. A person whose earnings have been below average throughout his or her working life will also have a below-average pension.

However, since benefits are also paid for periods without gainful employment and payment of contributions, the link with employment is supplemented by the solidarity principle. Credits are given for periods spent in vocational training and for time taken out of the labour market
in order to raise a family or care for family members. This is intended to compensate individuals for loss of income or lower earnings during such periods. The periods of vocational training for which credits are granted, which used to be very generous, have now been reduced to a maximum of three years, but the periods spent raising a family or caring for family members have been extended. Since 1996, credits have been granted to the mother or father for up to three years per child born after 1992. For children born before 1991, the maximum period is just one year. These periods can be added together if they are separated by periods of employment. Furthermore, since 2001, fathers or mothers of children up to 10 years of age with low contributions because of periods of part-time working or low earnings can have their contributions topped up to, at most, the level of average earnings. Finally, since the introduction of long-term care insurance in 1995, credits have been paid for unpaid part-time care (at least 14 hours per week) provided for family members or neighbours who work a maximum of 30 hours per week.

In order to tackle the major structural crises in manufacturing industry and in East Germany following German unification, a number of mechanisms for early exit from the labour market were put in place. Several series of heavily subsidised labour market programmes were introduced that created various possibilities for bridging the period between exit from a firm (in some cases from 57 or 59 years of age) and early retirement, which was available from the age of 60 onwards to women, the unemployed or workers with reduced earnings capacity. As a result, the employment rate for 55-64 year olds, which was 51.9% in 1970, fell to 36.8% in 1991 and remained low until the end of the decade (37.6% in 2000).

The high costs of early exit from employment, combined with the simultaneous ageing of the population, led to a change of policy at the end of the 1990s. From 1997, the age limits were increased step by step. Since 2005, old age pensions cannot be taken without reductions until a worker has reached the age of 65. The earliest age at which a pension can be taken with reductions is 63. The retirement age for women was equalised with that for men by 2010. From 2012, the retirement age will be increased step by step to 67 by 2029. The 1946 cohort was the last to be able to retire at 65. The 1964 cohort will be the first to which the retirement age of 67 will apply. Early retirement will also be possible from age 63, but with a reduction of 14.4%. At the same time, the conditions for accessing the invalidity pension (Erwerbsminderungsrente) have been made tougher. For every month before the age of 63 that a worker draws his or her pension, a reduction of up to 10.8% has to be accepted.

The standard pension level has also been reduced several times. In 1992, the annual pension uprating, which used to track the evolution of average earnings, was calculated on the basis not of gross but of net earnings. Since the 2001 pension reform, the annual uprating has followed the evolution of net wages but with a time lag. Between 2002 and 2004, a so-called private pension contribution totalling 4% of gross pay was introduced. It is assumed that all employees will offset losses in the statutory pension with the newly introduced subsidised private ‘Riester pension’, named after the then Minister of Labour. In 2005, the so-called ‘sustainability factor’ was introduced as a means of taking account, in determining pension increases, of the contributor-beneficiary ratio. When this ratio falls then so too do pension
increases. Finally, periods of unemployment are credited less generously and now hardly ever give rise to pension increases.

These adjustment measures have caused the standard pension level to fall (Figure 6). Since 1995, new pensions for men have been significantly lower than existing ones. The difference is greater in East Germany because of lower wage levels and higher unemployment. Women’s situation has evolved differently in the two parts of the country. Because women in the former GDR tended to have continuous employment histories, their pensions were higher than those of women in West Germany and higher than existing pension entitlements, which is now changing for the same reasons as for men in East Germany. Among West German women, on the other hand, new pensions are higher than existing ones because the cohorts now retiring were in employment for longer periods (Figure 7).

**Figure 6: Evolution of net standard pension level before tax 1985 – 2026 and 2030 Level of the net standard pension before tax (45 contribution years) as % of average annual earnings**

![Graph showing the evolution of the net standard pension level before tax from 1985 to 2030.](image)

* Lower limit of level safeguarding clause

Source: Data to 2008: Deutsche Rentenversicherung (2011): Rentenversicherung in Zeitreihen

Data from 2009: Bundesregierung: Rentenversicherungsbericht 2012, Berlin

The standard pension level will decline further in the coming years. In 1985, for a standard pensioner with 45 contribution years and average earnings it was 57.4% of the average wage; by 2012 it had fallen to 49.6% and according to figures published by the German Statutory Pension Insurance Scheme will decline further to 46% by 2026 (Figure 6). These figures do not include the liabilities to which the gradual taxation of pensions has given rise since 2005.

1 The German Constitutional Court decided in 2002 that the differential tax treatment of career public servants’ pensions, which were liable for tax, and other pensions that were not liable for tax was unconstitutional. As a result, pensions are gradually, between 2005 and 2040, being brought into the tax system. In return, contributions can to a large extent be offset against tax.
These massive changes to pension legislation were a result of the political objective, supported by all the major parties, of preventing old age insurance contributions from rising above 20% by 2020 and above 22% by 2030, in order to keep any increase in labour costs as low as possible because of demographic changes. If the standard pension level was to have been maintained, a contribution rate of 26% would have been required, which would have been equally divided between employees and employers. The ‘pension gap’ of four percentage points is supposed to be filled by private savings of 4% of income, that is the so-called Riester pension referred to earlier. Thus compared with the traditional funding of old age insurance, which was equally divided between employees and employers, the latter have seen their share reduced by two percentage points. The state pays subsidies or, optionally, grants tax reliefs. For a family with one earner, two children and an annual income of up to 20,000 euros, the subsidies were 84% (Bäcker et al. 2010: 457).

However, the Riester pension is not obligatory. Despite increasing take-up, by 2011 only about 40% of those entitled to do so had concluded a Riester contract. Take-up rates are particularly low among poorly paid workers. In the two lowest quintiles it is under 25%
Deadweight effects dominate among the higher income groups, since money that would have been saved anyway is being put into subsidised Riester pensions (Corneo/Keese/Schröder 2010). Moreover, the yields on many contracts are extremely poor and in many cases employees merely keep their contributions because of high acquisition and administrative costs (Hagen/Kleinlein 2011; Joebges et al. 2012). The aim of using the Riester pensions to combat poverty has utterly failed.

The pension gap cannot be filled by company pension schemes either. Only 21% of private-sector employees benefit from an additional company pension scheme. These are mainly employees in large companies. Only in the public sector is there a compulsory occupational pension scheme. It was the object of a national collective agreement and is quasi-mandatory because of the nearly 100% coverage by this agreement. The contributions to this system amount to 7.86% of the monthly gross wage of which the employers pay 6.54%. The intention was to raise the pension level of non-tenured civil servants (Angestellte) to the more generous pension level of career public servants (Beamte).

The pensions of civil servants have been adapted to these decreases. Now early retirement is only possible with deductions. Between 2003 and 2009 the maximum pension level was gradually reduced from 75% of the former gross income to 71.75%. As early as 1992 it was decided that the maximum level could be reached only after 40 years’ service instead of the previous 35 years (Färber et al. 2011: 101-103). Because of these changes actual pension levels decreased from 72.8% of the former income in 1994 to 69% in 2011.

A comparison of the pension levels of former public and private-sector employees is difficult, since no statistic captures the accumulated effects of the first and second pillar. Table 3 shows that the pensions of career public servants are far higher than ordinary state pensions. They are, however, subject to taxation, while pensions from the national pension system are tax-free. It can be assumed that the average pensions of non-tenured civil servants in the public sector are higher than in the private sector since the second pillar, the occupational pension, is mandatory while only 21% of employees are receiving an occupational pension. The traditional male breadwinner model with discontinuous employment careers for women is reflected in lower pensions for women in all categories. In the private sector, women are more likely than men to work in industries and companies with no occupational pensions. Because of the mandatory second pillar they are much better off in the public sector.
Table 3: Income sources and coverage for the over-65s, West Germany 2007

<table>
<thead>
<tr>
<th></th>
<th>Coverage in %</th>
<th>Gross pension per month in €</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>total men Women</td>
<td>total men women</td>
</tr>
<tr>
<td>State pension</td>
<td>90 89 90 958 1219 767</td>
<td></td>
</tr>
<tr>
<td>Occupational pension private sector</td>
<td>21 31 12 403 490 239</td>
<td></td>
</tr>
<tr>
<td>Occupational pension public sector</td>
<td>11 11 12 322 432 266</td>
<td></td>
</tr>
<tr>
<td>Career public servants' pension</td>
<td>8 11 6 2165 2577 1640</td>
<td></td>
</tr>
</tbody>
</table>


Since the German statutory pension insurance scheme is employment-dependent, the reduction in the standard pension level will be accelerated for the lower and middle income groups by the expansion of the low-wage sector. At present, a worker just above the low-wage threshold (75% of average earnings) has to work for 37 years full-time in order to accrue a pension entitlement above the basic social protection, known as social assistance for older people. By 2030, it will already be 45 years, which very few low earners actually achieve (Riedmüller/Willert 2009). In many occupational groups with high levels of physical and psychological stress, it is not possible to work until 67. In the case of invalidity, however, considerable reductions in pension level can be expected. The pension level also falls when a person moves from unemployment into retirement. The cumulative effects of the changes will lead to a drastic increase in the share of pensioners with an income below the level of basic social protection, particularly in East Germany (Table 4).

Table 4: Evolution of the share of people with low pensions in the statutory pension insurance scheme (simulation results, in %)

<table>
<thead>
<tr>
<th>Share of recipients of statutory pension with incomes under 600 euros</th>
<th>Germany</th>
<th>West Germany</th>
<th>East Germany</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total</td>
<td>Men</td>
<td>Women</td>
</tr>
<tr>
<td>Cohorts 1937-1951</td>
<td>29.9</td>
<td>2.7</td>
<td>54.2</td>
</tr>
<tr>
<td>Cohorts 1952-1971</td>
<td>32.5</td>
<td>2.3</td>
<td>53.8</td>
</tr>
</tbody>
</table>

* Pension income after deduction of contributions to health and long-term care insurance, basic scenario; contributions discounted to the base year 2005
Source: Steiner/Geyer 2010

6. Family policy

Family policy in the former West Germany was determined by the male single breadwinner model/housewife-carer model, in which the woman not only looked after the children when
they were very young but was always available for them while they remained at school and also to care for other family members when necessary. Protection of the family is enshrined in the German constitution, from which it was understood that marriage was an institution to be promoted, regardless of whether or not there were children. This model underwent a renaissance in the post-war period, since it helped to differentiate the German Federal Republic from the GDR. Accordingly, the expansion of childcare provision, the individualisation of social security in the GDR and the promotion of the adult earner model were interpreted until the 1990s as an unacceptable ‘Communist’ interference in families’ freedom of choice and the ideologisation of child raising rather than as attempts to adapt family policy to new ways of living and changed preferences. This ideological ballast continues even today to impede attempts to change family policy.

The dominance of this model means that family policy in Germany is even today characterised largely by transfers and tax reliefs, while services for families, particularly in the form of childcare and whole-day schools, play a significantly less important role than in the Scandinavian countries, for example (Table 5). What is also striking is the high share of tax reliefs that reflect the particular significance of status protection in family policy, since tax reliefs in progressive tax system will favour families with higher incomes.

Table 5: Share in GDP and distribution of expenditures for family policy 2009 (per %)

<table>
<thead>
<tr>
<th></th>
<th>Cash benefits</th>
<th>In-kind</th>
<th>Tax-reliefs</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>United Kingdom</td>
<td>2.46</td>
<td>1.38</td>
<td>0.38</td>
<td>4.22</td>
</tr>
<tr>
<td>France</td>
<td>1.44</td>
<td>1.76</td>
<td>0.78</td>
<td>3.98</td>
</tr>
<tr>
<td>Sweden</td>
<td>1.58</td>
<td>2.17</td>
<td>0.00</td>
<td>3.75</td>
</tr>
<tr>
<td>Denmark</td>
<td>1.63</td>
<td>2.27</td>
<td>0.00</td>
<td>3.90</td>
</tr>
<tr>
<td>Germany</td>
<td>1.16</td>
<td>0.89</td>
<td>1.01</td>
<td>3.07</td>
</tr>
<tr>
<td>Italy</td>
<td>0.78</td>
<td>0.80</td>
<td>0.00</td>
<td>1.58</td>
</tr>
<tr>
<td>United States</td>
<td>0.11</td>
<td>0.59</td>
<td>0.52</td>
<td>1.22</td>
</tr>
<tr>
<td>OECD average</td>
<td>1.41</td>
<td>0.94</td>
<td>0.28</td>
<td>2.61</td>
</tr>
</tbody>
</table>

Source: [http://www.oecd.org/els/soc/oecdfamilydatabase.htm](http://www.oecd.org/els/soc/oecdfamilydatabase.htm), Excel table

Child benefit and child tax allowances can be claimed until a child is 18 years of age or, in the case of unemployed children, until the age of 21 and for children in school, training or at university until the age of 25 (until 27 prior to 2007). Both benefits have been increased regularly in recent decades. In 2013, the tax allowance for a child was €7008 per year, while child benefit was €184 for the first and second child, €190 for the third child and €215 for the fourth child. Child benefit and child tax allowances have been linked since 2002. The tax office assesses which benefit is more favourable for any particular family. The tax allowances are more advantageous for higher earners. A family with three children can save up to €2100 per year in tax. These differences show that children are not treated equally by the state but rather that differences in status are supported by the public purse.
German family policy privileges marriage over other ways of life through the income splitting system for assessing married couples’ tax liability and the derived social insurance entitlements for spouses. In 2013, the maximum tax advantage conferred by income splitting was €15,718 for a taxable income of more than €501,462. The tax advantages for married couples were increased still further in 2013, when the earnings threshold for mini jobs was raised to €450 per month. In 2013, mini jobbers can earn up to €5400 (12 x €450) without this amount having to be included in a couple’s joint tax return. Even for lower and middle-income families, mini-jobs combined with income splitting and the derived healthcare benefits offer considerable financial advantages.

Parents’ freedom to choose between various models of economic activity was severely restricted by the inadequate provision of childcare and by half-day schools, which required a parent to be at home in the afternoon. German unification saw the West German model transferred to Eastern Germany. The previous, virtually universal system of child care in Eastern Germany was severely cut back after unification but provision still remained above the low level in Western Germany.

This combination of financial incentives for low levels of economic activity or even inactivity and the inadequate provision of childcare and half-day schooling has strongly influenced women's participation in the labour market. As in other European countries, improvements in education and changes in preferences have led to a sharp increase in women's participation rate in Germany as well. Between 2001 and 2012, the participation rate rose by nine percentage points from 58.7% to 67.7%, taking it well above the average for the EU 27, where the female participation rate in 2011 was 58.5%. However, since the share of mini jobbers and part-time workers increased disproportionately at the same time, the participation rate in full-time equivalents rose by only 5.5 percentage points from 46.5% to 51.8%, which is only slightly above the EU 27 level of 49.9% in 2011 (European Commission 2013: 403 und 409).

This fragmentation of employment relationships does not accord with women's preferences. Our analysis of socio-economic panel data (SOEP) shows that mini-jobbers and part-time workers in particular would like to work longer hours. In 2008, mini-jobbers worked on average 12 hours per week but wanted to work 20 hours per week; part-timers in jobs liable for social security contributions wanted to increase their working time from 22.9 to 26 hours per week.

Since the mid-1990s, growing dissatisfaction with the difficulties of reconciling paid work and family life, which was also increasingly influencing voting behaviour, has led to the gradual establishment of a modernised model of the family alongside the old one:
- in 1996, entitlement to a half-day nursery place for children aged between four and six was enshrined in law;
- at the beginning of 2001, full-time employees in companies with more than 15 employees were given the right to reduce their working time and move to part-time employment;
- in 2003, the Federal government made available €4 billion for the Länder to develop all-day schooling;
- as of August 2013, every child aged between one and three has a legal entitlement to a childcare place;
- On 1.1.2007, following the Swedish model, 14 months' paid parental leave was introduced in addition to the existing statutory maternity leave. Between 65 and 100% of the net monthly income is paid up to a maximum of €1800, with a minimum of €300 a month. Parents cannot claim the full 14 months unless the father takes at least two months' leave. 

On the basis of survey data, the federal government and the Länder had assumed that 35% (32% in West and 50% in East Germany) of children aged between one and three would require a childcare place. More recent surveys have shown that demand is actually closer to 39% (37% in West and 51% in East Germany). This is higher than the original assumptions, so that 790,000 places are now required rather than the 750,000 originally for children aged between one and three planned. The number of childcare places for children aged between one and three has risen from 137,667 in 2006 to 597,000 in 2013 (Autorengruppe Bildungsberichterstattung 2012: 54; FAZ, 11.7.2013). The number of places on offer is planned to reach 800,000 by the end of 2013, which will pose a major challenge to West German towns and cities in particular. They are under considerable pressure to reach this target, however, since parents will be able to bring a case against the local authorities if they do not.

The share of all-day schools is now in excess of 50%. However, in many cases the provision of all-day schooling does not extend to all pupils in the school; as a result, in 2012 only 28% of pupils were receiving all-day schooling (Autorengruppe Bildungsberichterstattung 2012: 78-79). Furthermore, the German definition of an all-day school differs somewhat from the usual understanding of the term. According to the official definition adopted by the Conference of Education Ministers of the German Länder, a school is regarded as an all-day school if it provides seven hours of teaching and supervision on at least three days a week. Moreover, the majority of pupils attend what are known as 'open all-day schools', in which the afternoon activities are voluntary. Only a minority of all-day schools have changed their teaching arrangements and provide lessons in the afternoon as well.

The take-up rate for the parental allowance (Elterngeld) is very high and the benefit has achieved its aims. Family incomes in a child's first year of life are increased by an average of €400 per month. Parental leave is taken by 25% of fathers and the incentives to return to paid work have increased (Wrohlich et al. 2012). In a child's first year, i.e. during the period when the parental allowance is paid, the participation rate for mothers has declined but rises again subsequently (Figure 8). It is noteworthy that this increase is attributable to part-time and virtually full-time jobs that are liable for social security contributions.
However, we cannot speak of an unambiguous change of direction in family policy. The old model has been reinforced once again by the childcare supplement for parents (the so-called Betreuungsgeld), which was introduced on 1 August 2013. Parents who do not send their 1 to 3 year olds to a nursery but look after them themselves receive a supplementary monthly allowance of €150. This child care supplement, which exists in several other European countries as well, has a selective effect. Parents with low levels of education and low incomes tend to opt for the child care supplement, even though it is their children who have a particular need for the support and stimulation nurseries offer (Wirth/Lichtenberger 2012).

Thus, at great expense, German family policy supports two contradictory models of the family. And since the policy measures tend to cancel each other out, the policy is not particularly effective. Moreover, the measures suffer from a very low level of transparency. In tax law, social policy legislation and public service pay structures, there were no fewer than 156 measures in 2010 supporting children and marriage, at a total cost of €200.2 billion. That is equivalent to around 5% of GNP and is significantly more than is shown in the OECD statistics (Table 5). Some of these measures have been evaluated. The effects on poverty prevention and the labour supply of women with children were investigated. The following measures proved to be particularly effective means of preventing poverty:

- the child supplement, which is paid to low-income households in addition to child benefit in order to stop them having to apply for unemployment benefit II;
- the advance on maintenance payments, which is available when an estranged parent is unable to pay maintenance or is late doing so;
the supplementary allowance paid to recipients of unemployment benefit II with children.

The income splitting system, the tax allowance for single parents and the tax relief for childcare costs prove to be ineffective measures, since they come into play only at a certain income level. Mothers' working time is particularly negatively influenced by the income splitting arrangement and the derived entitlement to health insurance without contributions, while public childcare, the advance on maintenance payments and the tax relief for childcare costs all have a positive influence in this regard (Prognos 2012: 11). All critical findings have been omitted from the official assessment of the evaluation reports by the Federal Government (BMFSFJ 2013).

Family policy in Germany is currently stuck in a stalemate between the old and new models. As a result, there is a shortage of funds for the expansion of high-quality childcare and all-day schooling. Since income splitting, derived social insurance entitlements and child benefit command widespread public support, it is risky for the main parties in particular to adopt a clear position. Consequently, it may be some time before the stalemate is resolved.

7. Health insurance

All dependent employees who earn up to the compulsory insurance threshold of €4350 per month have to be insured within the statutory health insurance scheme. Employees who earn in excess of this threshold may choose to insure themselves within the statutory scheme. Pensioners are also insured and have to pay contributions. The children and spouses of insured individuals are also insured and do not have to pay contributions. In 2012 the statutory health insurance scheme had almost 70 million members, which equates to around 87% of the population. In addition to the 30.1 million compulsorily insured individuals, there were a further 5.2 million voluntary members, 16.4 million pensioners and 17.7 million jointly insured family members.

The statutory scheme includes many different providers that have grown up over time. Thus there are local health insurance providers, company schemes and corporate schemes, such as those for white-collar workers or craftsmen. As a result of mergers, the number of schemes has shrunk from 1815 in 1970 to 134 in 2013. This wave of mergers, which is not yet over, has been driven by high administrative costs and the perils of an unfavourable combination of risks for the smaller schemes (e.g. high shares of older members). Not least because of these mergers, the statutory scheme's administrative costs were 5.5% in 2009, considerably less than those of the private health insurance schemes (14.3% in 2009), which spend not inconsiderable sums on advertising.

Only sick pay is calculated on the basis of the equivalence principle, at a rate of 70% of monthly earned income. All other benefits are benefits in kind that are granted on the basis of medical criteria. Consequently, there is a considerable degree of redistribution within the statutory insurance scheme, between the sick and the healthy, between single, childless

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2 Mini-jobs, whose full effect is felt only in combination with income splitting and derived social insurance entitlements, were unfortunately not included in the investigation.
individuals and married couples and families with children and between the young and the old. Pensioners pay their own contributions, it is true, but they cover only 40% of their treatment costs (Bücker et al. 2010b: 142).

Because of the ageing of the population, disproportionate increases in medical services and increasing health awareness among the general public, the costs of the statutory scheme have risen sharply. The contribution rate has increased from 12.5% in 1990 to 15.5% in 2013. In order to keep costs for employers stable, the equal funding principle was abandoned in 2005. Today the contribution rate for employers is 7.3% and for employees 8.2%. The federal government pays a subsidy for those benefits not covered by contributions, principally the joint insurance for family members.

Structural change in the economy placed many statutory health insurance schemes in a precarious position. In many regions, the share of unemployed people, low earners and pensioners rose disproportionately, creating a toxic mix of reductions in revenue and above average expenditure. As a result, many schemes had to increase their contributions, thereby jeopardising their very existence, since many members moved to other, cheaper schemes. This situation led to the introduction in 1994 of a risk equalisation pool. Insurance schemes with unfavourable risk structures received risk balancing payments from those with more favourable risk structures. In 2009, this risk equalisation system was reorganised with the introduction of the so-called 'health fund' (Gesundheitsfonds). Since 2009, there has been a uniform national contribution rate within the statutory health insurance scheme. Contributions are paid into the new health fund, together with all tax-funded subsidies. In addition to standardised allocations for administrative costs, the insurance schemes receive a uniform basic payment for each insured person from the health fund, plus age, sex and risk-adjusted supplements or reductions. In this way, health insurance schemes with older and sicker members receive more money than those with many younger, healthier members. The aim is to ensure that health insurance schemes do not suffer competitive disadvantages because of their membership structure. If insurance schemes do not pay out all the money allocated to them, they may pay their members bonuses. However, if their expenditure exceeds their allocated revenue, they are expected to operate more efficiently and, if the measures taken do not suffice, to impose additional contributions on their members, which have to be paid by the insured individuals alone. In 2010, 13 health insurance schemes imposed an additional contribution on their members.

In the last two decades, the private health insurance schemes have become part of the statutory system. The number of people they insure has risen sharply. In 1970, a total of 4.2 million people were fully insured by the private insurance providers; by 2011 the number had risen to almost 9 million. In addition, there are people insured under the statutory scheme who have taken out supplementary private insurance. The policies are governed by the same principles as any other private insurance policies, i.e. on the basis of a contract between the insurance company and the insured individual. Contributions are not income-dependent; instead, flat-rate payments are made. All family members have to pay contributions. Since 2009, however, all individuals resident on German territory who are not insured under the statutory scheme have been under an obligation to take out health insurance. Moreover, the private insurance providers have to offer a uniform basic tariff with 'affordable premiums';
they are under an obligation to contract but may not charge additional premiums for high-risk patients or exclude treatment for existing conditions. In addition, there is compulsory long-term care insurance.

8. **Long-term care insurance**

Until the introduction of long-term care insurance, long-term care basically had to be funded privately. If the person's own income was insufficient, then relatives in the direct line of descent, i.e. children, parents and grandchildren, were responsible for paying the costs. In most cases, the income of elderly people in need of care was insufficient, particularly when they required in-patient nursing care. It then fell to the social assistance system to pick up the bill, but the state did not assume permanent responsibility until the person's assets had been exhausted and family members had fully met their obligations. Around 80% of those requiring in-patient nursing care were in receipt of social assistance, which placed a heavy burden on local authorities.

In the traditional German social model, it was difficult to justify the fact that the risks of accident and sickness were covered by insurance schemes, whereas long-term care, an equally universal risk, had to be funded privately. After a debate that had dragged on for 20 years or so as the population aged, the traditional family, which had borne a large share of the costs, weakened and local authority expenditure soared, statutory long-term care insurance came into force in 1995 (Bäcker et al. 2010 b: 181-198).

The long-term care insurance scheme was modelled on the health insurance system. Everyone insured in the statutory health insurance scheme is obliged to take out long-term care insurance as well. In addition, everyone with private health insurance also has to take out a long-term care policy. It was only by extending the obligation to the private health insurance schemes, thereby making it universal, that the objective of reducing the burden on local authorities could be achieved. After all, some recipients of social assistance had not been insured under the statutory scheme, such as the self-employed for example. The aim of the long-term care insurance scheme was to make it possible for people to live in the environment to which they were accustomed for as long as possible. Consequently domiciliary care, support from relatives and neighbours and prevention and re-enablement were given priority over in-patient nursing care.

The benefits provided depend on the level of care needed. There are three care levels. Care level I includes those who require assistance at least once a day for two sets of activities (personal care, food preparation and eating and mobility) and help with household tasks once a week. Level III is for those who require care 24 hours a day. Benefits in kind, such as domiciliary care, monetary benefits, in particular the attendance allowance for relatives and neighbours, and in-patient nursing care are all funded at fixed rates.

The capital cost of providing the in-patient care facilities has to be borne by the Länder. The running costs and the cost of providing domiciliary care are paid by the long-term care insurance scheme. The contribution rate for the scheme was fixed in 1995 at 1% of total gross
wages, with contributions to be paid equally by employers and employees. In order to reduce the burden on employers, the Länder were, for the first time in the history of social insurance, given the possibility of abolishing a public holiday that always falls on a working day (Buß- und Bettag, or the Day of Prayer and Repentance). All the Länder with the sole exception of Saxony have availed themselves of this possibility. Unlike the health insurance scheme, the long-term care insurance scheme is a partial coverage scheme. Its fixed-rate benefits cover only a part of the costs. Moreover, the level of benefits is specified and cannot be adjusted when costs rise by increasing contributions, as is possible in the health insurance system. This leads to real reductions in benefits, which have to be absorbed privately or by the social assistance system.

Because of this inherent tendency towards reduced benefits and, at the same time, increasing care needs, particularly for in-patient nursing care, the sustainability of the funding for long-term care insurance was a subject for debate right from the outset. In the medium term, an increase in contribution rates seems inevitable. Changing over to a fully funded system, as proposed by conservatives, is not a solution either. The returns from capital investments are uncertain and insurees have to bear the burden of accumulating a stock of capital over many years (Bäcker et al. 2010b: 197-8).

In the end, daily care rates were increased in 2008 and 2013. The contribution rate had already been raised to 1.7% in 1996 and finally to 2.05% in 2013. In 2005, the contribution for childless people aged between 23 and 60 was increased by 0.25%, since the Federal Constitutional Court ordered that greater consideration be given to the expenditures of families with children, which as a rule are no longer taken into account. The number of insurance benefit recipients rose from 1.562 million in 1996 to 2.360 million in 2011. The majority of recipients are women (65% in 2011). The scheme's income and expenditure are stable because benefits are capped. The aim of reducing local authority expenditure on social assistance has been achieved. Such expenditure fell between 1994 and 2001 from 9.06 to 2.9 billion euros (Bäcker et al. 2010b: 194), although it had risen again to 3.6 billion euros by 2011.

9. Regional fiscal equalisation and the role of social insurance

The regions of Germany differ considerably in their economic strength. Consequently, the goal of ’creating the same living conditions' in all parts of the country, which is enshrined in the German Constitution (Article 72 of the Basic Law), can be achieved only by equalising the differences in financial strength between the Länder. In contrast to many other countries, the Länder in the German federal system have little autonomy when it comes to revenue. Virtually all taxes are fixed at a uniform level across the country as a whole (Stehn/Fedelino 2009: 6). However, a complex system of fiscal equalisation ensures that revenues are largely evened out across the Länder. Those that have below-average financial strength are brought up to the national average, while the fiscal capacity of the donor Länder is reduced to that same average. The most important taxes (VAT, corporation tax and income tax) are allocated in fixed proportions to the central state, the Länder and the local authorities. Three quarters of the Länder’s share of VAT is allocated to them on the basis of their population size, while the remaining 25% is used for financial equalisation (supplementary VAT transfer). There is also
a mechanism for horizontal financial equalisation between the Länder, whereby those with above-average tax receipts transfer money to the weaker Länder, as well as supplementary federal grants, which are intended to compensate for differences in per capita tax receipts and special needs (such as those of the federal capital).

For individual Länder such as Bremen, the Saarland and, in the immediate post-war period, Bavaria, which was still structurally weak at that time, fiscal equalisation was of fundamental importance. Before German reunification, less than 0.5% of GNP was redistributed via the fiscal equalisation mechanism (Figure 9). Tax receipts in the various regions were further evened out by means of industry-wide collective agreements, which had the effect of bringing wages in the Länder into line with each other.

After reunification, which brought with it increasing wage inequality, fiscal equalisation became increasingly important. In 1993, the five new East German Länder were incorporated into the fiscal equalisation system and up to 1.5% of GNP was redistributed among the regions (Figure 9). In Solidarity Pact I, the Länder's share of VAT was increased. Additional allocations from central government also ensure that each state's financial capacity is raised to 99.5% of the national average. In addition, the West Germans had to contribute to the fiscal equalisation mechanism, bearing 40% of the costs incurred by the new Länder. In Solidarity Pact II, which runs from 2005 to 2019, central government is making available to the new Länder some 207 billion euros of additional investment funds, to be paid in diminishing instalments. The federal government's additional expenditure is funded by the so-called 'solidarity surcharge', a surtax on income, capital gains and corporation tax levied since 1998 at a rate of 5.5% (7.5% between 1995 and 1997).

**Figure 9: Evolution of the Equalization Transfer System**
With the rise in structural unemployment since 1974 and after reunification, regional redistribution via the social insurance schemes and social expenditure funded by the federal government became increasingly important. Of particular significance in this regard are the old age and unemployment insurance schemes and the federally funded unemployment assistance (up to 2004) and the new unemployment benefit II introduced in the Hartz Acts.

Following reunification in 1991, wage levels in Eastern Germany were around half those in Western Germany. Wages had been even lower prior to reunification. If pension entitlements had been calculated on the basis of East German incomes, the differences in living conditions would have persisted for many decades. In order to prevent this, East German pension entitlements for each year of employment were multiplied by an uprating factor (the ratio of the average East German to the average West German income). As East German incomes have gradually converged with those in Western Germany, so the uprating factor has declined. For gross incomes in East Germany in 1985, the uprating factor was 3.3129, by 2008, it had fallen to 1.1827. As a result, East German pension entitlements over the entire working life were raised to the West Germany level. However, since contributions are calculated on the basis of the lower gross incomes that still prevail in Eastern Germany, considerable transfers from West to East are required. There are also considerable redistributive effects between West German regions, such as those from structurally weak regions with ageing populations to growing regions with younger populations.

The redistributive effects of unemployment insurance and unemployment assistance/unemployment benefit II increase as regional inequalities in unemployment rates widen. As a result of the high levels of structural unemployment in the East German Länder after reunification, both passive and active labour market policies had significant redistributive effects. However, structurally weak West German regions also benefit from these redistributive effects.

In 2003 and 2005, the volume of redistribution attributable to unemployment insurance, at 7.8 and 6.3 billion euros respectively, was close to the volume of transfers created by the fiscal equalisation mechanism (6.8 and 6.9 billion euros respectively). The volume of redistribution within the statutory old-age insurance scheme is even greater. In the same years it amounted to some 21 billion euros at Länder level, about three times the volume attributable to the fiscal equalisation mechanism. The recession of 2008/9 led to a reduction in the donor states' tax revenues; as a result, the volume of redistribution attributable to fiscal equalisation declined while that attributable to social insurance increased (BBSR 2012: 188).}

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3 Mientus (2009) rightly draws attention to the fact that transfers should not be equated with economic costs. The considerable migratory flows of young people from East to West Germany has triggered significant growth effects there. Such effects should be offset.
The regional fiscal equalisation system is now being heavily criticised because of its strong focus on the differences between East and West Germany and the inadequate funding of many local authorities in West Germany in particular. Federal legislation has placed many duties and responsibilities on the Länder and local authorities without making available the additional resources they require. This applies to assistance with living expenses (social assistance), the regulations on the funding of accommodation for recipients of unemployment benefit II, child and youth welfare, childcare etc. The situation is further exacerbated by the entrenchment of high levels of structural unemployment, which is increasingly affecting local authorities in West Germany. The increasing levels of social expenditure cannot be offset by additional allocations from the Länder (local authority financial equalisation) or increases in local taxes (particularly local business tax), especially in the structurally weak areas. The consequences are increasing indebtedness in many local authorities and a drastic reduction in their ability to fund investment in material assets. Local authorities account for around two
thirds of all public investment (Figure 11). Uniformity of living conditions is being increasingly undermined by this underinvestment in local infrastructure and reductions in services in many areas (e.g. culture and education). Demands are being made for a complete reorganisation of the regional fiscal equalisation system. In particular, social benefits laid down in federal legislation should be financed by central government in order to reduce the burden on local authority budgets (Bertelsmann-Stiftung 2012; Eichel/Fink/Thiemann 2013).

**Figure 11: Expenditure structure of local authority budgets 1970-2008**

![Expenditure structure of local authority budgets 1970-2008](image)

*Source: Bertelsmann Stiftung 2012: 47*

10. **Case study I: The German ‘jobs miracle’ in the financial crisis**

In the wake of the financial crisis, the German economy experienced its most severe slump since the Second World War (-4.9% of GDP in 2009). However, the effects on the labour market were different from those experienced in all other previous economic crises and in most other OECD countries. Most German experts expected firms to opt for a mix of external and internal flexibility. The joint spring prognosis of the big German economic research institutes forecast a substantial decrease in employment (-500,000) in 2009 and an increase in unemployment (+450,000) for 2009 (Projektgruppe Gemeinschaftsdiagnose 2009). This pessimistic prognosis did not come true. Employment did not decline as expected and unemployment did not rise. Moreover, youth unemployment did not increase, in contrast to experience in virtually all other European countries.
The Hartz Acts had created new sources of external flexibility, particularly through the deregulation of temporary agency work and mini-jobs; in the financial crisis, however, it was primarily internal flexibility that was strengthened. In order to achieve this, politicians and employers' associations that had argued for years in favour of labour market deregulation had to remind themselves of the virtues of the old German model of social partnership. An 'informal alliance for work' gradually took shape. Representatives of the federal government, the employers' associations and the trade unions agreed, in many rounds of talks, not only to avoid redundancies whenever possible but at the same time to maintain the number of new training contracts in the German dual vocational training system at the same level as the previous year in order to prevent an increase in youth unemployment. To that end, a package of policy measures was agreed, which was supplemented and implemented at a more decentralised level by industry-wide and company agreements.

In order to stabilise the economy, the German government launched two economic stimulus packages, together totalling some 70 billion Euros. Among other things, this money was used in 2009 and 2010 to fund public investment at federal, Länder and local level and a car scrappage scheme designed to encourage the purchase of new cars, to reduce taxes, to improve firms’ ability to write down their investments and to support labour market policy measures, such as short-time working, training and the recruitment of additional placement officers in job centres.

Among the various labour market policy measures taken, short-time working played the major role. Before the recent financial crisis, short-time working was intended primarily as a buffer for short-term reductions in orders but not as a response to a deep, long-term crisis. The maximum period for claiming subsidies for short-time working was increased from 6 to 24 months. From the seventh month onwards, employers' social security contributions were reimbursed. Furthermore, the short-time allowance (67% of monthly net income for hours not worked) was paid for every period of reduced activity and not just for reductions of 10% or more as before the crisis. Working time credits on working time accounts had to be used up before applications could be made for short-time working. The social partners negotiated improvements in the short-time working allowance. In some collective bargaining areas, particularly in the metalworking and chemical industries, an agreement on topping up the allowance to 90% of the previous monthly net wage was concluded.

The measures had different time horizons. The investment programmes had to be planned, debated and passed at the various levels of the German Parliament and then put out to tender, which led to delays of at least nine months and usually even longer, so that the labour market effect was not evident until 2010. The scrappage premium had an effect in the short term, but only in the automotive industry. Short-time working had the advantage of having an immediate and accurately targeted effect on all firms affected by the crisis and helped them to reduce their labour costs. Moreover, in conjunction with other measures firms took to cut working time temporarily, they had a strong levering effect.

Almost half of German companies have introduced working-time accounts in recent years, the details of which are specified in most cases in an agreement with the works council (Groß/Schwarz 2009). Furthermore, virtually all German collective agreements make
provision for temporary reductions in standard working time in economic crises, usually without wage compensation, in order to avoid redundancies. In some industries, the social partners have agreed to give the actors at firm level opportunities to reduce the collectively agreed working time temporarily in order to avoid dismissals. The extent of the possible reductions ranges from 6.75% to 25% of normal working time, that is between 2.5 and 10 hours per working week.

The expanded ‘tool box’ of instruments was used by many companies in a typical sequence. At the beginning of the crisis, companies used the cheapest forms of working time reductions i.e. reductions in overtime and use of working time accounts. This applied particularly to export-oriented segments of the manufacturing sector, which in the export-driven boom years between 2005 and 2008 had filled the accounts with some of the overtime hours worked when order books were full. In the first quarter of 2009, the overall impact of these measures on the decline in the volume of paid work was actually considerably greater than that of short-time working, largely as a result of the equalising of working-time accounts (IAB 2009). However, the elimination of surplus hours on working-time accounts, the reduction in overtime and the bringing forward of annual leave are one-off measures that become less significant over time. When these measures were exhausted companies could rely on short-time work or temporary working-time reductions without wage compensation. Since changes to working time at company level are subject to the agreement of the workforce, and since the reduction of standard weekly working time depended on an agreement with the relevant trade union, company working time strategies were usually developed in a dialogue between the social partners.

The use of short-time working reached a peak in May 2009, when 1,516,000 workers were on short time. This figure fell rapidly in subsequent months and by July 2010 had sunk to just 288,000 individuals because of the economic recovery (BA 2010b). Taking as a basis for calculation an average decline in hours worked per short-time worker of around 31% in June 2009, the number of employees on short-time equated to a total of 448,004 full and part-time workers (BA 2010a: 9).

In contrast to France, for example, there was no restriction on the volume of short-time working per employee per year, so that in theory firms could be on 100% short-time working for up to 2 years. However, this was the exception. In the vast majority of firms, short-time working was used only for part of the workforce and only for a part of their annual volume of work. In 2009 in more than 50% of firms making use of short-time working, less than 25% of the workforce was on short time, while in 80 to 90% of firms less than 50% of the workforce was on short time (Bosch 2011: 248-257). The works council were careful to ensure that short-time working was distributed as equally as possible among employees in order to keep income losses as low as possible for individuals.

Almost all industrialised countries sought to ease the impact of the crisis to some extent by reducing working time. Some counties, such as France, Belgium, the Netherlands and Austria,

4 Under the terms of the Works Constitution Act (Betriebsverfassungsgesetz), the works council has a right of codetermination on questions concerning the start and finish of working hours, the distribution of working time over the week and temporary reductions and extensions of working time (§87, para. 1, Works Constitution Act).
have long-established, subsidised short-time working schemes, the conditions for which were relaxed in the crisis. Many firms also reduced overtime and offered their employees sabbaticals or other forms of working-time reductions, with and without wage compensation (Eurofound 2009). Only in Germany, however, was the reduction in labour input almost completely absorbed by a redistribution of work (Figure 12).

**Figure 12: Percentage of fall in total labour input due to fall in working hours per employee (2008-9)**

![Bar chart showing percentage of fall in total labour input due to fall in working hours per employee (2008-9).](http://www.conference-board.org/economics/database.cfm)


The volume of work fell from 57,450 million hours in 2008 to 55,985 million hours in 2009, a fall of 1,465 million hours. This equated to an average reduction per employee of 41.3 hours per year. The government-subsidised short-time working was responsible for rather less than a third only of this reduction. A reduction in the normal weekly working time made roughly the same contribution, followed in more or less equal proportions by the increase in part-time working, the reduction in overtime and the withdrawal of working-time credits from working-time accounts (Figure 13).
An increase in unemployment cannot be avoided in a crisis simply by protecting existing jobs, since new cohorts enter the labour market every year. The second element of the German jobs miracle, which has been virtually ignored in the literature, was the prevention of high youth unemployment. Young people are a vulnerable group. In an economic recession they are often the group most hit by unemployment in the labour market since the first reaction of companies to a decline in orders is to stop recruitment. As outsiders leavers from the education and training systems they are not benefitting from employment protection.

Myriad studies have shown that occupational competencies acquired in apprenticeships systems with generally recognized standards make transitions into the labour market easier than competencies learned in school-based systems (Müller and Gangl 2003). The difficulties of the transition into the first job also depend on the structure of the labour market. Most of the literature on the transitions of youth into the labour market has differentiated between occupational and internal labour markets where labour market allocation predominantly relies on seniority and experience (Marsden, 1990). As outsiders young people have difficulties entering internal labour markets while occupational labour markets are open to them as soon as they acquire the necessary certificates. Germany was often taken as an example where fast transition of the majority of young people is facilitated by their apprenticeship systems which are closely linked to occupational markets. Most young Germans enter the labour market
through the dual system of vocational training (Bosch 2010). The proper functioning of the
dual system depends on the readiness of firms to provide training. In spite of the strong unions
and “patient capital” that until recently characterised the German employment model, short-
termism has constantly played an important role and endangered the proper functioning of the
dual system. Over the last 25 years, the dual system has been through several major crises. In
the mid-1980s, almost 700,000 new training contracts were concluded, while in 1995 the
figure was only 450,000. In the united Germany, 631,000 new contracts were concluded in
1999, compared with 550,000 in 2005. In the light of these fluctuations, the risks of young
people not finding a training place are all too obvious. Both conservative and social
democratic governments have negotiated “training pacts” over the last 20 years to keep the
demand for apprentices stable.

The effect of the training pacts of the 1980s and of today can be seen in the training rates
(share of apprentices of all employed). In 1985, a training rate of 8.8% was recorded. This
figure has fallen to slightly over 6% today. Without the pacts, however, training rates would
probably have fallen even lower in the economic crisis of 2002-2005. The training pacts and
public subsidies for training provide the only possible explanation for the survival of the dual
training system in East Germany after the collapse of the economy, even if considerable
subsidies were also required. In the other Eastern European countries that suffered an
economic collapse comparable to that in East Germany, firm-based vocational training was
reduced to a minimum after 1990, when the large state enterprises were dismantled and the
newly founded small firms had not accumulated the resources required for training.

There was much concern that the success story of the dual apprenticeship system would come
to an end in severe crisis in 2009 since it was difficult enough for companies to retain their
workforce. In contrast to the development in most other European countries unemployment of
young people did not rise very much and also not much faster than unemployment of workers
in prime age (Figure 14). In 2009 around 564 000 training contracts were concluded, 8.2% or
50 000 contracts less than in 2008. Because of the happy coincidence that the age cohort
entering the labour market in 2009 also declined by around 50 000 the situation for young
people looking for an apprenticeship did not deteriorate. In the following two years, the
number of new trainees stabilised at about the 2009 level (BiBB 2013: 10). In spite of
economic difficulties most companies see a social obligation to train. In addition they expect
in the coming years because of shrinking cohorts of young people skill shortages and training
is still seen as the most effective mechanism of recruitment.

Unions supported the integration of young people into the labour market. In 2009 and 2010 a
second focal point in collective bargaining (beside avoiding dismissals) the recruitment of
new apprentices and the continuation of employment after the completion of training. In the
chemical industry, for example, the social partners agreed an annual quota of 9,000 new
trainees for the period 2010-2013 and established a fund from which small and medium-sized
firms in economic difficulty could be supported to provide training. In spring 2010 the social
partners in the metal industry agreed to continue employment of all young journeymen for at
least one year after apprenticeship (Bosch 2011: 261-264).
How can the sudden shift of employers and the government from largely external to largely internal flexibility in the financial crisis and high level of new recruitments of young people be explained, particularly in an environment in which the Hartz Acts and the deregulation of temporary agency work have created new sources of external flexibility? I would suggest the following explanations:

- In the 1990s and at the beginning of the year 2000, in the wake of the deep disenchantment that set in at the end of the reunification boom, German companies assumed that their staffing requirements would be permanently reduced, with the result that they rapidly shed labour. By dismissing many employees, principally younger skilled workers, firms became so lean that in the 2005-2008 upturn they found themselves short of skilled workers, who had to be recruited at considerable cost. They have no desire to repeat this formative experience.

- Because of increased skill requirements and specialisation in high-quality products (Lehndorff et al. 2009), companies that in the past tended to rely on external flexibility, have built up their core workforces, which they wish to retain during the downturn.

- In response to the reduction in weekly working time, firms have introduced flexible forms of working time that have increased their opportunities for internal flexibility.
German firms, particularly in the manufacturing sector, had high volumes of overtime and credits in their working-time accounts after the export boom of recent years.

- Policies introduced in the 1980s, such as early retirement programmes, provided relatively inexpensive opportunities for job cutting which no longer existed in 2008. Instead, alternative to redundancies were offered by extending short-time working and reducing its cost.

- There was considerable political pressure from government and trade unions to use short-term working. As a result of the large-scale bailout of the banking industry, the state could have been at risk of losing its legitimacy if it had not also moved to support employment in the manufacturing sector, the cornerstone of the German economy. The imminent general election certainly helped to convince the political parties of the wisdom of this approach.

- Short-time working is an instrument for subsidising firms hit by a downturn which, unlike direct subsidies, is not subject to EU competition legislation. The regulations on short-time working were regarded as a means of helping to save the country’s industrial fabric in an exceptional situation. Short-time working was the most important support instrument for the capital goods industry, while the stimulus packages were mainly of assistance to the construction industry.

11. **Case study II: low pay and poverty in Germany**

12. **Conclusions**

In the years following the Second World War, the previously rather rudimentary German social model developed into an inclusive Bismarckian welfare state that protected the vast majority of the population from life's main risks and at the same time index-linked social benefits so that they kept pace with increases in productivity. The German social model is based to a large extent on social insurance schemes, i.e. entitlements are acquired through gainful employment. At the same time, however, family members were included through derived entitlements and reasonable entitlements could be acquired by means of an inclusive wage system with low pay differentials.

In the last 20 years, the social security system has been further developed and reorganised at a rapid pace. The most important drivers of the changes are the ageing of the population, the increase in women's labour market participation rate and criticism of the traditional male single breadwinner model, reunification and the emergence of new principles and approaches, in particular private provision, labour market deregulation and the reduction in the share of social expenditures to 40% (of what?) in order to improve competitiveness.

The various, partially contradictory objectives led to a mix of policies in which progress and dismantling of the welfare state were closely juxtaposed. The integration of the East German population into the West German welfare state, and in particular the strengthening of the
regional fiscal equalisation system and uprating of the East German pension entitlements (which, incidentally, would not have been possible with a private, fully-funded pension system), constitute a remarkable feat of solidarity. At the same time, however, an outdated model of the family was imposed on the East Germans, one that did not reflect the realities of their lives or their preferences. It was not until 15 years after reunification that the politically agonising process of reforming the German model of the family got under way. However, since the old single breadwinner model is still heavily subsidised, the modernised two-earner model, and particularly the necessary investment in care facilities for young children and in schools, is underfunded. As a result, Germany family policy is expensive and inefficient by international standards.

The introduction of long-term care insurance and the establishment within the health insurance system of the health fund, which acts as a financial equalisation mechanism between health insurance schemes with different risk structures, are also major social policy reforms that have strengthened social cohesion. The ending of early retirement, which was certainly necessary for demographic reasons, has raised the employment rate among older workers aged between 55 and 64 surprisingly quickly. However, the so-called 'Riester' pensions (voluntary but heavily subsidised private pension schemes), introduced for political reasons in order to strengthen the insurance industry, have not, as intended, helped to stabilise the reduced level of pensions through private provision, since they are not compulsory and are not being taken up by low earners, who are most in need of topping up their pensions.

The erosion of the German collective bargaining system and the deregulation of the labour market by the Hartz Acts will have far-reaching effects on the social welfare system. The reduction of pension levels over the coming decades will lead to an increase in old-age poverty because of the rapid expansion of the low-wage sector. At the same time, the increased expenditure needed to top up pay in the low-wage sector is a burden on the social budget. The Hartz Acts have increased turnover in the labour market, it is true, but not employment levels. Just like the measures introduced to cut social expenditure, the Hartz Acts were based on the mistaken diagnosis that labour costs in Germany were too high. Combined with the expansion of the low-wage sector in Germany, this social policy has contributed to the below-average increase in German wage costs, which is one of the reasons for the imbalances in the Eurozone and, as in the health insurance system, is calling into question the joint funding principle for social expenditure.

The financial crisis saw the strengths of the old German social model, which is based on social dialogue between the state and the social partners, being successfully mobilised. Through a combination of measures taken by central government and those agreed between the social partners, it was possible to avoid not only large-scale job losses but also an increase in youth unemployment. It is unclear whether the German jobs miracle was a one-off event. If that turns out to be case, the state and the employers' associations, captivated by the large-scale deregulation taking place in many European countries, may well return to the philosophy underlying the Hartz Acts.

The reforms that are needed in order to create a modernised but inclusive social model are fairly evident. The majority of the German population supports a statutory minimum wage
and increased coverage by collective agreements. In view of the high level of local authority indebtedness, the regional fiscal equalisation system will have to be reorganised. The traditional model of the family is losing support, making it possible to envisage a change of direction towards better reconciliation of paid work and family life as well as increased investment in childcare and education. Old-age poverty can be avoided only by introducing compulsory supplementary pensions or slowing the decline in pension levels. In view of the below-average increase in wage costs in Germany in recent years, it should also be possible to increase deductions for tax and social insurance.

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