Income Support in the Absence of a Legal Minimum Wage: the Case of Germany

Seminar on Work, Employment and Social Protection
From RMI to RSA: Minimum Income Support and the Labour Market
Centre d'Economie de la Sorbonne
Paris, November 27, 2008
Benefit System until 2004
(no children, under 45 years old)

≥24 months employment with social insurance contributions, ≥ 12 months within the previous 2 years

max. 12 months unemployment benefit at 60% of former net wage

unemployment assistance at 53% of former net wage, unlimited duration, 3% annual degression

‘Bismarckian’: earnings ↔ contributions ↔ benefits

hybrid benefit: tax-funded + means-tested, but relative status maintenance

poverty relief: tax-funded minimum support

means-tested social assistance, flat-rate, unlimited duration

≡ ARE

≡ ASS

≡ RMI, API
Benefit reform since January 2005

≥24 months employment with social insurance contributions, ≥ 12 months within the previous 2 years

max. 12 months unemployment benefit at 60% of former net wage

≥ 12 months within the previous 2 years

Means-tested unemployment assistance at 53% of former net wage, unlimited duration, 3% degression per year

‘Bismarckian’: earnings ↔ contributions ↔ benefits

Hybrid benefit: tax-funded + means-tested, but relative status maintenance

Poverty relief: tax-funded minimum support

No employment with social insurance contributions within the previous 2 years

Able to work 3 hrs./day

Unemployment benefit II’, flat-rate, unlimited duration

Unable to work, beyond working age

Means-tested social assistance, flat-rate, unlimited duration

Tax-funded basic income support (‘BIS’)

- Unemployed receiving insurance benefit
- Neither working nor unemployed
- Employed 15 hrs. or more, receiving supplementary BIS
- Not unemployed in BIS
- Employed under 15 hrs., receiving supplementary BIS
- 100% Workless in BIS
- Unemployed in BIS
Unemployment in the two regimes: Stocks, outflows into regular employment (thousands), and resulting exit rates (2005 - 2007)

<table>
<thead>
<tr>
<th></th>
<th>unemployment insurance</th>
<th>basic income support*</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>average annual stock</td>
<td>outflows into regular employment</td>
<td>re-employment rate</td>
</tr>
<tr>
<td>2005</td>
<td>2091</td>
<td>2206</td>
<td>105%</td>
</tr>
<tr>
<td>2006</td>
<td>1664</td>
<td>2019</td>
<td>121%</td>
</tr>
<tr>
<td>2007</td>
<td>1253</td>
<td>1874</td>
<td>150%</td>
</tr>
</tbody>
</table>

* customers registered as unemployed only (in BIS, roughly 50% of working-age claimants); re-employment ending unemployment only (>15 hrs./week)
## Basic Income Support, Current Rates

<table>
<thead>
<tr>
<th></th>
<th>basic rates</th>
<th>income support</th>
<th>housing &amp; heating (empirical data)</th>
<th>total net income</th>
</tr>
</thead>
<tbody>
<tr>
<td>single adult</td>
<td>351 €</td>
<td>351 €</td>
<td>248,57 €</td>
<td>600 €</td>
</tr>
<tr>
<td>adult partners</td>
<td>90%</td>
<td>631,80 €</td>
<td>315,36 €</td>
<td>947 €</td>
</tr>
<tr>
<td>15 to &lt;25 (partner or child)</td>
<td>80%</td>
<td>280,80 €</td>
<td></td>
<td></td>
</tr>
<tr>
<td>children &lt; 15</td>
<td>60%</td>
<td>210,60 €</td>
<td></td>
<td></td>
</tr>
<tr>
<td>adult couple, 1 child &lt;15</td>
<td>912,60 €</td>
<td>370,33 €</td>
<td>1283 €</td>
<td></td>
</tr>
<tr>
<td>adult couple, 1 child &lt;15, 1 child 15+</td>
<td>1193,40 €</td>
<td>439,81 €</td>
<td>1633 €</td>
<td></td>
</tr>
</tbody>
</table>

**single parent supplements depending on number and age of children**

<table>
<thead>
<tr>
<th></th>
<th>basic rates</th>
<th>income support</th>
<th>housing &amp; heating (empirical data)</th>
<th>total net income</th>
</tr>
</thead>
<tbody>
<tr>
<td>single parent, 1 child under 7</td>
<td>687,60 €</td>
<td>315,36 €</td>
<td>1003 €</td>
<td></td>
</tr>
<tr>
<td>single parent, 2 children under 16</td>
<td>889,20 €</td>
<td>370,33 €</td>
<td>1260 €</td>
<td></td>
</tr>
<tr>
<td>single parent, 3 children</td>
<td>1108,80 €</td>
<td>439,81 €</td>
<td>1548 €</td>
<td></td>
</tr>
<tr>
<td>single parent, 4 children</td>
<td>1361,40 €</td>
<td>542,55 €</td>
<td>1904 €</td>
<td></td>
</tr>
</tbody>
</table>

Criticism by social advocates:
- rates for children too low
- especially for children 6 to 15
Relevant 'Regime Aspects' of Basic Income Support

- 'Adult Worker Model' (in contradiction to male breadwinner model prevalent to the better off):
  - Adult recipients must fully exploit every possibility to end or reduce their need for support.
  - Formerly inactive spouses are thus re-defined as 'adult workers' as the household enters receipt of the benefit.
  - Children under three in general accepted as an exemption from availability for work (since public childcare not guaranteed for children under three).

- Almost unlimited acceptability of job offers:
  - acceptability not limited by previous training, professional practice or status
  - lower earnings, poorer working conditions, longer distance must be accepted
  - jobs paying below collective agreements or 'going rate' acceptable – no legal minimum wage in Germany
  - 'acceptable jobs' must not necessarily end need for the benefit or even end unemployment (if less than 15 hrs. per week)

- A 'benefit continued in work':
  - BIS not restricted to unemployed people but continued in work if need persists
  - BIS also available while being in work if need arises (e.g. birth of another child, job loss of partner, involuntary reduction of working hours)
  - no major and universal benefit conditional on taking up work (like working tax credits or PRE)
  - BIS = universal benefit for the able-to-work and (more or less working) poor
### Earned Income Deduction Privilege

<table>
<thead>
<tr>
<th>category of earned <strong>gross</strong> income</th>
<th>withdrawal rate of <strong>net</strong> income</th>
<th>net earnings kept on top of benefit at upper band ceiling</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 to 100 €</td>
<td>0</td>
<td>100 €</td>
</tr>
<tr>
<td>101 to 800 €</td>
<td>80%</td>
<td>140 €</td>
</tr>
<tr>
<td>801 to 1,200 €</td>
<td>90%</td>
<td>40 €</td>
</tr>
<tr>
<td>801 to 1,500 € (with at least one child &lt;18)</td>
<td>90%</td>
<td>70 €</td>
</tr>
<tr>
<td>maximum total (no children)</td>
<td></td>
<td>280 €</td>
</tr>
<tr>
<td>maximum total (with children)</td>
<td></td>
<td>310 €</td>
</tr>
</tbody>
</table>

- not the principal objective of the reform – no specific evaluation of incentives
- obviously not easy to understand
- fundamental incentive dilemma:
  - 'optimal' incentive ⇒ incomprehensible formula ⇒ no incentive

"Il semble en effet qu'il faille mettre sur pied une pédagogie du rSa..."

BIS as a Benefit Continued in Work: Example of Single Adult

![Graph showing the impact of benefits on worker's net wages and net income](image)

- **Worker's net wages without benefits**
- **Benefits**
- **Net income (wages + benefits)**

**Zone 1, Zone 2, Zone 3**

- **Monthly gross wage €**
  - 0 € - 280 €
The Fundamental Incentive Dilemma of Benefits Continued in Work

Criteria for optimisation lacking!
Supplementary Benefits on the Rise

- 1.3 million ≈ 25% recipients with earned income
- 20% of entries into supplementary benefit status only transitory: benefit bridges first month in work until wages are paid
- 'mini-jobs' (marginal part-time employment under 400 Euros/month) accounting for more than half of in-work benefits
Distribution of Declared Earned Incomes of BIS Recipients (Gross Income Values, January 2007)
Low-wage*) employment West / East / Germany

*) individual hourly wage < 2/3 median hourly wage (separate thresholds for East and West)

Source: German Socio-Economic Panel, calculations by IAQ

Emprical low-wage thresholds 2006:
9.61 € West
6.81 € East
Weakening wage regulation

| Percentage of workforce in establishments covered by collective agreement |
|-----------------------------|-----------------------------|
|                             | 1996 | 2005 |
| West                        | 69%  | 59%  |
| East                        | 56%  | 42%  |

- constitutional autonomy for social partners in wage bargaining
- some collective agreements under low-wage threshold
- almost 50% of workforce not covered by collective agreements
- no legal minimum wage
- *erga omnes* regulation possible with consent of the concerned social partners – but without existing agreement to be extended no *erga omnes* possible
Fundamental Dilemma of In-Work Benefits in Absence of Effective Wage Regulation at Lower End

- Supplement justified because the wage is low?
- Wage low because supplement is available?
  ⇒ Subsidising workers' livelihoods or subsidising employers' labour costs?

Empirical Uncertainty – Lack of Evaluation of Flow Data:

- Low wage workers applying for supplementary benefit?
- Benefit recipients hustled into low-wage jobs?
  ⇒ 'Activating' labour market policy merely compensating for or contributing to fraying of wages at lower end?
Thank you for your attention!