


Incentive Compatibility in Social Assistance: Reforms and Challenges in Germany

**IZA/World Bank/OECD
Conference on Activation and Employment Support Policies**

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Istanbul, 30-Apr 2012

Germany's federal political structure is a key framework for social safety net design and operation

Federal Republic of Germany	Level	Key Figures	Responsible for ...
	Federal ("Bund")	<ul style="list-style-type: none"> ▪ 82m population (79m by 2030)* ▪ €2,400bn Total GDP (2009) ▪ €363bn total federal budget (2009) (15% GDP) 	<ul style="list-style-type: none"> ▪ Labour market policy ▪ Unemployment Benefit I (social insurance) and II (tax-financed base benefit) ▪ Public pensions and health ▪ ...
	States ("Länder")	<ul style="list-style-type: none"> ▪ 16 states ▪ €309bn total state budgets (2009) (13% GDP) 	<ul style="list-style-type: none"> ▪ Schools (teachers) ▪ Child-care (w/ mun.) ▪ Police ▪ Culture ▪ ...
	Municipalities ("Städte, Kreise und Kommunen")	<ul style="list-style-type: none"> ▪ 11,300 Municipalities "Kommunen", of which ... ▪ ... 111 large cities "Kreisfreie Städte" ▪ ... 1,951 cities ("Städte") ▪ 301 Counties ("Kreise") outside of "large cities" ▪ €186bn total municipal budgets (2009) (8% GDP) 	<ul style="list-style-type: none"> ▪ Unemployment Benefit II (housing cost) ▪ Social Assistance (SGB XII) ▪ Schools (buildings) ▪ Child care (w/ states) ▪ ...

Sources: Destatis, Wikipedia, SVR Wirtschaft, authors calculations (* Estimate by SVR Wirtschaft)

Note: All financial indicators as gross expenditure. Additionally, the Public Social Insurance Schemes (Pension, Health, Unemployment (Social Insurance) add €506bn (2009) (21% GDP) expenditure. Total gross public expenditure is 57% of GDP in 2009. Total public debt is 73% of GDP (2010 notification to EU).

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Labour-market reforms in Germany (quick recap)

Segmenting the target group

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Work incentives

Fiscal federalism incentives

Case manager incentives

Current developments and summary

Germany implemented labour market reforms in 2003-2005 - activation increased but challenges remain



- Reform had three parallel thrusts:
 - **Redesign of Federal Labour Office**
 - **Benefit Reform** (single “Basic Income Support” scheme, 2% GDP)
 - **Deregulation** of Labour Market within “Coordinated Capitalism” model
- **Joint delivery structures** in majority of cities as cooperation between Federal Labour Agency and municipalities
- Central role of **case managers**: qualification and results-orientation
- **Evaluation and data systems** very important for ongoing system improvement
- But, challenges remain: (1) low-qualified groups still excluded and (2) shortage of skilled labour!

The package: Reorganization at Federal Labour Agency, merged benefits, more activation, labour market reform

(1) Redesigning the Federal Labour Office

- Reorganization of public employment services (**Federal Labour Agency**)
- Improved service standards
- Improved targeting & enlarged mandate
- Comprehensive evaluation scheme (increasing relevance to policy makers)

(2) Merging of Benefits and Focus on Activation

- Reforming and merging benefits
- Linking benefits and sanctions to activation services
- Requiring mutual responsibilities – proactive behavior of the unemployed
- Training and placement schemes

(3) Labour Market Reform / Self-Regulation

- Deregulation of the temporary work sector
- Allow exemptions from restrictions on fixed-term contracts and dismissal protection
- But: No fundamental switch away from German cooperative capitalism model, e.g. flexible handling of work hour accounts agreed within collective-bargaining system

Focus on benefits: tax-financed SA benefits were merged into „Basic Income Support / Unemployment Benefit II“ by 2005

Before 1 Jan 2005

Type of benefit	Description	Responsibility
Unemployment benefit (insurance-financed)	<ul style="list-style-type: none"> ▶ 60 - 67% of former wage ▶ Paid up to 32 months ▶ Eligibility: people paid unemployment insurance contributions 	Federal Labour Office ("Bundesanstalt")
Unemployment assistance (tax-financed)	<ul style="list-style-type: none"> ▶ 50 - 53% of former wage ▶ Paid for an unlimited period of time ▶ Eligible people: former recipients of unemployment benefit 	
Social assistance (tax financed)	<ul style="list-style-type: none"> ▶ Fixed amount (incl. housing benefits: Avg. ~EUR 650¹) ▶ For people not eligible to unemployment benefits or unemployment assistance 	

Since 1 Jan 2005

Type of benefit	Description	Responsibility
Unemployment benefit I SGB III	<ul style="list-style-type: none"> ▶ 60 - 67% of former wage ▶ Limited to 12 (24)[*] months ▶ Eligibility as before 	Federal Labour Agency (FLA, "Bundesagentur")

Focus of This Presentation: Social Assistance (SA)

Basic Income Support / Unemployment benefit II SGB II	<ul style="list-style-type: none"> ▶ Fixed amount: 364 EUR plus housing benefits ▶ Paid for an unlimited period of time ▶ For all job-ready job-seekers 	<ul style="list-style-type: none"> ▶ Cooperations between local FLA offices and municipalities ▶ In 69 locations: municipalities without FLA involvement
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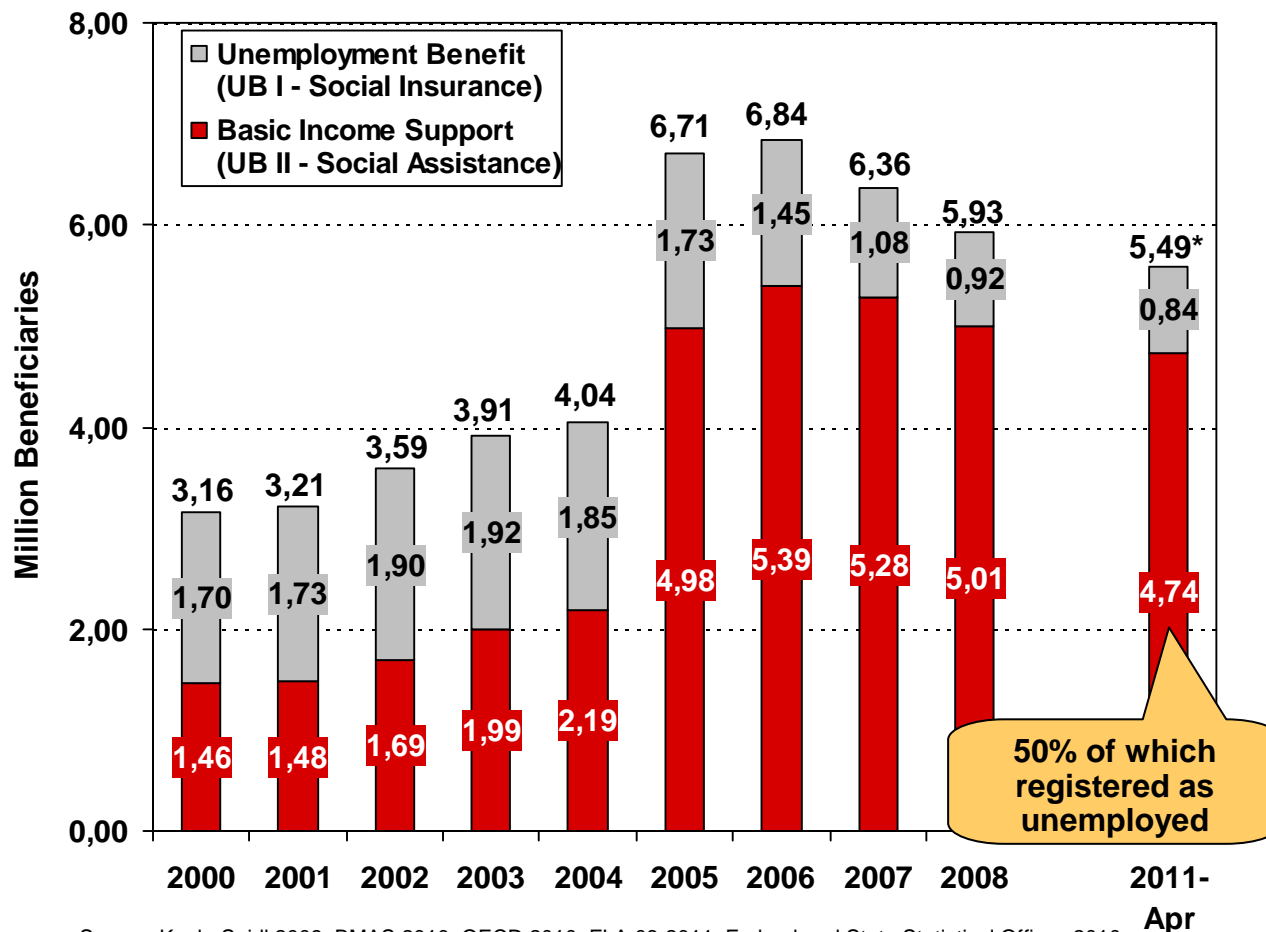
Continuation of old „Social Assistance“ as SGB XII for recipients not-capable of working and 65+years traditionally funded by municipalities. **

Note: SGB II, III and XII refer to the respective chapters of the German Social Code (SGB = "Sozialgesetzbuch")

* Over-58 workers receive 24 months of UB I

** Funding of SGB XII for > 65 years to be covered increasingly by federal government (full payment in 2014)

Hartz IV reform led to a step-change increase in the number of beneficiaries in 2005 and to subsequent fall in unemployment



- Basic Income Support covers 5.7% of population in Germany (including 1.4m in-work-beneficiaries)
- In addition: 2.6m recipients of “Sozialgeld” and “Sozialhilfe” not able and required to work (3.1% of population)**
- Political risk of very inclusive program (→ more beneficiaries)
- Initial negative name (“Hartz IV”) and image of program in Germany

Source: Konle-Seidl 2009, BMAS 2010, OECD 2010, FLA 08-2011, Federal and State Statistical Offices 2010

* 90,000 cases of double-benefits UB I and UB II eliminated from summation

** Sozialgeld (SGB II transfer for dependents not able and required to work) 1.8m beneficiaries, Sozialhilfe (SGB XII transfer mainly for old-age income support) 0.8m beneficiaries (2008 data)

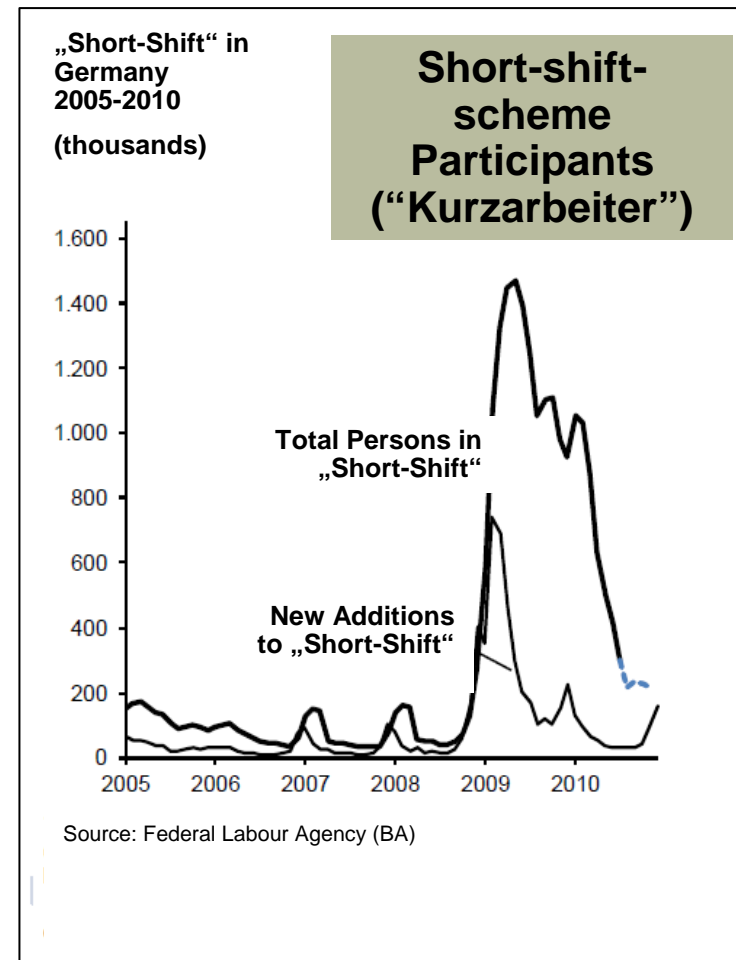
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Post-reform labour-market performance: resilience and agility in the 2008/2009 economic crisis



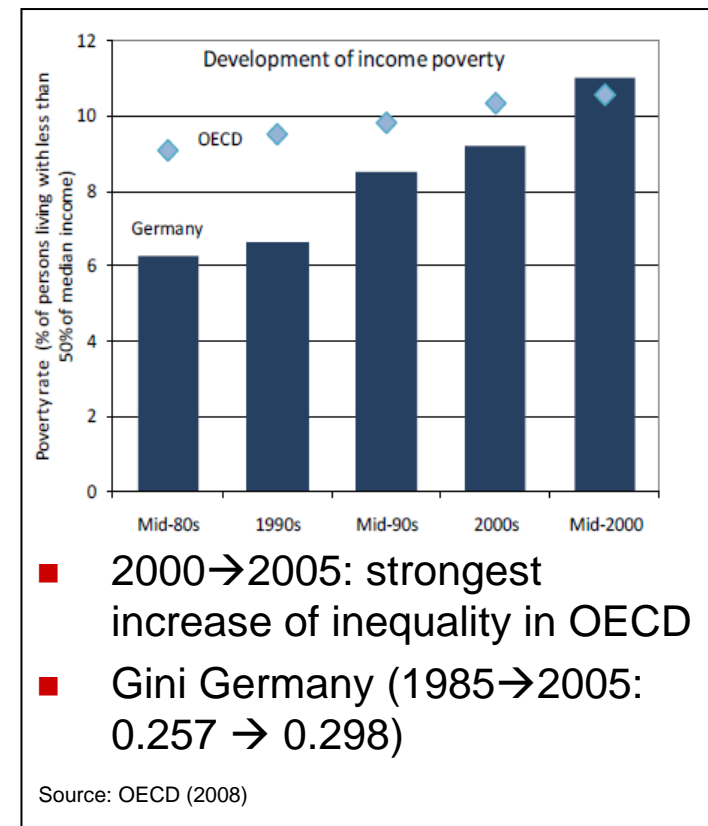
- Labour hoarding by businesses during crisis (anticipation of qualified labour shortage)
- Short-shift scheme > €10bn in 2008-2010 from FLA (additional cost borne by businesses)
- Wide-spread use of work-hour accounts (available to 51% of German workers)

Source: SVR 2012



Despite all-time labour force participation high, long-term unemployment and low-paid jobs feed into income inequality

- Of a total population of 82m, 41m were participating in the labour force in Q2/2011. Highest post WWII absolute number. Amongst other factors ...
 - Improved matching / activation via reforms
 - Improved Labour Force Participation of 55+ and women
 - 7.3m “Minijobs” ($\leq 400\text{€}$) in labour force*
- Increase of inequality and poverty
- Integration difficulties of long-term unemployed
- Of 1.17m labour market entrants from Unemployment assistance (UB II) benefit in 2008
 - > 50% entered jobs with in-work benefits
 - 13% returned to benefit within 6 months



* IAB 2012: Monthly earnings below 400€, limited taxes and social insurance contributions paid, approx. 5m Minijob only, approx 2m combination of full employment with Minijob
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Segmenting the target group: Activating the work-able unemployed

Indicative numbers
2010

# of persons	UnE Insurance UB I (SI)	Basic Income Support UB II (SA)	Other
In-Work Benefit	Core Area of Activation Regime 1.4m		
Unemployed (able (and required)* to work)	1.0m	2.0m	
Inactive (able, but not required to work)		1.4m	
Totals UB I and UB II	1.0m	4.8m	
“Social Money” (SGB II) (unable to work but living with UB II recipient)		1.8m	35bn€
“Social Assistance” (SGB XII) (unable to work or >65years)			0.8m** 4.3bn€
Asylum benefits / war veterans			0.2m*** 1.1bn€
Total Basic Income Population		7.6m (=9.3% of pop)	40.4bn€ ~1.7% GDP
other: Youth Benefits (SGB VIII) ****			N.N. [6.4bn€ / 0.27% GDP]
other: Handicapped (SGB XII)			0.8m [11.2bn€ / 0.48% GDP]

* UB II only

** 85% of whom are >65years

*** 127k Asylum Seekers, 46k War Veterans and spouses

**** HzE-Benefit. No federal-level case numbers available, spending data only.

Sources: Destatis 2010, FLA 2008 and 2010

Segmenting the target group: A closer look to the activation target group

Indicative numbers
2010

# of persons	UnE Insurance UB I (SI)	Basic Income Support UB II (SA)
In-Work Benefit	Core Area of Activation Regime	1.4m
Unemployed (able (and required)* to work)	1.0m	2.0m
Inactive (able, but not required to work)		1.4m

“Aufstocker”

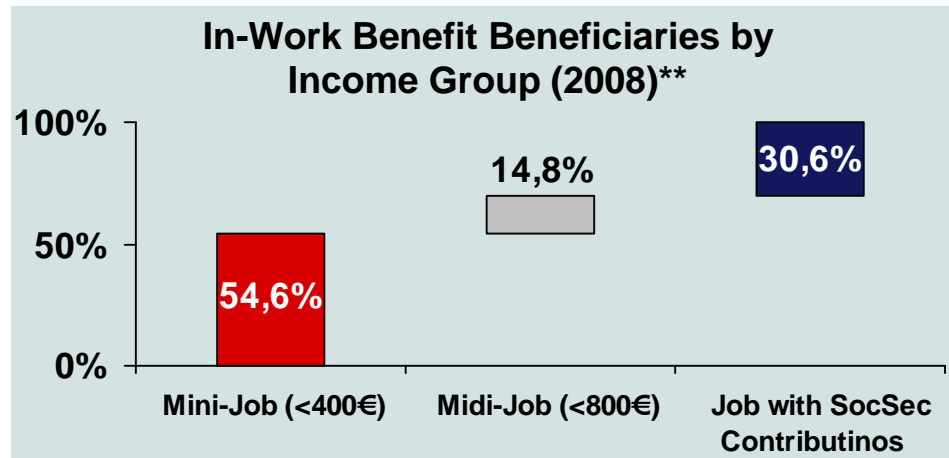
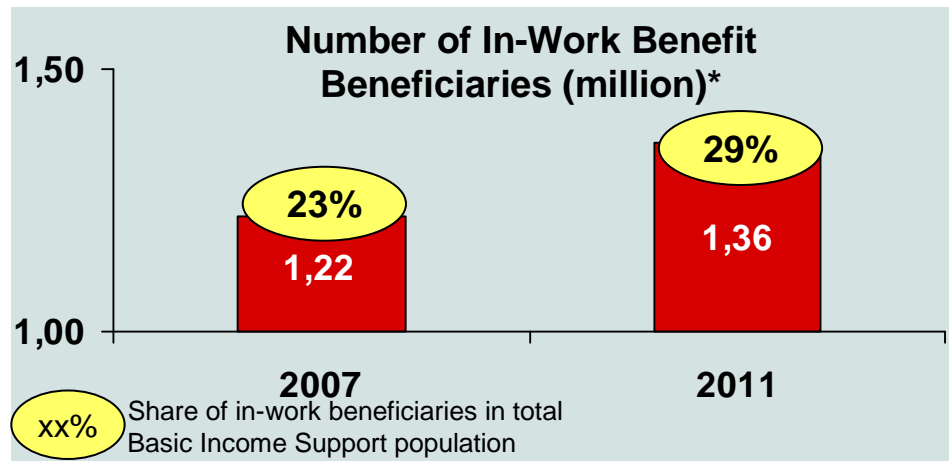
- 55% earn <400€
- 93% employed
- #'s increased +43% 2005/2009

Core Unemployed Basic Income Population

- 41% Long-Term Unemployed (> 12 months)
- Male/Female-ratio 50:50
- 20% of households with children are in BIS / UB II (54% of which single-parents, mostly mothers)
- East / West Germany-ratio 35/65 (pop-ratio is 20/80)
- Of total BIS / UB II population (4.8m) ...
 - 2.1m Entries (of which 50% returnees (in 12 month period))
 - 2.4m Exits

“Not required to work”
e.g. mothers with children in first three years (→ hum-cap loss leads to dependency lock-in)

The number of in-work Basic Income Support recipients has increased – majority employed in low-wage “Minijob” scheme



Source: FLA Statistics 2010

* 2007 annual average, 2011 June data

** 2011 data follows similar distribution Jobs with Social Security (Health, Retirement, Care) contributions can be full or part time

- Numbers of in-work beneficiaries have increased in absolute and relative terms
- Majority in “Minijob”, not paying taxes and social insurance contributions
- Anecdotal evidence suggests combination of “Minijob” with undeclared income / grey-economy work and intention to avoid further activation measures
- Exit probability out of benefit increases with level of earnings (@ 24-months)
 - No-income: 75%
 - Minijob: 77%
 - >800€: 87%

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Three dimensions of incentives in social assistance: work/benefit, fiscal federalism, case-workers

Conceptual

1 Work-Incentives

Example: couple with two children (one earner)

disposable net income in €

Gross Income in € per month

- Basic Income Support for Jobs (from Oct 2004)
- before welfare reform (Social Assistance 2004)

- Basic Benefit, in-work Benefit, disregards, etc.
- In-work Benefit trap, marginal disincentives, etc.
- Dilemmas between work-incentive, high fiscal cost, public job schemes, increased beneficiary numbers, etc.

3 Case Worker Incentives

Beneficiary ↔ Case Worker

- Public management topic
- Reporting and MIS to be in place
- PES / municipality staff contract and collective bargaining issue

2 Fiscal Federalism Incentives

Joint Delivery Structure

Municipalities and local job FLA office working together on:

- Benefits
- Training Schemes
- Job Placement
- Additional Social Services
- ...

- Co-financing of benefits
- Asymmetric phase-out of benefits
- Joint operation of Basic Income Support delivery centers

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Work incentives are mainly driven by income / benefit discussions – non-financial dimension important as well

Necessary condition

1a Financial Incentives

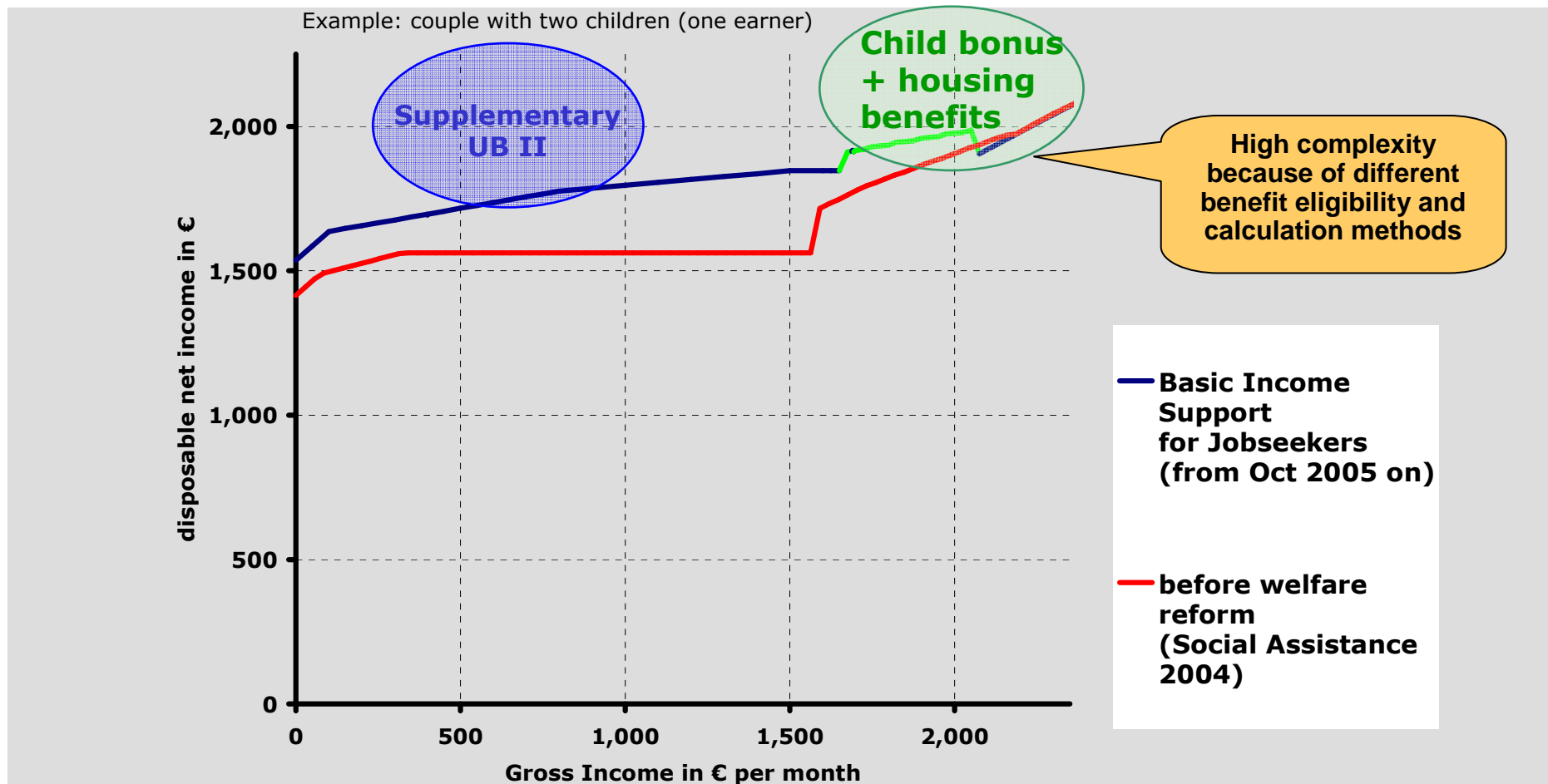
- Incentive for Basic Income Support recipient to take up work or expand hours worked or increase salary earned
- Benefit / income schedule (disregards, earnings retention rates) and marginal effective rates (taxes, contributions, etc.) as main drivers of financial dimension
- Combination of legal in-work benefit income and undeclared “grey-market” income (→ no hard evidence available)
- “Interaction” between Basic Income Support and other benefits (additional child benefit, housing benefit, etc.) → not in focus here

Sufficient condition

1b Non-Financial Incentives

- Social context, cultural norms and motivation are important
- “Barriers” to employment can counter financial incentives (health conditions, child-care needs, etc.)
- Activation regime: Attraction (→ support with job search) and penalties (→ reduction of benefits in case of non-compliance)
- Distaste for volatility → “complicated” prediction of monthly net income for in-work benefit recipients

Basic Income Support (2005-reform) improved take-home pay for in-work recipients



Source: BMAS 2009


Note: 2011 legislation increased retention rate of earnings between €800 and €1000.

SVR Wirtschaft (2010: 233) estimates minimal effects of 14k jobs p.a. at fiscal cost of €230m p.a.

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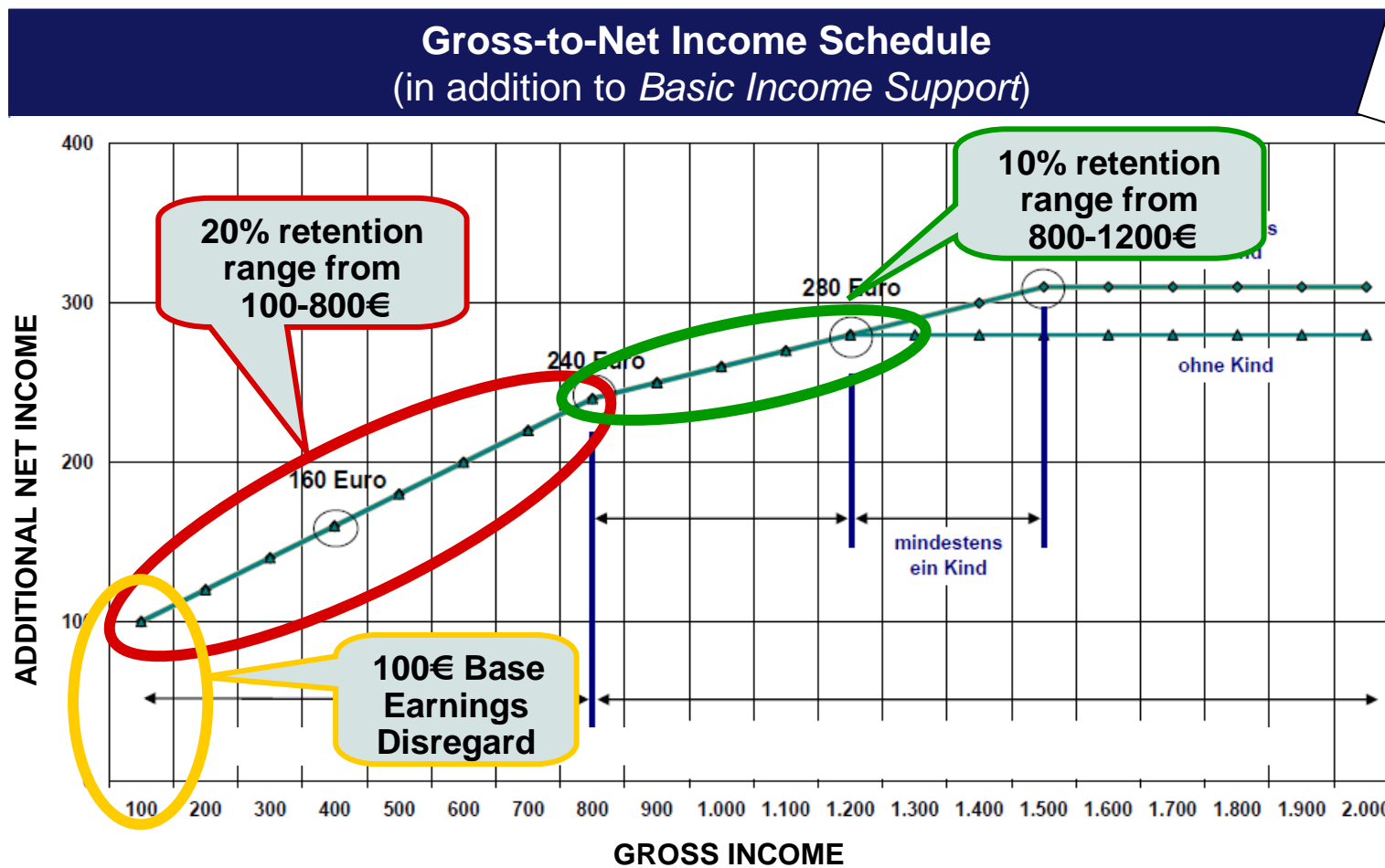
Basic Income Support for families with children can be 100+% of comparable work-income, providing little work-incentive

General Initial Conditions	Beneficiary Household Set-up	Benefit-to-wage-differential I*	Change of Set-up	Benefit-to-wage-differential II
<ol style="list-style-type: none"> 1. Low qualifications 2. Tertiary sector employment 3. West Germany 	Single 30yrs	63% / 78% 	Improve qualification to "high"	37% / 46%
	Married 2 children one earner	95% / 104%	Add one earner	43% / 53%
	Single parent 2 children	100% / 111%	n/a	-- / --

Source: Boss 2010: "Die Hartz-IV Falle" ifw Working Paper

* Second number denotes benefit-to-wage-differential with 400€ Minijob

Basic Income Support allows for in-work-benefits with a 100€ initial disregard and an initial 20% earnings retention range



Simplified view, without additional child disregard in 1200€+ range

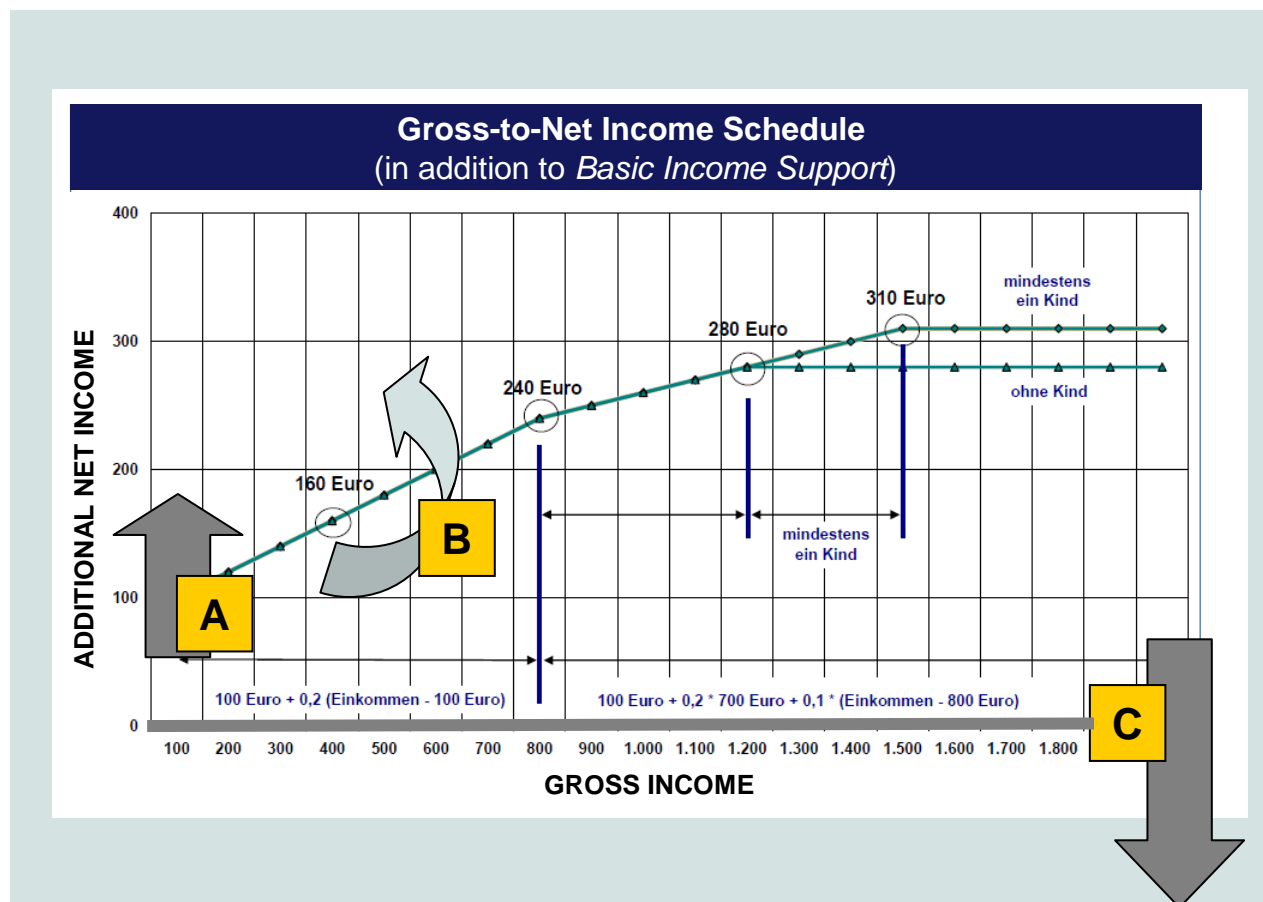
Source: FLA Statistics, March 2010 "In-Work Beneficiaries of Basic Income Support"

Reforms for incentive improvement have been proposed on the base disregard, earnings retention rate and benefit level

A Base Earnings Disregard
100€ → 200€

B Earnings Retention Rate*
20% → 40%

C Base Benefit
-10%**



Source: FLA Statistics, March 2010 "In-Work Beneficiaries of Basic Income Support" and SVR Wirtschaft 2010/2011

* in 100€ to 800€ range

** From 264€ to 328€

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Reform proposals increase participation rate but come at relatively prohibitive fiscal or political costs

Target Variable	A Increase Base Disregard	B Increase Earnings Retention Rate	C Decrease Base Benefit
Participation Rate (%)	+0.6%	+0.8%	+1.2%
Hours worked / week (h)	-0.8h	-0.9h	+0.2h
In-Work-Benefit Recipients (#)	+0.6m	1.0m	-0.2m
Net Fiscal Cost (-) / Savings (+) (bn€)	-2.8bn€	-4.8bn€	+6.3bn€

- Increasing the base disregard or increasing the earnings retention rate would yield small participation gains while (1) increasing number of in-work beneficiaries (→ negative political signal) at (2) great fiscal cost (→ reduced fiscal space)
- Decreasing the benefit politically not feasible (currently). Needs to be combined with public employment scheme to ensure ethical subsistence minimum (→ controversial)

Source: SVR-Wirtschaft 2010/2011, Microeconomic Simulation Model

Survey data reveals differences between *Basic Income Support* beneficiaries and general working age population

Category	General Working-Age Population	Basic Income Support Beneficiaries
Health Issues	22%	35% to 60%
Handicapped	9%	11%
Giving Care	7%	9%
Life Satisfaction (0-10)*	7,1	4,9
Willing to work, even if income is not needed	40%	49%
No professional training	19%	37%

Numbers rounded

Reflection of the very inclusive “ability to work” rule (→ 3h / day)

Survey data suggests high motivation – to be tested in labour market behaviour

Source: IAB, Survey-panel of 18k persons in 2006/2007

* Scale from “0” = not satisfied to “10” = fully satisfied

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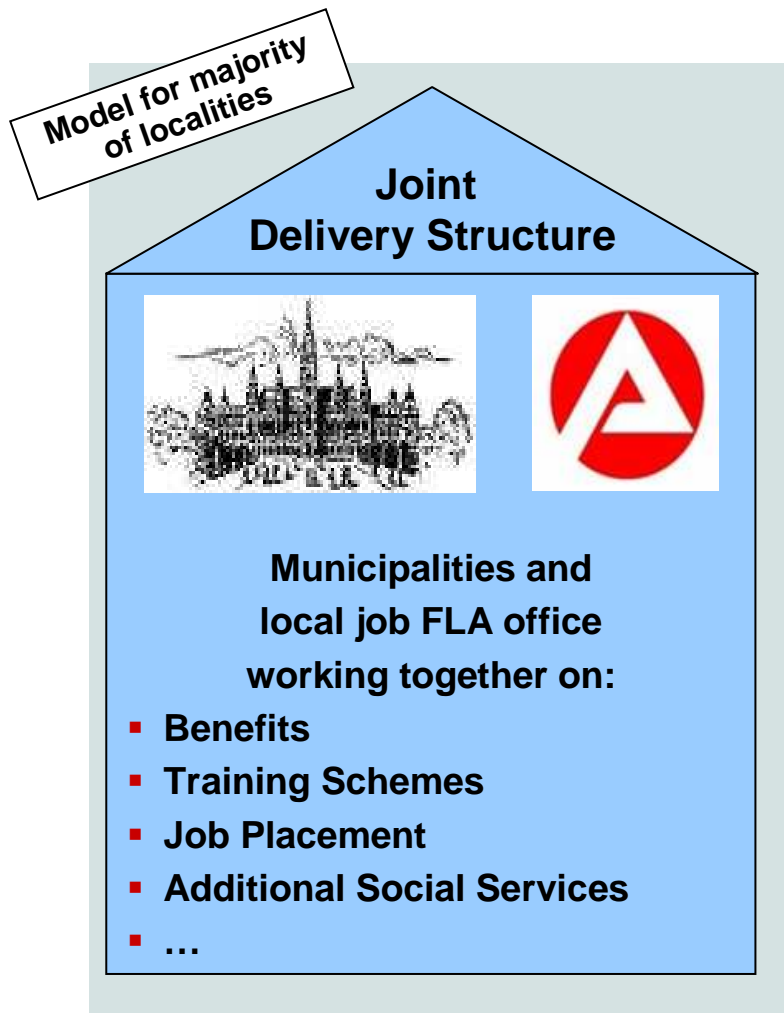
Work incentives

2 Fiscal federalism incentives

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Current developments and summary

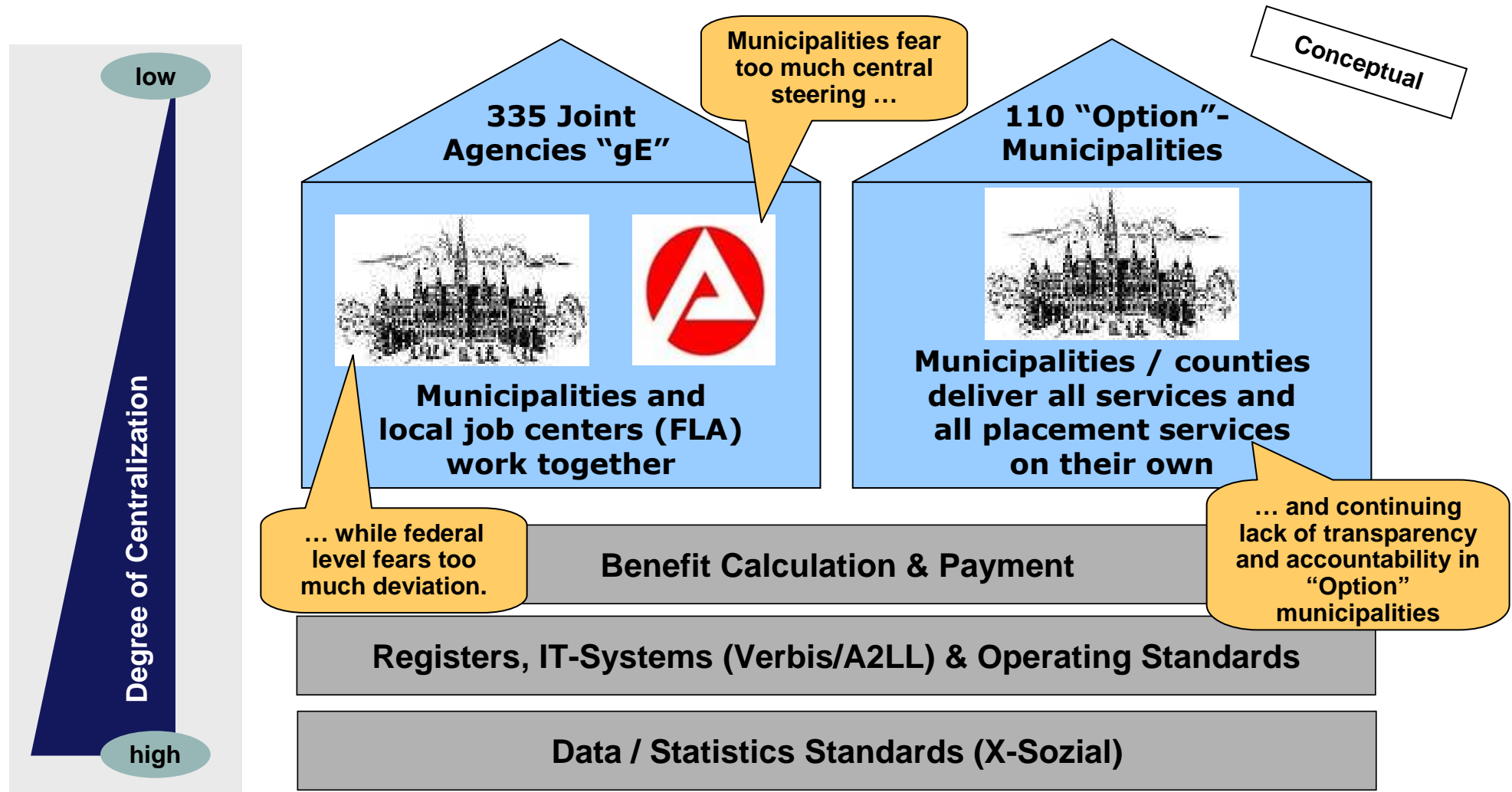
Basic Income Support mainly delivered via cooperation of Federal Labour Agency (FLA) and municipalities



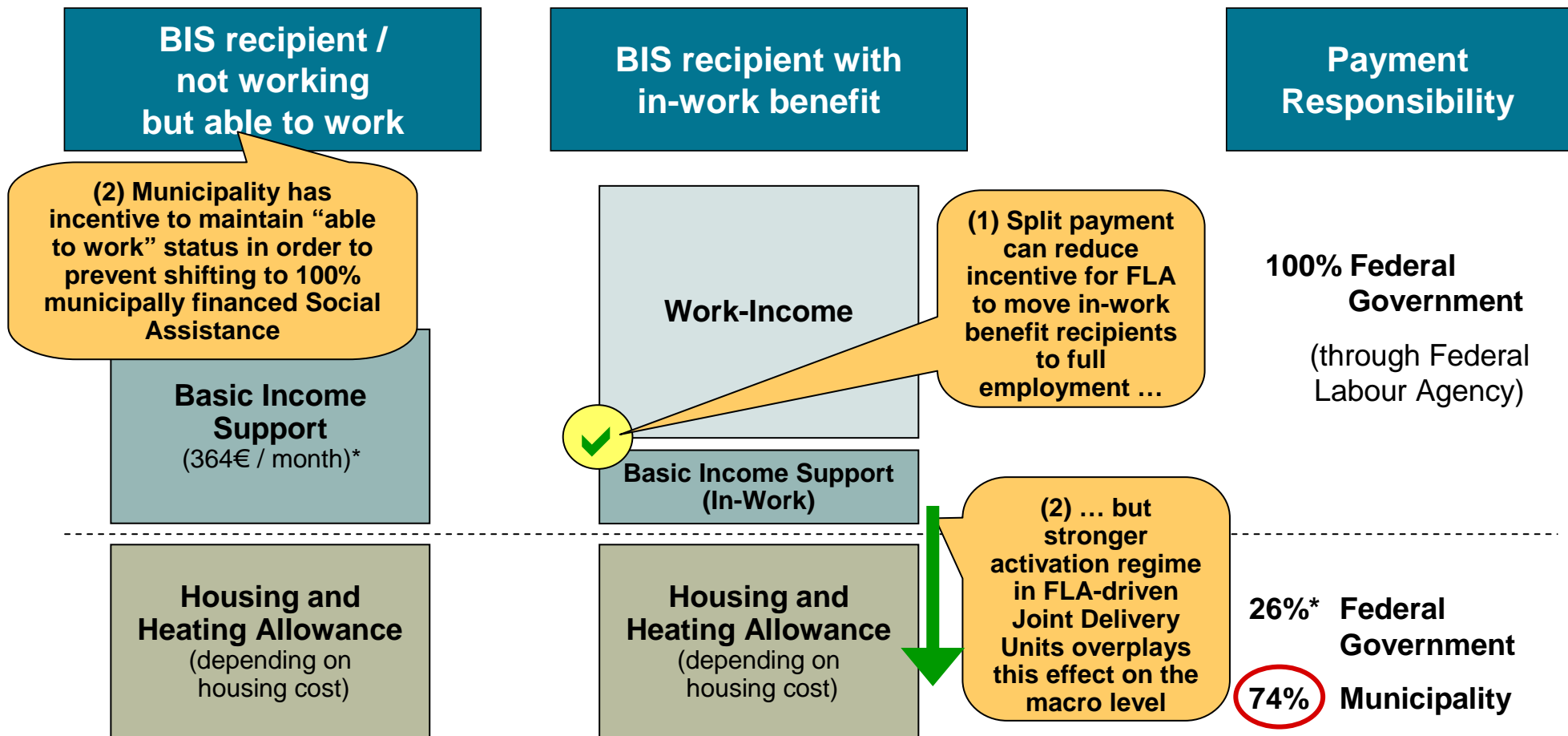
- Approx. 350 “ARGE/gE”* joint delivery units established between FLA and municipalities
 - Approx 100 “Option” municipalities deliver services by themselves (without FLA)
- ARGE/gE merges two logics:
 - Central: labour market, integration, training, standards, controlling, etc.
 - Local: social worker logic, focus on individual, neighbourhood work, etc.
- Central data and controlling systems required to ensure results-orientation of the organization
- Evaluation shows success factors:
 - intensive, activating and comprehensive case management
 - company-based training / activation measures
 - linkage to social services

* ARGE = Arbeitsgemeinschaft (pre-2010 term), gE = gemeinsame Einrichtung (post 2010 term)

Despite two parallel local delivery setups, federal regulations ensure a minimum compatibility via joint base systems

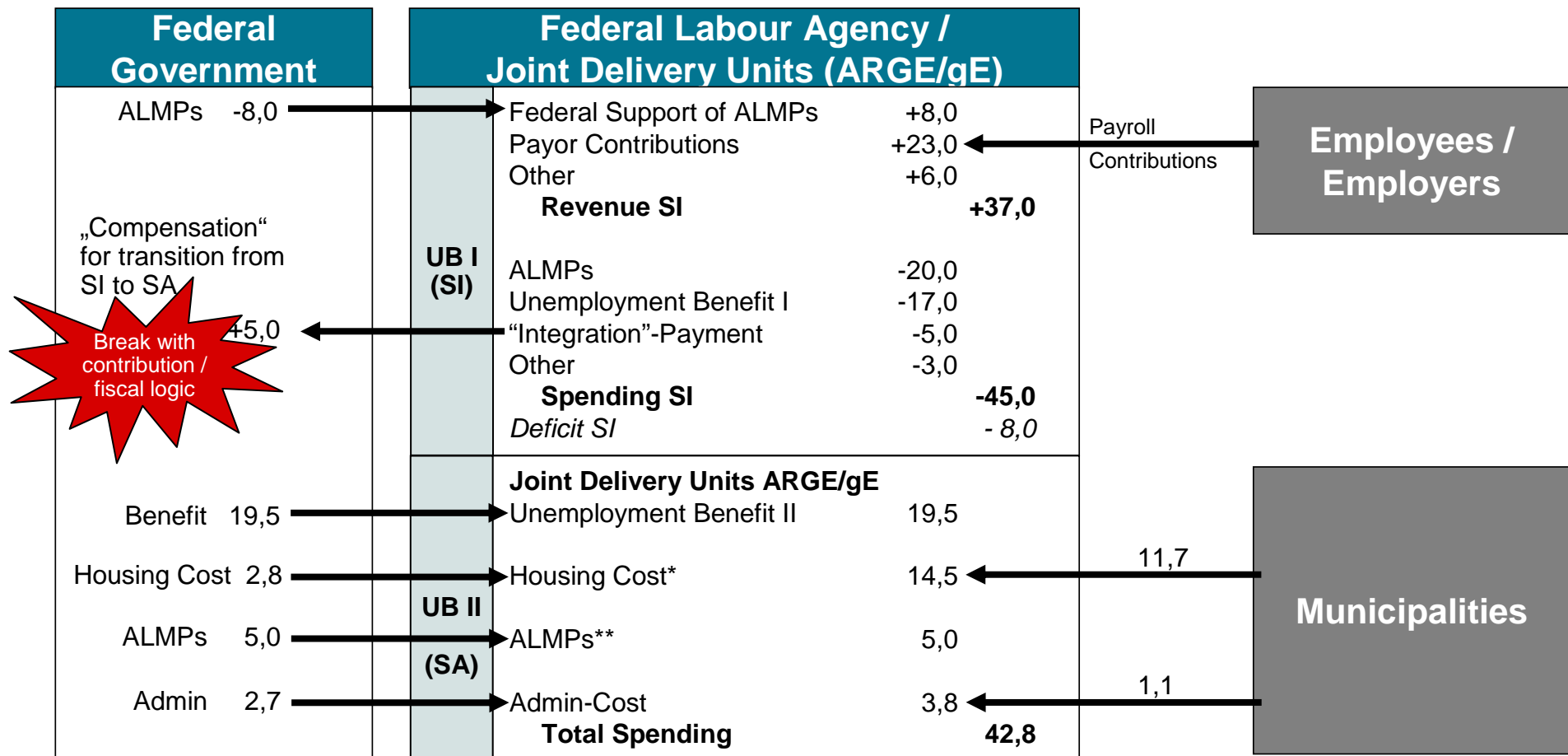


Split payment responsibility between federal and local level can lead to load-shifting incentives



** Note: 26% federal cost share in housing and heating allowance is average number, varies slightly by state.

Background information: High-level financing flows for Social Insurance and Social Assistance in Germany (€bn, 2010)



* Measure of total-system housing cost not consistent with local 26% federal / 74% municipal cost share owing to “Option/zkT” delivery model in some localities

** of which: Public-Employment-Schemes 33%, Employer-Subsidies 20%, Training 16%, Job-Placement 12%

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Staff incentives and management: Asymmetric regulations between Federal Labour Agency staff and Municipal staff

Simplified

General Public Employment Contracts (Municipal Regime)

- Municipally employed tenured civil servants (“Beamte”) subject to respective state civil service law
- Public employees (“Angestellte”) subject to Germany-wide “TVöD” (collective public sector wage agreement)
- In both municipal contracts, almost no scope for performance-based pay

“Old-school” public sector employment with no incentive pay and strong union-veto rights

Federal Labour Agency Staff Contract (Federal Regime)

- Framework agreement negotiated with unions applies to all federally employed civil servants and employees
- Comprehensive function and skill-based payment scheme
- Staff can be moved between agencies
- Total pay: base pay + functional pay + incentive pay (up to 10% of base pay)
- Annual work-hour accounts allowed

Most modern staff employment contract in public sector in Germany

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Incentive structure: Political economy makes fundamental change unlikely – but policy opportunities remain at margins

- **Work incentives** redesign requires either ...
 - Lowering of benefit level (politically opposed because of “right to basic income” or requirement of massive public works provision)
 - Or, extension of the number of in-work beneficiaries at high fiscal cost (→ and rising number of “poor” BIS recipients → negative political signal!)
- But **work incentives** can be strengthened by limitation of “Minijobs” and increased activation / monitoring above the 400€ range
- **Fiscal federalism incentives:** Maintain “incentive balance” in fiscal federalism arrangements, especially by barring opportunities to “shift” and “reclassify” beneficiaries groups between federal and local level. Recognize that fiscal federalism might block “centralized” deal on benefit reform
- **Case manager incentives:** Public management reform matters
- Recent developments **challenge the “incentive” regime** in German SA:
 - “Education package” for children of BIS recipients breaks with lump-sum logic and again opts for monetization instead of “in-kind” provision of basic needs
 - “Betreuungsgeld” – payment to “honor” mothers who raise children at home. Incentive for low-income households to withdraw children from pre-school

Labor market / social safety net reforms in Germany: main axes of action and general lessons learned

- From status maintenance and long benefit durations to labor market integration (from “worker citizenship” → “social citizenship”)
 - From segmented populations to one pool of beneficiaries and delivery channel
 - From flexibility at the margins (pre-2005: mini-jobs) to flexibility at the core of the labour market (erosion of collective bargaining, deregulation of temp-labour)
 - From old-school bureaucracy to applied New Public Management
- 
- Allow for local variance via cooperation-model with municipalities while keeping central systems (data standards / reporting) strictly central without compromise
 - Invest into case management and placement-oriented activation measures
 - Invest into capability of the Public Employment Service (PES)
 - Be prepared for a jump in recipients when including the inactive
 - Allow for non-profit actors to support training but maintain competition among them
 - Make evaluations a mandatory piece of policy and bank on long-term secondary effects (data availability, better ALMPs) even without immediate policy-advice impact

THANK YOU / VIELEN DANK!



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