

The German transfer system for the working-age population: design, changes and consequence

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Introduction

A comparison of indicators of economic inequality between Germany and the UK reveals some stark and maybe also surprising patterns: according to the Luxembourg Income Study, Germany's Gini coefficient stood at 0.26 and the poverty rate at 12% in 1996, compared to 0.33 and 21% in the UK. By 2016, both indicators had increased to 0.29 and 16% in Germany, while declining to 0.31 and 16% in the UK. At the same time, the rate of low-wage employment, as reported by the OECD, increased from 14% to 19% in Germany (compared to 21% and 19% in the UK). This pattern of convergence between both countries alone makes Germany an interesting case of comparison. This is all the more true, given that Germany also implemented some quite fundamental changes to its transfer system during this period. In this commentary, we want to highlight the role of social transfers in the wider context of national welfare states and social inequalities. We use the example of the German transfer system and its recent changes to assess consequences of benefit design for social inequalities in times of changing labour markets. We argue that while producing winners and losers, the reform's immediate consequences for the generosity of transfers were modest, but did change some of the basic design principles of the transfer system. While it is still debated to what extent the reforms of the transfer system can explain the combination of decreasing unemployment and increasing labour market inequalities, they certainly modified the institutional context in a way that fundamentally altered the preconditions for the politics of combating inequality.

In their chapter, Hoynes, Joyce, and Waters (2023) offer a comprehensive analysis of the system of transfers in the UK and emphasise some important issues and characteristics. In our commentary, we complement this by briefly discussing the structure and changes of the transfer system in the German case. While we underscore some fundamental differences between both countries that will also eschew a direct transferability of insights, we believe that the experience in Germany is highly relevant to many of the themes in the chapter. In particular, given that strengthening social insurance is presented as one potential direction of change in the UK, Germany's experiences with social insurance and the weakening of this principle in recent reforms are important.

In the following section, we start with some general thoughts on the set-up of transfer systems and their implications from a sociological perspective, drawing on a rich literature on welfare regimes and types of benefit systems. Against this background, we describe the German case and its structural problems, as well as the most important changes implemented with the so-called 'Hartz-IV reforms' in the early 2000s. We then discuss the evidence on the effects of the reforms. In line with the literature cited in the following section, we argue that these effects go beyond the impact on economic outcomes, and we also discuss the social and political impact of the changes. We conclude with a focus on what can potentially be learned from the German case for other contexts.

Worlds of welfare and types of transfers

There is a long tradition of differentiating between different types of welfare provision: one prominent differentiation distinguishes Beveridgean systems that provide tax-financed universal flat-rate benefits, from Bismarckian systems that are financed by payroll contributions from employers and employees and where earnings-related benefits aim at status maintenance. Richard Titmuss (1974) introduced the differentiation between residual welfare states that only step in when both the market and the family fails, and institutional welfare states with a much

wider responsibility for the social welfare of their citizens. The influential typology of Esping-Andersen (1990) combines these two lines of differentiation and introduces the famous three worlds of welfare capitalism: the liberal type, which provides minimal state intervention mainly focused on preventing (extreme) poverty; the conservative type, which mainly aims at status maintenance and is strongly segmented along the lines of occupational and class differences; and, finally, the social-democratic welfare state, which aims to provide universal social rights and is most strongly committed to combating not only poverty, but also inequality.

For our commentary, we would like to highlight mainly the two features of welfare regime theory that are an interesting starting point for our argument.

First, Esping-Andersen's approach incorporates the idea that regimes systematically use different forms of cash transfers that will influence their specific pattern of stratification. The ideal typical liberal welfare state would use mainly means-tested and flat-rate benefits, which would cater to the needs of the lower classes, thus increasing dualism between those groups that are dependent on the welfare state and the rest of society. Conservative welfare states would rely on social insurance systems that actively maintain social status and thereby also social inequalities between groups, while excluding groups that are not – or only marginally – active in the labour market. The social democratic welfare state would use more universal benefit systems that provide benefits to most social groups, thereby achieving the highest level of social rights and the strongest effects on redistribution.

There is a clear rank-order between the welfare regimes with respect to how effectively transfers ensure social rights and how strongly they foster social equality. Especially, a reliance on means-tested benefits and social assistance is seen as problematic for effectively combating inequality. This is partly due to the issues of non-take-up, work incentives, and stigma, which are highlighted by Hoynes, Joyce, and Waters (2023). Another potential disadvantage of income-tested benefits has been identified by the so-called 'paradox of redistribution' (Korpi and Palme, 1998); that is, designing benefits in a way that would be most profitable for the poor was empirically found to be associated with lower levels of redistribution. In their theoretical argument, Korpi and Palme stress that there is a trade-off between the degree of low-income targeting and the size of the redistributive budget: in systems that rely mainly on means testing, there will be a strong conflict over resources between the societal majority that does not profit from transfers and those with low income. Because the latter group is a clear minority, the generosity of these benefits will typically be low. In contrast, encompassing systems that provide benefits also to the middle classes will rest on a much stronger coalition of groups that have an interest in strengthening benefit systems. Additionally, the public perception of recipients of means-tested benefits is often more divisive and their deservingness is more often questioned than for other benefit types; for a recent review of the paradox of redistribution and the related research, see Gugushvili and Laenen (2021).

The second aspect we want to highlight is that welfare regimes provide a framework for thinking about specific policies – such as cash transfers to the working-age population – as features that are not randomly introduced and that do not necessarily produce the same effects in different contexts: Esping-Andersen underscores the fact that welfare regimes are the outcome of different power resources of political actors. However, these politico-economic forces interact with ideological beliefs about inequality and public intervention, which are themselves reinforced by institutional set-ups. As a result, different types of state intervention will have varying degrees of legitimacy depending on the welfare-state tradition in a country. These different 'moral economies' are visible in surveys on attitudes towards the welfare state. Indeed, individuals in conservative welfare states tend to support norms of reciprocity and the value of 'good' work more strongly than in liberal welfare states (Koos and Sachweh, 2019; Taylor-Gooby et al., 2019). This is also reflected in ideas on how welfare benefits should be designed: whereas in the UK, only slightly more than 10% of respondents say that higher earners should get higher unemployment benefits, more than 60% agree to this statement in Germany (Reeskens and van Oorschot, 2021).

The transfer system in Germany and its change over time

Germany is often taken as one of the main representatives of a conservative welfare state type, while the UK is usually sorted into a cluster of liberal welfare states. However, the regime types

identified by Esping-Andersen (1990) are most appropriately conceived as ideal types, and thus the match between the ideal characteristics with the empirical types is not perfect. Furthermore, policy changes can increase or decrease a welfare state's similarity with an ideal type. In Germany, there is a debate on how the reforms discussed below changed the German model and its classification as a conservative welfare state (e.g. Seeleib-Kaiser, 2016). We focus on the public transfers that were most affected by the reforms (i.e. social assistance to those able to work and unemployment benefits). Family benefits are not targeted at those with low incomes in Germany and are not discussed in this commentary.

Germany's employment-centred welfare state and its challenges

In line with Esping-Andersen's characterisation of the conservative welfare state model, social insurance systems that are financed mainly through contributions from employers and employees are the most prominent elements of the Germany welfare state. Some analysts argued that these systems should be considered 'quasi-universal', because the coverage of social insurance was very high in the golden age of the welfare state (Palier, 2012). Coverage of social insurance strongly depends on employment, however, and there are forms of economic activity that are not subject to social insurance contributions and that are thus excluded from receiving benefits in case of unemployment, such as self-employment, marginal employment, and civil service. In 1992, 77% of all people in employment in Germany were in jobs that were subject to social security contributions (*sozialversicherungspflichtig beschäftigt*; Bäcker, Naegele, and Bispinck, 2020). Other so-called non-standard forms of employment are not excluded from social insurance, but typically lead to lower levels of benefits because of low or interrupted contributions, such as fixed-term employment or regular part-time employment (Eichhorst and Tobsch, 2015).

The amount of cash benefits received is strongly tied to previous contributions in all insurance tiers. For unemployment insurance, a non-taxable benefit of 60% (67% for individuals with children) of prior net earnings is paid to insured workers with a sufficient contribution record since 1994. Unemployment insurance, however, was not the only transfer to the unemployed: unemployment assistance (*Arbeitslosenhilfe*), in existence since the Weimar Republic, constituted a second-tier and tax-funded benefit system to provide an earnings-related benefit mostly to workers who have exhausted their first-tier benefit eligibility, albeit set at a lower level than in the first-tier unemployment insurance and paid contingent on a household income test. Due to the strict principle of earnings-relatedness, however, neither the unemployment insurance nor the unemployment assistance system has any minimum benefit level implemented, thus leaving workers with low prior earnings dependent on supplementary social assistance transfers to lift families above the applicable poverty line. Social assistance (*Sozialhilfe*) always formed the safety net of last resort for anyone not eligible for other benefits, including unemployed individuals without or with insufficient contribution records in the unemployment insurance system, unemployed workers who exhausted benefit duration in the unemployment insurance system, and also workers with generally insufficient earnings, irrespective of their insurance and employment status.

During the 1990s, and reinforced by the cost of German reunification, the social insurance system in Germany seemed increasingly unsustainable: the lack of employment opportunities led to more and more people relying on the relatively generous exit options provided by the welfare state that included, inter alia, the possibility to retire from the labour market by the age of 58, because they were able to receive unemployment insurance for an extended period and then to transition to the public pension system via generous early retirement options. This put financial strain on the insurance system while low employment rates also limited revenues through social insurance contributions. Consequently, the payroll tax rate increased, which in turn increased labour costs and thereby hindered job growth in jobs with lower productivity (Manow and Seils, 2000). Indeed, the unemployment rate in Germany was never below 10% between 1992 and 2006, and reached a peak in 2005.

At the same time, while the share of unemployed individuals who received insurance benefits remained above 40% until the early 2000s, a growing share of the unemployed depended on the income-tested benefits of unemployment assistance and an increasing share of the population received social assistance (Alber and Heisig, 2011; Clasen, 2011; Clasen and Goerne, 2011; Dingeldey, 2011), signalling a growing importance of social risks that were not covered within the German system of social insurance. Indeed, the share of individuals covered by social insurance

declined by 10 percentage points between 1992 and 2005 to 67% of those in employment, due to the growth of non-standard forms of employment and marginal employment in particular (Eichhorst and Tobsch, 2015; Bäcker et al., 2020).¹ At the same time, there were strong institutional divisions between unemployment insurance and social assistance rooted in a traditional separation of policies for workers and for the 'poor' (Leibfried and Tennstedt, 1985). Social assistance was administered by the municipalities and while these also organised activation programmes for recipients, these could differ a lot depending on the local resources and were not integrated with the programmes offered by the Federal Employment Office that was responsible for the insured unemployed only (Hassel and Schiller, 2010; Alber and Heisig, 2011). In sum, the quasi-universal German system of social insurance was challenged by structural changes that threatened its financial basis, but also revealed gaps in the welfare state (Alber and Heisig, 2011; Clasen, 2011). Incremental changes to qualifying conditions further restricted coverage of unemployment insurance (Bothfeld and Rosenthal, 2018). Furthermore, in view of the transition to a service-based economy and the associated growth of low-wage employment, it became increasingly evident that income maintenance for workers with low earnings was one challenge not explicitly addressed in the German welfare state at all. While there has never been a dedicated system of in-work transfers that would be comparable to the system of tax credits in the UK or in the United States, below we discuss how supplementary social assistance benefits to some extent assume this role in the German welfare state.

The reforms of the transfer system in 2005

The challenges discussed above were forming the background to a series of reforms under the Red-Green government led by Gerhard Schröder in the early 2000s. While the first three policy packages implied a deregulation of non-standard forms of employment and a reorganisation of the federal employment administration, here we focus on the fourth policy package (colloquially called Hartz IV, after Peter Hartz, an executive board member with Volkswagen and chairperson of the government reform committee behind the policy changes). This implemented notable changes in the transfer system for the working-age population that came into effect in 2005 and 2006. Because different policy changes were implemented in short succession, we do not aim to isolate the effects of any single measure here, but rather focus on describing the main thrust of the changes and their implications.

With respect to the first-tier system of unemployment insurance, the Hartz IV package shortened the maximum benefit duration to 12 months for workers older than 45, and to 18 months for workers older than 55, whereas benefits had been paid for up to 32 months previously, depending on age brackets and contribution record (for workers aged 58 and older, the maximum benefit duration was increased to 24 months again in 2008). The main changes occurred in the second-tier system, however, where prior unemployment assistance and social assistance benefits to able-bodied working-age recipients were merged into a newly uniform second-tier jobseeker's allowance (*Grundsicherung für Arbeitsuchende*, literally minimum income protection for jobseekers, or *Arbeitslosengeld II*, i.e. unemployment benefit II). The new benefit was thus merging the two traditionally tax-funded benefit systems, yet did so mainly by aligning itself with principles of social assistance (i.e. a minimum income protection system), in terms of benefit generosity, reliance on and strictness of means-testing, as well as job search requirements. In contrast to the earlier social assistance programme, all working-age benefit recipients could now participate in the various active labour market programmes administered by the Federal Employment Agency, irrespective of sufficient social security contribution records. In addition, means-testing became slightly less strict and benefit withdrawal rates became slightly more generous in order to improve claimants' work incentives. Compared with the earlier unemployment assistance, however, the new benefit now involved a fairly strict means test rather than an income test, job search requirements and associated sanctions became significantly tighter, and, most importantly, benefits became tied to the poverty line rather than to claimants' prior earnings or contribution record. In 2004, immediately before the Hartz IV reform took effect, 1.8 million individuals received unemployment insurance, 2.2 million received unemployment assistance and 1.9 million aged between 15 and 65 received social assistance benefits. In 2006, 1.4 million individuals received unemployment insurance benefits and 5.4 million received the new jobseeker's allowance (Alber and Heisig, 2011).

¹ Note, however, that growing employment since 2006 led to a partial reversal of this trend. In 2018, 73% of the labour force have been employed in jobs covered by social insurance.

Overall, the Hartz reforms visibly shifted the design principles that underlie the German transfer system for the working-age population away from status maintenance to increased means testing and poverty alleviation, but assessing their effects along different dimensions of generosity and activation is far from trivial: to what extent the shortening of benefit duration in the unemployment insurance system represents actual retrenchment depends on the empirical duration of unemployment spells among mid-career and older workers. Also, while former recipients of social assistance experienced few changes in the transition to the new system, except for gaining access to active labour market policies, former claimants of unemployment assistance could lose substantially if they had relatively high earnings before becoming unemployed or if stricter means testing were to exclude them from claiming benefits altogether. In addition, it should be emphasised that, despite its name, the new jobseeker's allowance is not restricted to providing benefits to those actively searching for employment, but also provides (supplementary) benefits to households with low earnings and individuals with care responsibilities, as long as they are able and available to work for at least three hours a day.

Indeed, summary evaluations of the Hartz reforms differ widely. Some authors argue that the main pillars of the transfer system remained intact, because unemployment insurance is still relatively generous and still around one-third of the unemployed receive the first-tier benefits after the reform (Clasen and Goerne, 2011). Looking at unemployment flows instead of stock data, those who lose their job and receive unemployment insurance are still a clear majority, and less than one-quarter of those leaving employment receive minimum income benefits immediately after becoming unemployed (Bundesagentur für Arbeit, 2022). Other authors argue that the reform represented a radical change because of the abolishment of the unemployment assistance system, the shorter benefit duration in the first-tier unemployment insurance system, but also stronger job search requirements and an increasing focus on activation all contributed to erode the principle of status maintenance (Eichhorst, Grienberger-Zingerle and Konle-Seidl, 2010; Eichhorst, 2015; Bothfeld and Rosenthal, 2018). Finally, some assessments mainly rest on how poverty risks and economic inequality changed after the reforms (Seeleib-Kaiser, 2016). In this commentary, we refrain from providing such a broad characterisation of the overall direction of institutional change, but instead we discuss the available evidence on empirical effects of the reforms for different outcomes and dimensions.

Impact of the reforms

Economic consequences

Mechanical effects on benefit generosity, take-up and redistribution

As argued above, assessing the mechanical effects of the Hartz reforms on redistribution is not straightforward, and there were indeed winners as well as losers. Among the former claimants of unemployment assistance, a little more than half lost income due to the reforms and many were not eligible for any type of transfer after 2005, usually because of additional incomes in the household that were now more strictly considered in the means test (Goebel and Richter, 2007; Bruckmeier and Schnitzlein, 2009). However, even among these individuals, about one-third also benefited from the reform; for example, because their previous earnings and, by implication, their unemployment assistance benefits had been so low that they lived below the level of the new jobseeker's allowance or because they were already receiving social assistance in addition to their benefits (Becker and Hauser, 2006).² In addition to this group, there are two other groups of winners and losers. On the one hand, individuals with low earnings could benefit from the reform, because benefit withdrawal rates were slightly more generous under the new system; indeed, it has been shown that public transfers have become more effective in lifting employed households with low earnings above the poverty line post-reform (Gerlitz, 2018). On the other hand, older people with long histories of stable employment could lose out considerably, because they would be transferred from earnings-related first-tier unemployment benefits to the poverty-line jobseeker's allowance after a much shorter period of time. However, because most people find employment before exhausting their benefit eligibility, only a minority eventually transition to means-tested social assistance (Clasen and Goerne, 2011). Focusing on unemployed individuals,

² According to survey data, roughly 30% of claimants of unemployment assistance topped up their incomes through social assistance benefits (Goebel and Richter, 2007).

the amount of transfers received empirically hardly changed after the reforms, although increased targeting is visible in a slight increase in transfers among households with low market incomes relative to others (Brülle, 2021). The same study finds that the principle of status maintenance continues to be visible in higher transfers among the unemployed who were in well-paid and stable employment both before and after the reforms. In addition, another likely effect of the reform was an increase in the take-up of benefits among eligible individuals (Bruckmeier and Wiemers, 2012). Indeed, the number of recipients in the new jobseeker's allowance widely exceeded expectations based on the previous number of claimants (Koch, Kupka and Steinke, 2009; Alber and Heisig, 2011).

In summary, while certainly leading to income losses among some households, studies looking at the mechanical effects of the reforms for redistribution hardly find any effect on the overall level of either inequality or poverty. While, descriptively, transfers less frequently lift unemployed individuals over the poverty threshold than before the reforms, this observation can be explained by lower market incomes and a changing household composition (Brülle, 2021). Similarly, whereas descriptive figures show a drastic increase in the poverty risks among the unemployed between the 1990s and the period after the reforms, this seems to be largely due to changing selectivity and duration of unemployment, as the immediate impact of losing a job on poverty did not change after the reforms (Heyne, 2012). Also, the changes in the transfer system do not seem to have contributed to rising economic inequality in Germany, and may have even had an inequality-reducing effect (Biewen and Juhasz, 2012).

Effects on unemployment and job matching

The previous results focus on the mechanical effects of the reforms on transfers and redistribution and do not take into account potential behavioural changes or changes in the functioning of the labour market. The large drop in unemployment from 11.7% in 2005 to 5% in 2019 after the reforms is often associated with the changes to the transfer system. However, econometric studies are inconclusive and recent estimates of the reforms' contribution to the decline in unemployment range from no effect at all (Bradley and Kügler, 2019, looking only at male respondents) to more than 3 percentage points (Hartung, Jung and Kuhn, 2018). At the same time, studies also vary in their assessment of different mechanisms of how the reforms reduced unemployment. There is some evidence from employer surveys that the reforms did increase the readiness to make concessions in terms of lower wages and working conditions for both jobseekers and employees (Rebien and Kettner, 2011; Möller, 2015). Wages upon re-employment have decreased among displaced workers after the Hartz reforms, but the causal contribution of changes in the transfer system is unclear (Woodcock, 2022). The matching process in the labour market also seems to have improved after the reforms. However, this seems to be due mainly to the earlier Hartz reform packages that liberalised employment contracts and changed the organisational structure of the Federal Employment Agency (Fahr and Sunde, 2009; Klinger and Rothe, 2012; Launov and Wälde, 2016).

A closer look at employment flows gives some additional hints at the potential effects of the reforms. First, several authors note that a large part of the positive development of employment and unemployment after 2005 stems not so much from faster exit rates from unemployment, but rather from a decrease in separation rates of existing employment relationships (Hartung et al., 2018; Burda and Seele, 2020; Carrillo-Tudela, Launov and Robin, 2021). Second, many workers stopped registering with the employment agencies after the reforms and thus transitioned to non-employment (Carrillo-Tudela et al., 2021). Finally, it seems that whereas men hardly benefited from the reforms in terms of employment, women increasingly transitioned from non-employment to low-wage and part-time employment (Carrillo-Tudela et al., 2021). Thus, while changes to the transfer system could have contributed to declining unemployment, this is not necessarily due to the most intuitive mechanism – a lower reservation wage and changing job-search behaviour among the unemployed. To put the potential effect of the reforms of the transfers system into perspective, it should also be noted that the German 'labour market miracle' was set against the background of economic recovery in the Eurozone and strong international demand for manufacturing products (Möller, 2010), where the specific construction of the joint currency system probably benefited the competitiveness of the German export sector – potentially with the side effect of further increasing wage inequality (Iversen, Soskice and Hope, 2016; Ochsenfeld, 2018). Overall, wage moderation likely facilitated the strong employment growth in Germany. We review the evidence of the effect of the reforms on wages in the next section.

Effects on wages

To some extent, the effects on wages are the flipside of the employment effects discussed above. One of the main mechanisms for explaining the potential effect of the benefit system reform for unemployment is that workers may settle for lower wages out of fear of falling into means-tested transfer receipt and that the unemployed accept lower-paid jobs more quickly, as the transfer system has become less likely to sustain high reservation wages. While this narrative fits with the general growth of the low-wage sector in Germany, wage inequality and low-wage employment actually started to rise before the reforms. There are also other plausible explanations: *inter alia*, changes in collective bargaining and technological changes that change the demand for different types of jobs (Dustmann, Ludsteck and Schönberg, 2009; Dustmann et al., 2014). In addition, the preceding reform packages I–III, which liberalised employment contracts and fostered marginal and temporary agency employment, could also have contributed to a growing polarisation of employment in Germany. However, studies find that the changes in the transfer system could be responsible for a decrease in wages of 2%–3% (Arent and Nagl, 2013; Bradley and Kügler, 2019). These effects seem to be stronger for those with low education and could thus also have contributed to increasing wage inequality (Bradley and Kügler, 2019).

As argued above, the mechanical effects of the reforms on redistribution were likely negligible. However, if the reforms contributed to rising low-wage employment and wage inequality, they could also have contributed to the increase in inequality of household incomes. Indeed, increasing earnings and wage inequality are probably the most important factors in the strong increase of inequality in Germany between the 1990s and the 2000s (Biewen and Juhász, 2012). After 2005, while inequality in monthly earnings continued to increase, this was compensated for by improved employment opportunities that led to stability in the inequality of annual earnings (Biewen, Ungerer and Löffler, 2019). Looking beyond the labour market, the combination of declining wages and increasing employment could have benefited owners of capital and thus contributed to a declining wage share (Gerlitz, 2018; Grüner, 2019). To the extent that the reforms contributed to wage moderation, they could also have helped the continued success of the German export sector (Avlijaš, Hassel and Palier, 2020).

The combination of transfer receipt and employment in the German transfer system

One group that came into greater policy focus after the Hartz reforms consisted of employed individuals who are receiving means-tested transfers. Indeed, in spite of its name, the jobseeker's allowance can be considered the largest in-work benefit system in Germany, and between 1.3 and 1.4 million claimants receive transfers while working (Clasen, 2020). Receiving supplementary social assistance benefits to top up low earnings was also possible before the reforms, yet applicable earning disregards were made more generous in 2005 (Alber and Heisig, 2011; Rudolph, 2014). While basically representing an extension of the transfer system to an important new risk group, the sheer fact of in-work benefit receipt and the high number of employees affected is mainly discussed as an institutional failure in Germany, and it is deemed highly problematic that the labour market is unable to provide sufficient earnings to lift households above the poverty line and thus avoid benefit receipt. Low wages, however, are only one aspect of the issue of the combination of transfers and work: fewer than a quarter of claimants work more than 32 hours a week, and these workers are mostly living in larger households, whereas marginal employment – meaning jobs at fewer than 16 hours a week and yielding less than 450 euros in monthly earnings, which are tax-exempt as well as exempt from payroll taxes – is widespread (Bruckmeier et al., 2013). As a result, the introduction of a national minimum wage in 2015 hardly reduced the number of employed people in receipt of supplementary benefits (Bruckmeier and Wiemers, 2015).

The negative public image notwithstanding, research into the consequences of combining benefits and work indicates that compared with the unemployed, working benefit recipients show higher levels of life satisfaction and a heightened sense of belonging to the wider society (Alber and Heisig, 2011; Sthamer, Brülle and Opitz, 2013; Hetschko, Schöb and Wolf, 2020). The same has been found for participation in activation programmes that provide recipients with small jobs (Wulfgramm, 2011; Gundert and Hohendanner, 2015). However, all studies also indicate that employment without benefit receipt still provides the largest benefit in terms of well-being and the positive effects compared with unemployment depend on the characteristics of the job, with better jobs in terms of remuneration and work conditions also providing larger benefits. Thus, while the evidence offers some arguments for the idea that any job is better than not having a job, this does not hold unconditionally.

Social and political consequences

The previous subsection has already hinted at further consequences of welfare benefits beyond the immediate economic gains for work and incomes. There is some evidence that the integration of benefits in 2005 also affected these broader outcomes. For the unemployed, one study indicates a decline in life satisfaction during and after the reform period, which is explained only partly by a decrease in income and satisfaction with income (Deter, 2021). Similarly, the self-rated health of recipients of the jobseeker's allowance was lower than for former recipients of unemployment assistance benefits (Shahidi et al., 2020). Both results, however, are based only on a subgroup of individuals affected by the reforms and might overestimate total effects on well-being.

Perhaps the most visible effects of the reforms of the transfer system have in fact been political. The announcement of the reforms in 2003 led to an immediate decrease in satisfaction with democracy and an increase in the intention not to vote at the next elections, both by about 5 percentage points and mostly among the unemployed (Fervers, 2018). Furthermore, during the reform process, a new left-wing party was founded in explicit opposition to the Hartz reforms, from a base of union activists and left-leaning members of the German Social Democratic Party (SPD), including its former chairperson and federal minister of finance (i.e. Chancellor of the Exchequer) Oskar Lafontaine. This party later merged with the PDS, the successor of the former communist party that ruled the German Democratic Republic, aptly relabelling itself as 'The Left' (Die Linke), and was able to establish itself as a permanent political force to the left of the SPD after 2007 (Schwander and Manow, 2017). The 2005 reform of the transfer system thus became a signature policy issue of the mid-2000s, and effectively sparked a major shift in the German party system that implied a split in the left political spectrum. This resulted in a significant electoral decline of the SPD, and contributed to alienate the SPD from its traditional union base. None of this has helped the competitive position of the social democrats, or the ability of the political left to achieve political majorities or leadership of coalition governments at the federal level.

The changing structure of party competition could be one way in which the Hartz reforms might be assuming long-term implications for the scope for inequality-reducing policies in Germany. Another way in which the reforms might matter for future efforts of poverty alleviation is that they made means-tested benefits a more important and much more salient feature of the German welfare state. As a result, the determination of the poverty line that is the basis for the benefit level in the jobseeker's allowance has become an even more important parameter in combating inequality and poverty. In line with Korpi and Palme's prediction, means-tested benefits are generally low and develop less favourably over time than wages or median incomes (Van Mechelen and Marchal, 2012). In Germany, benefit increases are supposed to roughly follow prices and the expenditure of those with low incomes, but there is also some discretionary scope and arbitrary political tinkering with the details of the poverty line construction, which have become more commonplace than under the former social assistance system (Cremer, 2016). As a result, the basic benefit level in the jobseeker's allowance (i.e. the poverty line net of housing costs) increased by 25% between 2005 and 2020, whereas net wages increased by more than 36%.³ Survey data on citizens' support for welfare state programmes and on their perceptions of benefit generosity likewise indicate that public support for increasing benefits in the minimum income programme is limited in Germany, especially when compared with other branches of the welfare state, including the unemployment insurance system (Ullrich, 2008; Hörstermann and Andreß, 2015).

Conclusion

Despite its complexity and the fact that some findings on the effects of the reforms are still inconclusive, the German experience reveals some important lessons about policy efforts to combat inequality. For empirical inequality trends, changes in the labour market in Germany have been crucial and if the reforms of the transfer system have contributed to the increase in inequality at all, then their impact was mostly indirect, via increasing wage inequality and low-

³ See <https://www.sozialpolitik-aktuell.de/files/sozialpolitik-aktuell/Politikfelder/Sozialstaat/Datensammlung/PDF-Dateien/abbIII44.pdf>.

wage employment. If the bolder estimates in the literature are correct, then the shortening of unemployment insurance and abolition of the second-tier system of unemployment assistance was one key element of Germany's development from a high-wage economy built on restricted labour supply from certain demographic groups, such as older workers and women, to a more polarised service-based labour market with high employment participation. One factor in this transformation would not mainly have been bringing the jobless into work, but rather that falling into unemployment and the associated risk of poverty became such a frightening idea that employees have been willing to concede to declining working conditions to keep their jobs. Given that the direct change in the generosity of unemployment compensation has been rather limited, it seems reasonable to conclude, however, that the symbolic dimension of breaking the traditional political promise of long-term status maintenance in the face of adverse life events and the negative image of the new jobseeker's allowance in public discourse might have been at least as important in triggering these developments as have been the factual changes in themselves.

Furthermore, in terms of anti-poverty and egalitarian political agendas, the Hartz reforms seem to have navigated the German system into something of a dead end. Formerly, the legitimate way to check inequality was seen in a combination of a relative egalitarian distribution of earnings and the provision of earnings-related benefits when unemployment strikes. Over time, both elements have been weakening, as collective bargaining coverage is less binding than it used to be and as the transfer system now more strongly rests on a means-tested benefit that is widely unpopular and seen as stigmatising. One approach to change matters could involve pursuing the opposite direction of the Hartz reforms, that is, strengthening the principles of social insurance instead of relying on means-tested benefits. While less exclusively focused on reducing poverty and inequality, tying benefits to previous wages has some important advantages: these types of benefits are typically less stigmatising, and take-up is higher. Also, generosity will automatically follow the development in earnings and these benefits have been shown to be less vulnerable to retrenchment (Nelson, 2007). Because unemployment is a social risk that is concentrated on those with low resources, unemployment insurance also achieves higher redistribution than, for example, pensions, even if focused on the idea of status maintenance. However, in the absence of adjustments to increase coverage levels of the unemployment insurance system and absent a minimum (i.e. poverty-avoiding) benefit level, insurance benefits can be hollowed out due to structural changes in labour markets that increase low-wage and precarious employment outside the social insurance system. Consequently, a discussion about expanding coverage of the social insurance system by expanding mandatory contributions to the marginally employed, to the self-employed or to civil servants is a perennial feature of the German public discourse, although mostly targeted at the pension and the health-care system rather than at inclusion in the unemployment insurance system at present. Furthermore, while precise estimates vary, there has been a political lesson learned insofar as employment rates might arguably be lower in Germany today if benefit duration in the first-tier unemployment insurance system had remained at the same level, and if subsidised early retirement through the social insurance system had remained as generous as before the reforms.

In light of growing low-wage and part-time employment in the service sector (see Brülle et al., 2019), and also referring back to the evidence on the latent functions of work and its benefits beyond providing a source of income, a quite different approach could lie in establishing a more generous system of in-work benefits. While representing the largest in-work benefit in Germany, transfers are still withdrawn at rates of 80%–90% after the first 150 euros under the jobseeker's allowance. Incentives are thus high to take up employment with very low working hours, while increasing labour supply further is often not paying off very well in terms of net income. Yet given low wages at the bottom of the distribution, increasing possibilities to top up earnings have empirically been shown to be the main way in which minimum income benefits can become more generous (Cantillon, Parolin and Collado, 2020). However, taking this direction also implies a broadening of the reach of means-tested benefits further up into higher strata of the income distribution, which has already proven deeply unpopular in the context of the Hartz reforms in Germany. Furthermore, the idea of in-work benefits has generated strong principled opposition in Germany, inter alia because of concerns that low-wage employment might be growing even further due to the implicit subsidy provided by generous in-work benefits or tax credits (Clasen, 2020). Thus, while theoretically offering an important tool for combating poverty and inequality (Kenworthy, 2011), expanding in-work benefits might presently not be a feasible solution in the German political context. Instead, the main anti-poverty policy option that is on the table and targeted at working-age households is to develop the current system of universal flat-rate child

benefits into a broader child-centred minimum income system (*Kindergrundsicherung*) to minimise gaps in coverage and other frictions created by the somewhat uneasy co-existence of several targeted tax and transfer instruments.

Finally, future policy efforts could build on one strength of the reforms – improving access to benefits for individuals who traditionally have held more peripheral positions in the labour market (Eichhorst et al., 2010). This can be seen as one precondition of supporting both the unemployed and those in precarious employment not only financially, but also by providing them with opportunities to develop their skills and other types of assistance. While there are some indications that activation became more efficient after the reforms (Jacobi and Kluve, 2007), expenditure on activation and training measures has been declining recently, in spite of a stable number of claimants (Walwei et al., 2019). Strengthening the enabling elements of activation in the context of the new system of unemployment benefit could improve both individual employment prospects as well as popular support for the benefit system as a whole. And in fact, the latest turn in anti-poverty policy in Germany has followed precisely this pattern: as one of its signature policies, the new coalition government of Social Democrats, Greens and Liberals under Chancellor Scholz has been introducing a new Citizens' Basic Income (*Bürgergeld*) transfer that is to replace the unpopular Hartz IV benefit from January 2023. While representing an incremental reform rather than a radical break with the earlier benefit system, the new Citizens Income implies a 10% nominal increase in benefit levels, is set to prioritise training and active labour market policy over pressurising job seekers into low-wage employment, and is creating a somewhat broader zone of in-work benefits by lowering the transfer withdrawal rate on earnings from part-time jobs above the threshold for marginal employment.

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