

Alber, Jens; Heisig, Jan Paul

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Do new labour activation policies work? A descriptive analysis of the German Hartz reforms

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Wissenschaftszentrum Berlin
für Sozialforschung



Jens Alber
Jan Paul Heisig

**Do New Labour Activation Policies Work?
A descriptive analysis of the German
Hartz Reforms**

Discussion Paper

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Wissenschaftszentrum Berlin für Sozialforschung gGmbH
Reichpietschufer 50
10785 Berlin
Germany
www.wzb.eu

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Jens Alber, Jan Paul Heisig

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Abstract

Do New Labour Activation Policies Work? A descriptive analysis of the German Hartz reforms*

by Jens Alber and Jan Paul Heisig

The German “Hartz reforms”, introduced by the Red-Green coalition government in the years 2003 to 2005, form part of a broader pattern of European activation policies which have become known as “new labour” policies. The idea of these reforms was to reduce welfare dependency and to boost activity rates by making work pay, and by transforming the welfare state from a passive instrument of social protection to an enabling social investment that fosters universal labour force participation as the ultimate form of social inclusion. The German variety of these policies abolished earnings-related benefits to the long-term unemployed, partly fused the unemployment compensation scheme with the minimum income social assistance scheme and increased activating pressures on able-bodied people at working age by combining new sanctions with an extension of placement services. Based on a description of the relevant institutional changes, we show that means-tested benefits have become the major form of social transfer payments to the unemployed. The reforms also entailed a massive growth in German employment and especially in low-wage employment. As non-standard forms of employment proliferated, growing proportions of economically active people joined the ranks of the working poor by combining earnings from work with means-tested in-work benefits. Based on survey data from the German Socio-Economic Panel (GSOEP), we show that the working poor enjoy higher life satisfaction, social integration and civic engagement than the non-working poor. However, these individual and social benefits of employment critically depend on pay levels and overall job quality, as our own analyses confirm for the case of men’s life satisfaction. The welfare gains achieved by Germany’s recent reforms may therefore be smaller than suggested by employment rates alone, because people near the poverty line are now more willing to make concessions and to accept job offers even if the jobs they get are of minor quality.

Keywords: Minimum income support, unemployment compensation, labour market reforms, Hartz reform, activation policy, social inclusion, recommodification, working and non-working poor

JEL classification: I38, J68

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Wie funktioniert die Aktivierungspolitik à la New Labour? Eine deskriptive Analyse der deutschen Hartz-Reformen

Die von der rot-grünen Bundesregierung nach der Jahrtausendwende durchgesetzten Hartz-Reformen sind Teil eines allgemeinen Musters der Aktivierungspolitik, die von mehreren sozialdemokratischen Regierungen Europas unter dem Stichwort „new labour“ betrieben wurde. Das Ziel dieser Reformpolitik war es, die Abhängigkeit von staatlichen Transferzahlungen zu mindern und das Beschäftigungsniveau zu steigern, indem Arbeit im Niedriglohnsektor mit Hilfe von Subventionen attraktiver gemacht und der Sozialstaat von einer reaktiven Instanz des sozialen Schutzes zu einem befähigenden Instrument sozialer Investition umgebaut wurde. Die deutsche Variante dieser Politik schaffte die einkommensbezogenen Leistungen für Langzeitarbeitslose ab, fusionierte die soziale Sicherung der Arbeitslosen teilweise mit der Sozialhilfe und erhöhte den Aktivierungsdruck auf die Leistungsempfänger durch eine Politik des „Forderns und Förderns“, die neue Sanktionsmöglichkeiten mit verbesserten Bildungs- und Vermittlungsdiensten verband. Auf der Grundlage einer Beschreibung der wichtigsten institutionellen Reformen zeigen wir, dass die an Bedürftigkeitstests gebundene Grundsicherung heute die bei weitem häufigste Transferzahlung für Arbeitslose darstellt. Das Beschäftigungsniveau ist seit den Reformen insbesondere im Niedriglohnsektor beträchtlich gestiegen. Da vor allem diverse Formen atypischer Beschäftigung zugenommen haben, zählt ein wachsender Teil der Erwerbstätigen zur Gruppe der arbeitenden Armen, die ihr Erwerbseinkommen mit Leistungen der Grundsicherung aufstocken. Auf der Basis von SOEP-Daten zeigen wir, dass die arbeitenden Armen nicht nur zufriedener, sondern auch in vielfältiger Weise besser sozial integriert sind als vergleichbare nicht arbeitende Arme. Wie wir am Beispiel der Lebenszufriedenheit von Männern zeigen, hängen die positiven Effekte der Erwerbstätigkeit allerdings entscheidend von der Entlohnung und anderen Aspekten der Arbeitsplatzqualität ab. Die Wohlfahrtsbilanz der Hartz-Reformen könnte deshalb ungünstiger ausfallen, als die Beschäftigungsentwicklung vermuten lässt, da Arbeitsuchende nun eher zu Konzessionen bereit sind und auch schlechtere Stellenangebote akzeptieren.

Schlüsselwörter: Mindestsicherung, Arbeitslosenunterstützung, Arbeitsmarktreformen, Hartz-Reform, Aktivierungspolitik, soziale Inklusion und Teilhabe, Rekommodifizierung, arbeitende und nicht arbeitende Arme.

JEL Klassifikation: I38, J68

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1 The overhaul of the German poor relief system in the 2000s and the new emphasis on activation

1.1 The situation before the reforms and the new challenges after German unification

The German constitution – which is called The Basic Law (*Grundgesetz*) of the Federal Republic – declares the Federal Republic to be a *federal and social state* under the rule of law. This implies a state obligation to provide a minimum income scheme for the support of people who are unable to help themselves. The federal social assistance law (*Bundessozialhilfegesetz*) adopted in 1961 instituted an effective minimum subsistence guarantee by entitling every citizen passing a means-test to a poor relief benefit which would enable the recipients to lead a life in keeping with human dignity including a certain degree of participation in civic and cultural life. Hence benefits took the household size into account and were designed to cover the cost of nutrition, of clothing, of reasonable housing and of the occasional attendance of cultural events. The idea was to provide a basic safety net for people in extraordinary circumstances who were either unable to work or who could not earn enough in the labour market to achieve the minimum standard which the law stipulated for a household of the respective size. The poor relief scheme paid the difference between the actual household income and the minimum standard. Hence if a family had no income at all, the tax-financed federal social assistance scheme would pay the entire amount of the standard benefit. To take inflation into consideration, the basic rates were regularly reviewed and upgraded, basically following the expenditure pattern of the bottom quintile in official surveys of the income distribution.

The law required all potential beneficiaries to make full use of their own earning capacity.¹ If this requirement was not met, the benefit could be reduced or denied entirely. People who used the benefit to augment insufficient earnings from work had a certain amount of their earnings disregarded for purposes of the means-test so that the combined income from work and social benefits would be higher than the standard assistance rate (in order to take additional costs arising in the context of work – the so-called “*Mehrbedarf*”, originally reckoned to be one fifth of the standard rate – into account). Thus two of the elements which are usually regarded

¹ Following the principle of subsidiarity, § 18 of the old Federal Social Assistance Law stipulated that every potential benefit claimant is obliged to make full use of his earnings capacity to provide for himself and his family and that he must actively look for job offers. § 19 stipulated that the welfare relief agencies should provide work opportunities for those who cannot find work, while § 25 furthermore stipulated that the right to benefits is forfeited if a suitable work offer is refused.

as key characteristics of the new “work first” approach were already part and parcel of the old German poor relief scheme, i.e. the obligation to make use of one’s earning power and the right to retain some of the earned income from work without reducing the benefit entitlement.

The original assumption of policy makers was that the social assistance scheme would merely serve as a safety net of last resort in extraordinary special circumstances, because full employment and nearly universal social insurance schemes covering the standard risks of income loss would provide sufficient opportunities to reach the minimum standard of living without any form of public relief. Table 1 showing how the expenditure of the scheme and the number of recipients actually developed since the early 1960s illustrates to what extent this assumption met the test of reality. While the standard rates of the benefit were recurrently upgraded in a fashion that allowed them to keep more or less pace with inflation and also to preserve a rather constant relationship to the level of net earnings of the dependently employed labour force, the number of beneficiaries and the total outlays of the scheme mushroomed especially in the 1990s following the unification.

Table 1: Social assistance and social expenditure in Germany 1970-2004

Year	Social assistance expenditure			Social assistance recipients		Social budget	
	Total (in bio. DM/€)	As % of social budget	As % of GDP	Total (in 1000's)	As % of population	Total (in bio. DM/€)	As % of GDP
1970	3.335	1.9	0.5	1491	2.4	175.8	23.0
1980	13.266	2.8	0.9	2144	3.5	474.1	28.1
1985	20.846	3.6	1.1	2814	4.6	573.2	27.5
1990	31.782	4.3	1.3	3754	5.9	731.5	20.3
	€					€	
1991	19.090	4.5	1.2	(3747)	4.7	423.6	26.7
1995	26.669	4.8	1.4	(4001)	4.9	559.4	29.2
2000	23.319	3.6	1.1	(4136)	5.0	643.0	30.1
2004	26.351	3.8	1.2	(4423)	5.4	697.0	30.5

Sources: Statistisches Taschenbuch 2010 (and earlier editions). For GDP and absolute figures for social budget, *ibid.*, plus Materialband zum Sozialbudget 1997, and Sozialbericht 2009.

Up to the 1970s the social assistance scheme spent less than 2 % of all outlays of the German welfare state contained in the so-called “social budget”. By the mid-1990s close to 5 % of social outlays were spent by the supposed scheme of last resort. The runaway expenditure was basically related to three causes all of which gave rise to institutional reforms. The first reason was that the collapse of communism and the

civil wars in Yugoslavia led to a massive influx of *refugees* who could claim social assistance benefits.² When the proportion of foreigners receiving the standard benefit of the social assistance scheme surged from below 10 % in the early 1980s to around one third in the early 1990s³, a public debate on the abuse of the asylum legislation set in. Asylum seekers were eventually excluded from the social assistance scheme and shifted to a new categorical program for refugees with considerably lower benefits following legislation in 1993 (*Asylbewerberleistungsgesetz*). The second reason was that a growing proportion of social assistance outlays was devoured by the rapidly rising expenditure for *long-term care*. This led to the introduction of a new long-term care social insurance scheme in 1994 which effectively unburdened the assistance scheme from the responsibility for this new standard risk (Alber 1996). Finally, unemployment and long-term unemployment soared in Germany in the 1980s and especially following the German unification in the 1990s. Neglecting short-term fluctuations with the business cycle, unemployment increased in three big leaps (1975, 1983, 1992) from below 3 % to peaks above 10 % in the 1990s. The average duration of unemployment increased from below 26 weeks in the 1970s to peaks above 60 weeks after the turn of the millenium. This meant that growing proportions of the unemployed had exhausted their benefit entitlements under the unemployment insurance scheme and were eventually shifted to the social assistance scheme which was originally not designed to cope with lasting unemployment. It was this problem that eventually led to the reforms of the Red-Green coalition government under chancellor Schröder which became known as the Hartz reforms and amounted to a basic overhaul of the old system of poor relief.

Originally, the post-war German welfare state had pursued a three-pronged approach to cope with the problem of unemployment. Labour market insiders with more or less stable jobs in the core labour force were protected by a rather generous *unemployment insurance scheme* that aimed at status preservation by paying benefits that replaced 68 % of lost net earnings for a normal duration of 12 months since the 1970s. Piecemeal reforms beginning in the 1980s later lowered the benefit level to 60 % for singles and to 67 % for parents with dependent children, while the maximum duration was tied more strictly to the length of the contribution record and to the age of the unemployed. It became limited to a maximum of 32 months for the oldest category of workers with long insurance records in 1987 (capped to 18 months in 2005, and re-extended to 24 months in 2008 – Wörz 2009, p. 17).

For those who either had exhausted their benefit duration or had never built up a sufficient contribution record to claim insurance benefits there was a special means-tested *unemployment assistance scheme* which consisted of two branches, both financed from the federal government budget (and hence by general taxation).

² The number of asylum seekers had been below 100,000 throughout most of the 1980s, but it grew above 200,000 in 1991, to above 400,000 in 1992 and was still above 300,000 in 1993.

³ Data for the 1980s may be found in *Übersicht über die soziale Sicherheit* 1990, p. 449.

The first branch functioned as an *extended unemployment benefit* once the maximum duration of the insurance benefit had expired. Calculated as a percentage of previous earnings, this means-tested assistance benefit was also designed to preserve the attained standard of living to some degree. However, the earnings replacement rate was lower than the insurance benefit, i.e. 57 % of previous net earnings for parents with dependent children and 53 % for singles. This benefit was paid for unlimited duration, but with annual reviews of the claims. Until 2000 there existed also a second branch of unemployment assistance, the so-called *original unemployment assistance* (*originäre Arbeitslosenhilfe*) for those who did not have any previous entitlement to an insurance benefit. The lawmaker abolished this special assistance benefit in several steps. Unemployed school-leavers or graduates from educational institutions were the first to be excluded in 1975. In 1982 the benefit was made contingent upon a previous minimum employment record of 150 days (rather than 70 days as previously). In 1994 its maximum duration was limited to one year, and in 2000 the benefit was abolished completely (Hassel und Schiller 2010: 82-83; 175).

As unemployed people without an entitlement to an unemployment insurance or assistance benefit had to rely on the social assistance scheme, the number of poor relief recipients mushroomed after the German unification. Up to the mid-1980s the number of people receiving the regular outdoor assistance (*Hilfe zum Lebensunterhalt außerhalb von Einrichtungen*) had always remained below 2 million, but after the German unification their number grew to a peak of 3.8 million in 1993 (including asylum seekers who were then excluded). The number of those who received the outdoor benefit while being registered as unemployed even tripled between 1994 and 2004 (from about 319,000 to 930,000 – see table 2). Expenditure on outdoor relief increased by 60 % from 6.1 bio € (11.8 bio. DM) in 1990 to 9.8 bio €. in 2004.⁴ Since the social assistance scheme is predominantly financed by local authorities (with some participation of state governments), local government finances ran into a major fiscal crisis with mushrooming deficits (data in Hassel and Schiller 2010: 179). Hence there were massive calls for a reform of the poor relief system and of the unemployment compensation schemes.

⁴ Data on recipients of and expenditure on outdoor relief are taken from various editions of the statistical yearbook (Statistisches Jahrbuch, *Hilfe zum Lebensunterhalt außerhalb von Einrichtungen*).

Table 2: Recipients of minimum income support in the German social assistance scheme, 1970-2004

Year	Recipients of outdoor relief		Recipients of outdoor relief aged 15-65		Recipients of outdoor relief aged 15-65 registered as unemployed		Recipients of outdoor relief aged 15-65 in employment	
	No. in 1000 (% of popul.)		No. in 1000 (% pop.)		No. (1000)	% of col. 3	No. (1000)	% of col. 3
1970	698.0	(1.1)						
1980	1254.0	(2.0)						
1985	1987.0	(3.3)						
1990	2781.0	(4.4)	1083.0	(1.7)				
1994	2258.0	(2.8)	1307.8	(1.6)	319.3	24.4	89.5	6.8
1995	2516.0	(3.1)	1511.6	(1.8)	466.7	30.9	109.2	7.2
1996	2689.0	(3.3)	1645.1	(2.0)	580.5	35.3	121.4	7.4
1997	2893.0	(3.5)	1782.1	(2.2)	702.5	39.4	137.5	7.7
1998	2879.0	(3.5)	1766.4	(2.2)	709.3	40.2	148.6	8.4
1999	2792.0	(3.4)	1701.0	(2.1)	690.3	40.6	150.2	8.8
2000	2677.0	(3.3)	1620.0	(2.0)	644.2	39.8	146.1	9.0
2001	2699.0	(3.3)	1632.2	(2.0)	682.5	41.8	142.1	8.7
2002	2757.0	(3.3)	1681.4	(2.0)	732.1	43.5	143.4	8.5
2003	2816.0	(3.4)	1779.9	(2.2)	836.4	47.0	147.1	8.3
2004	2910.0	(3.5)	1867.1	(2.3)	930.4	49.8	149.4	8.0

Sources: Statistisches Taschenbuch and Statistisches Jahrbuch (various volumes), data in columns 3 and 4 provided by the Statistisches Bundesamt via email.

The new call for reforms combined with earlier attempts to boost employment and to abandon the German tradition of well-paid jobs for insiders who were protected by employment regulation laws and by the union strategy to curb labour supply. Traditionally, the German model combined rather high and equal wages for those who were in employment with a low rate of female employment, with a comparatively small low-wage sector and with widespread early retirement. The strategy of labor shedding became unsustainable, however, as the increasing social insurance contributions drove a growing wedge between gross and net earnings that made especially low-skill labor increasingly unattractive for employers and employees who

paid the social insurance contributions. When mounting unemployment combined with growing demographic imbalances in the pension insurance scheme and with the crisis of public finances following unification, there was widespread consensus that Germany needed labor market reforms that would increase the employment rate.⁵ The christian-liberal coalition governments under chancellor Kohl initiated a series of de-regulating labour market reforms which facilitated access to non-standard forms of employment in the low-wage sector and aimed at making work more attractive by allowing the recipients of social assistance relief to have growing proportions of earnings from work disregarded in the calculation of their benefit entitlements (for summaries of the early reforms see Alber 2003; Breyer 2002; Eichhorst and Marx 2011).⁶

When the red-green coalition government came to power in 1998, chancellor Schröder continued this reform path by stressing the importance of labour market reforms that would lower the burden of social insurance contributions, strengthen individual responsibility and would transform the social security system from a potential inactivity trap to an enabling springboard with extended education and training programs (Presse- und Informationsamt der Bundesregierung 1998: 12, 25, 26). Schröder's new "agenda 2010" met with widespread resistance among the German Left, and eventually led to the break-up of the Social Democratic Party, as some of the left wingers decided to split away and to form a new party. After a merger with the post-communist left in East Germany, the new party adopted the name "Die Linke" which cleared the 5 % threshold of German electoral law in several elections. The split-up has made it much more difficult for the social democrats to win elections or to form coalition governments.

The reform path of Schröder's red-green coalition government was smoothed by two factors, however. First, the new intentions were perfectly in line with the Lisbon agenda of the European Union which had declared the goal to raise the European employment rate (of the population at working age 15-65) to 70 % by 2010 as the cornerstone of its agenda for growth and competitiveness. Second, the so-

⁵ Norbert Blüm, the former Christian democratic minister of labour once captured the new spirit in the line: "Better to be temporarily employed than to be in permanent unemployment." However, one should not underestimate the flexibility of the German labour market. In 2009, an annual average of 3.4 mio people were unemployed, but there were 9.2 mio entries into and 9.0 mio exits from unemployment, so that there is a rather permanent come and go (Bundesagentur für Arbeit Jahresrückblick 2009: 21).

⁶ In the old social assistance scheme, the standard rate for economically active recipients was increased by one fifth, because people in employment were deemed to have additional work-related expenses so that 20 % of the standard rate could be earned without limiting the claim (*Mehrbemerkungszuschlag*). Legislation of the 1990s then introduced a new "deductible" (*Absetzbetrag*) of 25 % of the standard rate, and it added the right to keep 15 % of additional earnings up to an undefined reasonable limit. In practice, this meant that a single social assistance recipient could receive the standard rate of 280€ in 2001, augmented by one fourth of 70 €, and a further 15 % of additional earnings of 467 € so that a total of 140€ could be earned in addition to the standard rate (Breyer 2002: 209; see also Koch, Kupka and Steinke 2009: 35-36).

called “placement scandal” (*Vermittlungsskandal*) of 2002 had opened a window of opportunity for reforms that would depart from the German tradition of tripartite corporatism in social programs.⁷ Schröder used the opportunity to propagate a reform for which an independent commission under the leadership of Peter Hartz, a former VW manager, would develop the blueprint. The commission’s work finally resulted in four acts called Hartz I to Hartz IV (see table 3). The last one – Hartz IV – went into effect in 2005 and overhauled the German system of unemployment compensation and of social assistance.⁸

Table 3: The single components of the Hartz reforms

	Subject	Year of legislation	In effect
Hartz I	De-regulating employment contracts (e.g. facilitating agency work and temporary employment)	2002	2003
Hartz II	Reforming and facilitating minor employment (mini and midi jobs)	2002	2003
Hartz III	Reorganisation of the Federal Employment Agency (from office with tripartite boards to agency with more hierarchic structure)	2003	2004
Hartz IV	Unifying unemployment assistance and social assistance into one comprehensive outdoor relief scheme for able-bodied persons and their household members (with one-stop local job centres)	2004	2005

The basic goal of the Hartz reforms was to boost the German employment rate and to unburden the state by strengthening individual responsibility. To pursue these goals the reforms instituted six new key principles:

⁷ In 2002, the Federal Audit Office (*Bundesrechnungshof*) disclosed that the Federal Employment Office (*Bundesanstalt für Arbeit*) had falsified placement statistics in order to report higher activity levels (see Hassel and Schiller 2010: 17; 216f.)

⁸ For summaries see Kemmerling and Bruttel (2006); Hinrichs (2007); Dingeldey (2010); Eichhorst and Marx (2011), as well as the book by Hassel and Schiller (2010).

- (1) Unite the formerly separate unemployment assistance and social assistance programs into one unified new cash assistance scheme for all able-bodied beneficiaries at working age under the umbrella of a common legislation (*Sozialgesetzbuch II*) and with one joint administration (*Arge*, i.e. joint job centres uniting the local employment agencies as a subdivision of the federal employment agency with the local or municipal social assistance offices).
- (2) Limit the principle of earnings-related benefits to the unemployment insurance benefit of limited duration, which is now called unemployment benefit I (*Arbeitslosengeld I*).
- (3) Make the new unemployment assistance benefit – now called unemployment benefit II (*“Arbeitslosengeld II”*) – a flat rate benefit aiming at the guarantee of a minimum income rather than an earnings-related benefit aiming at some degree of status preservation also for the long-term unemployed.
- (4) Strengthen the obligation of able-bodied beneficiaries to make use of their earnings power, but combine demanding pressures to actively seek work with enabling supports that facilitate the task of finding a job; this was called the new dual principle of “challenging and promoting” – *Fordern und fördern* – and required a better staffing of the employment offices.
- (5) Make work pay, by allowing to combine earnings from work with the receipt of means-tested benefits to a much higher degree than previously.
- (6) Re-organize the Federal Employment Office in order to make it more effective by shifting from tripartite administrative boards to a new more hierarchic management structure with a chief CEO and a management board appointed for five years on top of the agency.

The next sections describe how the new system works in practice.

1.2 How the new system functions for people inside and outside of the labour force: An overview

The Hartz reform unburdened the social assistance scheme because it united all forms of public assistance to able-bodied people at working age under the roof of the new unemployment benefit II. Having become only responsible for people outside the labour force, the social assistance scheme declined in relative importance. Unburdened of the responsibility to care for new standard risks such as long-term care, asylum seekers or long-term unemployment, the program came closer to being the scheme of last resort for people in extra-ordinary circumstances that it was

once designed to be. Its share in total social spending decreased from a peak of 5 % in 1995 to 3.2 % in 2008.⁹ The number of recipients receiving the standard benefit (*HLU* inside or outside of institutions) declined from 2.9 million in 2004 to 325,000 in 2008 (Statistisches Jahrbuch 2007: 213; Statistisches Jahrbuch 2010: 219).

A law passed in 2001 (in effect in 2003) introduced a new special right to a minimum income for elderly or handicapped people (*Grundsicherung im Alter*). Elderly people above age 65 as well as handicapped people became entitled to a means-tested benefit corresponding to the level of the full social assistance benefit (plus 15 % for special one-time needs plus the appropriate cost of housing and heating). In contrast to social assistance, the parents or children of the claimant were exempted from the legal obligation to support even if living in a common household with the claimant.¹⁰ The new benefit is tax-financed and administered by the local authorities of districts and municipalities.¹¹ In 2005, the special old age support was incorporated into the general social assistance scheme, but the more favourable conditions regarding kins' obligations were preserved. Together with social assistance, the benefit is now regulated in the twelfth volume of the social law statute (*Sozialgesetzbuch XII*). At the end of 2008 768,000 people were in receipt of the special minimum income benefit, among them 410,000 elderly people above age 65 (Statistisches Jahrbuch 2010: 219). Expenditure amounted 3.8 bio € in 2008 corresponding to roughly 17 % of the total social assistance outlays (Ibid.: 220).

For people inside the labour force, the Hartz IV reform left the unemployment insurance benefit basically unchanged, but renamed it to "*unemployment benefit I*". The benefit level has remained uncurbed, amounting to 67 % of previous net earnings for those with dependent children and to 60 % for individuals without family duties. Financed from social insurance contributions, the duration of the benefit continues to vary with the length of the contribution record and with the age of the recipient. The reforms limited the maximum duration to 12 months for those under 50 years of age (with a peak of 24 months for those over age 58 with long contribution records).¹² As a result of these limitations, the number of recipients of unemployment benefit I fell below the level of one million in recent years, and is now clearly surpassed by the number of people who receive the means-tested unemployment as-

⁹ These numbers are taken from the German Sozialbericht; including the outlays of the special scheme for asylum seekers, they deviate somewhat from the data in table 1 above; sources: Sozialbericht 2001: 27-28; Statistisches Jahrbuch 2010: 203-204.

¹⁰ Kins living in the same household are obliged to render support if their annual income exceeds 100,000 €, but the standard assumption under the law is that this limit is not surpassed.

¹¹ The federal government compensates the single states for increases in expenditures related to the new law (Sozialbericht 2001).

¹² Originally limited to 18 months for those age 55 and older but upgraded for older workers in 2008.

sistance benefit which is now called *unemployment benefit II* (see section 2.2 below for more details on recipients).¹³

The new *unemployment benefit II* is for all able-bodied people at working age who have never acquired or else exhausted a claim to the insurance benefit. It is a flat rate benefit which varies with household size and is paid at the same rates as the social assistance benefits for those who are not considered capable of work. As we will see below, it is practically on par with the old social assistance rates. This implies that it is less generous than the old earnings-related unemployment assistance benefit for most people. Transforming the old benefit into a new means-tested flat rate benefit has put especially middle class families under strain and under growing work pressure, because the new benefit is merely designed to secure a minimum standard of living. For middle class earners whose former salaries had been above average this meant that they had to adapt to a sizable income decline once their unemployment insurance benefit was exhausted. For a transition period, there was, however, a special increase (*Zuschlag*), which was payable for a maximum of two years and designed to smooth the transition from the higher earnings-related to the lower flat rate benefit.¹⁴

For all able-bodied residents who exhausted the claim to unemployment insurance benefits after 12 months the obligation to work was enhanced. The duty to report regularly at the job centres was strengthened and the definition of “suitable” job offers was made much more stringent as claimants were now obliged to accept any work offer even if it does not match their skill level, if the level of pay is low or if the place of work is far away from the place of residence (§ 10 SGB II).¹⁵ The stricter demands on activation also meant that the system of sanctions in the case of a failure to observe reporting duties or to accept a suitable job offer was tightened and further developed (see section 2.3 below).

While various new demands and challenges aimed at pushing benefit recipients into the labour market, there was also a new set of instruments designed to promote their employability and to pull them into work. The personal situation of job-seekers is now assessed through interviews or questionnaires trying to determine how skills match job offers (“profiling” – see Kemmerling and Bruttel 2006: 94). Every jobseeker who is unemployed for more than six weeks is entitled to a place–

¹³ In December 2010 there were 874,000 recipients of unemployment benefit I, among them 765,000 or 88 % officially registered as unemployed (Bundesagentur Monatsbericht Dezember und Jahr 2010: 36). Recipients not counted as unemployed may be participants of educational training courses or other activities (*Maßnahmen*) or be temporarily unfit for work and hence not registered as seeking a job.

¹⁴ This transitional benefit was halved after one year and initially limited to a maximum of 160 € for singles and 320 € for couples (with an additional maximum of 60 € per dependent child). It was based on § 24 SGB II but expired at the end of 2010.

¹⁵ Exemptions are only possible for claimants engaged in family care for children under three or family members in need of care (see also the criteria of suitability for recipients of unemployment insurance benefits in SGB III §§ 38 and 121).

ment voucher through which he can hire a private placement agency to find a job offer (Ibid.: 95). To improve the guidance and counselling of the job seekers, the personnel of the job centres was to be augmented so that the staff ratios stipulated by the law would be realized. The law recommended staff-client ratios of 1:75 for clients under age 25 and of 1:150 for those above this age.¹⁶

1.3 The impact of the reform on aggregate welfare spending

During the 1990s the unemployment compensation schemes and the social assistance scheme together spent around 16 % of the social budget of the Federal Republic and around 4.5–5.0 % of GDP. Exact comparisons of the spending patterns over time are not possible, because the official social budget published by the Ministry of Labour and Social Affairs fails to give annual data, whereas the social budget data published in the statistical yearbook are not identical with those published by the Ministry. Comparable data for 1995 and 2005 indicate, however, that the reform did not lead to any massive aggregate savings, as the share of the combined schemes in the social budget reached a peak of 17.4 % in 2005, corresponding to 5.0 % of GDP. Since then, and mostly due to decreases in unemployment, these expenditure shares have gone down to 14.2 % and 4.1 % respectively in 2008. The outstanding feature of the reform in terms of spending patterns is that the relationship between the earnings-related unemployment insurance benefit and means-tested unemployment assistance benefits has been reversed. In 2000 the spending ratio was still 3.3:1 in favour of the former (in 1990 even 4:1), but after the reform it was 1.3:1 in favour of the latter (in 2006 as well as in 2008).¹⁷ Thus, the German unemployment compensation system has seen a significant shift from fairly universal insurance coverage to a more selective targeted approach.

¹⁶ *Sozialgesetzbuch II, § 44c*. These targets were not met in practice, and the nation-wide averages conceal vast regional variations. A government answer to a parliamentary interrogation in 2010 named average ratios of 1:85 for those under age 25, and of 1:157 for those above the age limit (*Bundestagsdrucksache* 17/2892 p. 44; see also *Bundestagsdrucksache* 16/5837 on the situation in 2007).

¹⁷ Calculated on the basis of the social budget (*Sozialbericht* 2009, and *Statistisches Jahrbuch* 2010).

2 An analysis of how the reform works in practice for the clients

2.1 Benefit levels and benefit package

Whereas the benefit level remained virtually unchanged for the recipients of the insurance-based unemployment benefit I, there was a major change for those depending on the new means-tested unemployment benefit II (which is also called “Hartz IV”). As a rule of thumb, the new benefit is more stringent than the old unemployment assistance benefit, but it is roughly comparable to the rates of the old social assistance scheme. Table 4 shows how the rates developed before and after the Hartz reform. Compared to average net wages, the standard rate for single persons has maintained a fairly stable relationship to average net earnings in the 1990s, fluctuating around a level of 20 %. This implies, however, that there have been occasional setbacks in the purchasing power of the benefit. The increase in 2005 – the year of the implementation of the reform – is more apparent than real, because it is due to the fact that one-time benefits that used to be paid on special occasions in addition to the social assistance standard benefit, were now incorporated into the standard rate.¹⁸ As experts estimated the special benefits to amount to some 16 % of the standard rate of the old system, a realistic comparison over time would either augment the old benefits by 16 % or reduce the new ones by this margin. It then becomes evident that the reform actually brought a decrease in the purchasing power of the benefits. As in the old social assistance scheme children and other dependent members of the household who are ineligible for work are also entitled to benefits. These benefits for children and dependents are called “social allowance” (*Sozialgeld*).

¹⁸ The old social assistance system provided special benefits (*einmalige Leistungen*) for the purchase of necessary new goods such as clothes or the replacement of broken refrigerators which were estimated to amount to 16 % of the standard rate. It was also estimated that a need for such benefits arises after one year at the latest. This implies that the integration of special benefits into the standard rate was to the advantage of those with short benefit spells, but to the disadvantage of those with longer spells and recurrent needs for major new purchases.

Table 4: The development of the standard rate of the social assistance and unemployment benefit II (excluding housing costs; in current and constant prices, and as percent of average net earnings)

	Standard rate (in current prices – €)	Standard rate (in constant prices – €)	Standard rate as % of average net earnings
1970	75	163	16.5
1980	159	251	17.6
1985	189	285	18.7
1990	223	277	18.5
1994	265	297	20.5
1995	267	293	20.5
1996	266	288	20.5
1997	269	288	21.0
1998	272	301	20.9
1999	274	302	20.7
2000	277	300	20.5
2001	280	297	20.1
2002	285	298	20.2
2003	290	301	20.4
2004	291	296	20.0
2005	340 (286)	334 (281)	23.3 (19.6)
2006	340 (286)	329 (277)	23.4 (19.6)
2007	347 (291)	337 (283)	23.5 (19.7)
2008	351 (295)	339 (285)	23.4 (19.7)
2009	359 (302)		24.1 (20.3)
2010	364 (306)		

Sources: Statistisches Taschenbuch 2010 (table 8.13A), deflated with the consumer price index in 2000 prices, Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung (2010).

In 2010 the German Constitutional Court ruled that the rates of the unemployment benefit II were calculated in too schematic a fashion and would have to take the special needs of recipients, above all the special needs of children, more specifically into account. Up to the Court's decision, the children's benefits varied with age and were similarly calculated as a percentage of the standard rate for adults as the rates

for children in the old social assistance scheme.¹⁹ Now the children's rates cannot be simply expressed as proportions of the benefits for adults any more, but must depart from an empirical analysis of the special needs of children at various stages of development. In response to the Court's decision, the rates for adults were raised moderately in 2011, whereas a special educational component was introduced for children. The universal child allowance to which every German child is entitled is deducted from the targeted child benefit entitlement that is presumed to cover all needs.²⁰

Similar to the old social assistance benefit, the new unemployment benefit II can also be used to augment insufficient earnings from work or insufficient earnings-related unemployment benefits I which do not reach the level of entitlement of the flat rate scheme.²¹ People who receive such a supplement are called "augmenters" (*Aufstocker*). In the old social assistance scheme, around 150,000 people were registered as receiving outdoor relief benefits in addition to being in employment prior to the reform (see table 2 above).²² Following the reform, the number of augmenters rapidly grew from an annual average of 878,000 to 1.4 mio in 2010.²³ As the Federal Employment Agency notes, the latter figure corresponded to 29 % of all unemployment II beneficiaries who are capable of work, and who bring their combined income from work and transfers to a level which is distinctly above the mere standard benefit rate.

It was a key concern of the Hartz reforms to augment earnings disregards in the calculation of benefit entitlements so that income from work could be increasingly combined with the receipt of selective benefits.²⁴ The old social assistance scheme had left much to administrative discretion, but as a rule of thumb about 150€ could be earned in addition to the assistance benefit shortly before the old system ended (Koch, Kupka and Steinke 2009: 315). After an early 2005 amendment immediately following the reform, the situation was as follows:

¹⁹ However, the reform had lowered the rates for children above age six. Parents with low income under an income threshold who do not receive Hartz IV or unemployment benefits II can claim a child allowance increment of 140 € per child and month (*Kinderzuschlag*, introduced as part of the Hartz-IV reform in 2005 – § 6a Bundeskindergeldgesetz).

²⁰ In the old social assistance scheme there was also a disregard of 10,25 € of the child allowance per child, but this disregard was abolished with the Hartz IV reform.

²¹ In December 2010 there were 96,000 persons who augmented their unemployment benefits I with the additional receipt of unemployment benefits II (Bundesagentur Monatsbericht Dezember 2010: 35).

²² It remains to be clarified how the number of employed HLU-recipients relates to the number of people in *Arbeitsgelegenheiten*.

²³ Bruckmeier, Graf, Rudolph 2008: 17; Bundesagentur für Arbeit Monatsbericht Dezember und Jahr 2010: 38; see also table 10 in section 3.1.

²⁴ In addition to the increment for dependently employed wage earners there are a number of other in-work benefits. The most notable one among them is a subsidy supporting start-ups of unemployed people moving into self-employment (*Existenzgründungszuschuss* and *Überbrückungsgeld*, now united in the new *Gründungszuschuss* – Caliendo et al. 2007).

- The unemployment benefit II amounted to 340 € (standard rate without housing increments which is around 360 € for singles – Sinn, Geis, and Holzner 2009).
- An additional 100 € could be earned without any deductions.
- For further earnings between 100-800 € there was an earnings disregard of 20 %, corresponding to a maximum of 140 €. ²⁵
- For earnings between 800-1200 € 10 % were disregarded, corresponding to a maximum of 40 €. The ceiling was moved to 1500 € for parents with dependent children. ²⁶
- Earnings exceeding 1200 € (or 1500€ for parents) were completely deducted from the benefit and hence not compatible with the receipt of benefits.

The maximum income that can be drawn in addition to the benefit was thus 100 + 140 + 40 €, or 280 € altogether (or 310 € for parents in charge of minors). ²⁷ This implies that persons earning more than 150 € – the old informal threshold of the earnings disregard in the former social assistance scheme – were now among the winners of the reform. It also means that a single living person combining income from work with the unemployment benefit II could increase the benefit amount from 700 € (340 for the standard rate plus 360 € for the cost of housing) to 980 €, which corresponds to an increase of 40 %. The following table shows how this compared to average earnings and to the 60 % at-risk-of-poverty threshold used by Eurostat and German official statistics for the measurement of relative income poverty in 2005. ²⁸

Analyses of the standard of living of recipients of the new basic income support can now be based on the panel on labour market and social security (*PASS – Panel Arbeitsmarkt und soziale Sicherung*). ²⁹ First studies on this basis came to the conclusion that the new minimum income is usually sufficient to guarantee the possession of basic goods such as renting an apartment with a bath and central heating, or owning a washing machine or a freezer, as between 70–90 % (depending on the item) of the Hartz IV clients declare to possess these items. An index measuring what proportion of the goods deemed as “absolutely necessary” by at least two thirds of the population is possessed showed Hartz IV clients to lack on average 6 % of these goods (as compared to 0.8 % among those not living on welfare). If the possession of all 26 goods on the list was analysed, Hartz IV recipients lacked 30 % of

²⁵ A 2011 amendment increased the ceiling to 1000 €.

²⁶ The new law changed the 10 % disregard range to 1000-1200€ (and left the upper ceiling for parents unchanged).

²⁷ In 2011 changed to 100 + 180 + 20 = 300 € (see § 11b Sozialgesetzbuch Zweites Buch).

²⁸ Source for poverty threshold: SOEP Monitor; for net earnings: Statistisches Taschenbuch 2010: Table 1.14. for housing costs: Sinn, Geis, and Holzner. 2009: 25.

²⁹ First wave: 2007/07 with 18,954 persons in 12,794 households.

these goods, compared to 8 % among people who are not on welfare (Christoph 2008).

Table 5: The level of augmented benefits combining transfers with earnings in 2005

	Absol. amounts	% of poverty threshold	% of average net earnings
60 % poverty threshold	733 €	100	50.2
Average net earnings of dependent workers	1460 €	199	100
Unemployment benefit II (for singles incl. housing)	700 €	95.5	47.9
Incl. maximum earnings	980 €	133.7	67.1

A similar study of poverty among children showed that less than 3 % of the children living in families drawing Hartz IV benefits have to live without a set of basic goods including a warm meal per day, a heated flat with a bathroom, a toilet, a freezer, or a washing machine for financial reasons. Much higher proportions reported that they could not afford quality goods such as a computer with internet access (21 %), a sufficient number of rooms in the home (22 %), the regular purchase of new clothes (33 %), a car (47 %), having friends for dinner once a month (46 %), a monthly visit of the cinema, the theatre or a concert (55 %), going out for dinner once a month (73 %), having an annual vacation trip (78 %), or making monthly savings (80 %) (Lietzmann et al. 2011). In sum, basic needs seem to be met fairly well, but beyond that there is a measure of considerable material deprivation, and the participation in social and cultural life remains conspicuously limited.

2.2 Take-up rates and non-take up rates

For a long time throughout the 1970s to 1990s recipients of the higher earnings-related unemployment insurance benefit outnumbered the recipients of the unemployment assistance benefits by far. In 1990, for example, 65 % of all recipients of unemployment benefits received the higher insurance benefit. Since 2003 the relationship has been reversed, however (see table 6). Today, close to 90 % of all unemployed people are in receipt of some form of unemployment benefit, but among these the recipients of the unemployment benefit II providing only the minimum support account for about 70 % of all recipients. Hence, among the 2.9 million jobless recipients of unemployment benefits in 2010, only 880,000 received the earnings-related unemployment benefit I, whereas 2.1 million received the unemployment benefit II.³⁰

The unemployment benefit II is not only paid to unemployed people or able-bodied claimants at working age but also to their children and to other needy members sharing the household with them. Hence we have to distinguish between three groups of recipients:³¹

- recipients who are capable of work (4.731 mio. in Dec. 2010; 4.753 mio in April 2011);
- those among them who are registered as unemployed (roughly 41 % or 1.9 mio. in Dec. 2010; the 2.8 mio people drawing the benefit without being registered as unemployed include augmenters with insufficient earnings from employment (29 %), people participating in training programs, and people who are exempted from the obligation to actively seek work due to school attendance or due to family care duties);
- beneficiaries who are not capable of work (about 1.8 mio. or 27 % of the total 6.5 mio. beneficiaries in December 2010; more than 90 % of these are children under age 15).

³⁰ The official statistics on beneficiaries are difficult to compare over time, because definitions changed. In 2010, there were 1.024 million recipients of unemployment insurance benefits, among them 880,000 who were counted as unemployed. In the same year, 4.493 million people received the unemployment benefit II, with 2.069 among them counting as unemployed. The sum of unemployed recipients in both branches – 2.949 million – is not identical with the total of unemployment beneficiaries which are reported as 2.866 million recipients after the elimination of double counts (see Bundesagentur für Arbeit, 2011: Arbeitsmarkt in Deutschland – Zeitreihen bis 2010, Table 9.1).

³¹ Based on Bundesagentur für Arbeit Monatsbericht Dezember und Jahr 2010, and on Bundesagentur für Arbeit: Analyse der Grundsicherung für Arbeitsuchende.

In short, in December 2010 there were altogether 6.5 mio. recipients of unemployment benefit II, but only 4.7 mio. of these were deemed capable of work, and only 1.9 mio. among the latter were actually registered as unemployed.

Table 6: Unemployment and recipients of unemployment benefits in Germany

Year	Number of unemployed people (annual average in 1000)	Recipients of unemployment insurance benefits (as from 2005: ALG I)	Recipients of unemployment assistance benefits (as from 2005: ALG II)	Sum of beneficiaries*	Beneficiary ratio (recipients in column 4 as % of unemployed in column 1)
1970	149	96	17	(113)	(75.8)
1980	889	454	122	(576)	(64.8)
1985	2304	836	617	(1453)	(63.1)
1990	1883	799	433	(1232)	(65.4)
1994	3698	1989	988	2671	72.2
1995	3612	1851	1021	2618	72.5
1996	3965	2068	1149	2936	74.0
1997	4384	2241	1408	3310	75.5
1998	4281	1987	1504	3190	74.5
1999	4100	1829	1495	3031	73.9
2000	3990	1695	1457	2856	71.6
2001	3853	1725	1477	2869	74.5
2002	4061	1899	1692	3180	78.3
2003	4377	1919	1994	3450	78.8
2004	4381	1845	2194	3477	79.4
2005	4861	1728	4982	4016	82.6
2006	4487	1445	5392	3684	82.1
2007	3760	1080	5277	3121	83.0
2008	3258	917	5010	2800	85.9
2009	3414	1141	4908	3012	88.2
2010	3238	1024	4893	2866	88.5

* Not identical with the sum of columns 2 and 3, because of elimination of double counts and referring exclusively to beneficiaries who are registered as unemployed

Source: Statistisches Taschenbuch (various volumes), Bundesagentur für Arbeit (2009): *Analytikreport der Statistik. Arbeitsmarkt in Deutschland. Zeitreihen bis 2007*, Table 8.1.

When the Hartz reform went into effect in 2005, the number of recipients of the unemployment benefit II who were capable of work (roughly 5 million in 2005) was almost one million higher than what might have been expected on the basis of the sum of the number of previous recipients of unemployment assistance (2.2 mio) and of the recipients of outdoor relief at working age (1.9 mio). The conspicuous increase – which has been called “the Hartz IV effect” – received much attention among poverty researchers and journalists alike. Basically it is due to two factors. First, able-bodied family members at working-age were now counted among the beneficiaries in addition to the family head claiming the unemployment benefit. Secondly, it is assumed that more eligible people made a claim after the reform. This leads us to the question of how benefit take-up and non-take up developed.

While the media tend to focus on stories of benefit abuse, a recurrent result of German poverty research is that there are rather high non-take up rates of means-tested benefits. For the old social assistance scheme a rule of thumb used to be that only about half of those who were entitled to a benefit actually made a claim. In other words, for every beneficiary there was another one who would have been eligible but who chose not to claim benefits. To denote this phenomenon, the early German poverty research spoke of “hidden” or “bashful” poverty (Hauser, Cremer-Schäfer, Nouvertné 1981, Hartmann 1985). More recent research on the situation before the Hartz reform arrived at non-take-up estimates of between around one half and two thirds (Frick and Groh-Samberg 2007).³²

The magnitude of non take-up around the reform was the subject of two studies. Based on 2004 data from the German social-economic panel (GSOEP) just before the reform, Becker (2007) found non-take-up to be a particular problem of the working poor. She estimated the size of the working poor not drawing benefits despite a legal entitlement to be three times higher than the actual number of augmenters who combine earnings from work with the unemployment benefit II. Based on more recent editions of the same data set, Bruckmeier and Wiemers (2011) found non-take-up rates of 49 % in 2005, of 42 % in 2006, and of 41 % in 2007. The authors interpret the decline as an indication that German households needed some time to adapt to the new benefit system, and they conclude that the Hartz reform actually led to a significant reduction in the non-take-up of minimum income guarantees.

A remarkable conceptual change among German poverty researchers is worth noting. What used to be called hidden or bashful poverty in the 1970s and 1980s, is now called “rational poverty”. The new concept is used to denote a situation where the costs of claiming benefits are too high compared to the potential advantage of receiving them (Riphahn 2001). This implies that predominantly those households which are just below the eligibility threshold abstain from making a claim, and that the higher the monetary benefit is likely to be, the higher is the probability of benefit take-up (Bruckmeier and Wiemers 2011: 18).

³² Their calculations showed 43 % for 1999, 63 % for 1999, and 67 % for 2002.

2.3 Sanctions and benefit abuse

Whereas poverty researchers have recurrently drawn attention to the remarkable frequency of non-take up, public debates focussed more on the issue of benefit abuse. Data on benefit abuse are hard to come by and must be based on administrative statistics on sanctions. A key feature of the Hartz reforms was to combine enabling forms of assistance in training and job search with stricter controls that would activate the unemployed and eventually push them into work. Comparisons of the number and proportions of people who were sanctioned before and after the reforms are impeded by the fact that the old social assistance scheme did not produce any routine data on the frequency and type of sanctions, whilst the administrative data on the working of the unemployment compensation schemes only reported jointly on the insurance and the assistance branches together. In contrast, the new data on sanctions after the reform refer separately to the unemployment benefits I and II.

In the unemployment compensation system, disqualification periods used to be the major sanctioning instrument. Originally, a disqualification period could be imposed for three reasons: (1) voluntary unemployment; (2) declining a suitable job offer; (3) abandoning participation in a qualifying training program of active labour market policy. The Hartz reforms added three more reasons in 2005 and 2006: a) insufficient search for work; b) failure to report sufficiently to the job office (*Meldeversäumnis*); c) delay to register as unemployed.³³ The latter reason recently came to prominence because employees and apprentices are obliged since 2006 to register as unemployed three months prior to the termination of an employment contract. In case they forget or postpone to do this, they are sanctioned by a disqualification period. The maximum duration of the disqualification used to be four weeks up to the 1980s, but successive steps of legislation extended the maximum to twelve weeks in the 1990s (Wilke 2004: 48). By 2003, 12 weeks had become the normal duration.

The Hartz reforms replaced the uniform standard duration by a more flexible system of specific graded sanctions. Voluntary unemployment still results in a disqualification period of twelve weeks. In the cases of the decline of a job offer or a refusal to participate in a job integration measure, there are now stepwise increases in the disqualification periods which amount to three weeks for the first sanction, six weeks for the second one, and twelve weeks for the third one. Cumulative disqualification periods of 21 weeks result in the complete termination of benefits (before: 24 weeks). This implies that a third imposed disqualification period now leads to the complete loss of benefits (before: the second one – Müller and Oschmiansky

³³ See Bundesagentur für Arbeit, 2006: Arbeitsmarkt 2005, p. 102, and Bundesagentur für Arbeit, 2010: Arbeitsmarkt 2009, p. 46.

2006: 30). The Hartz reforms also reversed the burden of proof in relation to good reasons that may justify leaving a job or declining an offer: now it is up to the unemployed person to provide evidence for the existence of a sufficient reason (rather than to the job centre to prove the opposite – Bundesagentur für Arbeit 2006: 102; Eichhorst et. al 2010: 90).

Table 7 shows how unemployment insurance sanctions have developed by volume and type since the 1990s. Data prior to the Hartz reforms refer to the joint statistics of the unemployment insurance and unemployment assistance schemes together, whereas data since 2005 refer exclusively to the unemployment benefit I with insurance character. Hence comparisons over time are seriously impeded. The increase in sanctioning rates reported in the table is partly an artefact stemming from three facts. The first one has to do with the changing denominator. In the years before the reform, the number of beneficiaries referred to the unemployment insurance and assistance systems together, whereas after the reform the numbers in column I leave the much larger number of unemployment benefit II recipients out. Secondly, it would be more telling to relate the number of disqualifications – which is an annual flow figure of newly imposed disqualifications – to the number of annual entrants into unemployment rather than to the average annual stock of unemployed, especially because the delay in reporting unemployed has become such an important reason for sanctions. If the number of annual entrants into unemployment is taken as the denominator, the sanctioning rate drops to about one quarter, having developed as follows in the years 2006–2009: 18.0 – 25.0 – 28.5 – 26.3 % (Deutscher Bundestag Drucksache 17/1837, Table 4). The third reason is that not all imposed sanctions go uncontested and pass the test of judicial review. In 2009, 26,896 sanctions were revoked at least partly. Expressed as a proportion of all imposed sanctions (843.0 thousand), this corresponds to a repeal rate of roughly 3 %.

Expert studies came to the conclusion that the rate of sanctions has increased after the reforms. One study pointed out that tougher and more flexible sanctions were not only rooted in new legislative provisions but also in a new implementation culture that put more demands on the unemployed (Müller and Oschmiansky 2006: 30). As the duration of disqualifications has become more flexible, however, and since new types of disqualifications with only short sanctioning periods moved to the fore, it is unclear if the total volume of sanctions – defined as the product of the number of sanctions and their average duration – has increased also (Ibid.).³⁴

Regarding the reasons for sanctions, voluntary unemployment (defined as leaving a job without good reason) used to be the most important reason before the reforms (see table 7). In 1998 this cause accounted for more than 80 % of all imposed sanctions, a share that later declined to slightly over one half. After the reform the

³⁴ The federal Employment Agency does not publish data on the duration of the disqualification periods.

Table 7: Sanctions against the unemployed: 1998 – 2004 unemployment insurance benefit and unemployment assistance benefit recipients; 2005 – 2009 unemployment insurance benefit I only

Year	Recipients of unemployment benefit (total – yearly averages in thousand)										Complete termination of benefits – in thousand (in % of all sanctions)
				Reason for Sanction (in % of all sanctions)							
		No. of sanctions (in thousand	Sanction rate (sanctions as % of recipients of unemployment benefit)	Volunt. unemp.	Decline of a job offer	Insuffic. efforts to look for work	Not participating in job integration measure	Abandoning an integration measure	Failure to report	Delayed registering as unemployed	
1998	3,491.2	317.5	9.1	81.2	10.3	–	4.1	4.5	–	–	10.7 (3.4)
1999	3,323.4	337.0	10.1	78.9	11.6	–	4.2	5.3	–	–	14.7 (4.4)
2000	3,151.2	307.7	9.8	75.9	14.9	–	4.3	4.9	–	–	16.9 (5.5)
2001	3,202.0	309.0	9.7	75.2	17.0	–	3.4	4.4	–	–	17.1 (5.5)
2002	3,590.8	315.6	8.8	72.9	18.2	–	4.3	4.6	–	–	15.5 (4.9)
2003	3,913.5	423.8	10.8	56.2	36.0	–	4.1	3.7	–	–	12.0 (2.8)
2004	4,038.8	367.6	9.1	56.9	34.7	–	4.7	3.7	–	–	10.8 (2.9)
2005*	1,728.0	261.1**	(15.1)	43.9	10.2	1.6**	1.4	0.7	42.2	–	1.3** (0.5)
2006*	1,445.2	526.9	(36.5)	34.2	4.5	1.3	1.3	0.6	29.5	28.7	2.1 (0.4)
2007*	1,079.9	639.2	(59.2)	26.7	3.6	1.5	1.3	0.5	29.0	37.5	4.7 (0.7)
2008*	917.0	741.1	(80.8)	24.5	3.7	1.4	1.4	0.5	28.8	39.7	6.6 (0.9)
2009*	1,140.7	843.1	(73.9)	24.5	2.5	1.3	1.6	0.7	28.8	40.6	6.7 (0.8)

* Data refer only to recipients of unemployment benefit I not to recipients of the means-tested unemployment benefit II.

** Data only for May to December and without sanctions relating to delayed registering; in 2006: 241.7. Sources: Bundesagentur für Arbeit, 2011: Arbeitsmarkt in Deutschland – Zeitreihen bis 2010, Tab. 9.1, and Bundesagentur für Arbeit, 2010: Arbeitsmarkt 2009, Table IV.D.5, p. 108.

share went down to currently some 25 % (2009), because new reasons moved to the fore. Sanctions because of declining a suitable job offer increased considerably immediately after the reforms, roughly tripling from 57,000 in 2002 to 152,000 in 2003. In subsequent years, sanctions for this reason went down again, as the newly established reasons became more important.³⁵ The new cause “insufficient efforts to look for work” more than doubled in absolute numbers after 2005, but still plays a comparatively negligible role in relative terms. Sanctions because of a delay in reporting unemployed and because of insufficient reporting to the job centres now clearly predominate. Taken together these two sanctions now account for roughly two thirds of all imposed disqualifications.

Research based on microdata that would give additional insights into the determinants and effects of imposed sanctions is still in scarce supply.³⁶ Regarding the determinants of imposed sanctions, studies have come to the conclusion that younger people below age 25, low-skilled workers, and men are over-proportionately likely to draw sanctions (Müller and Oschmiansky 2006: 30). There is, however, considerable variation in the sanctioning practices of different job centres. Better-manned job centres with higher staff-client ratios tend to impose sanctions more frequently than more poorly equipped centres (Ibid.). The regional labour market also has an impact: Where unemployment is low, sanctions are imposed more frequently. The effect of imposed sanctions is poorly researched. One study concluded that sanctions have a positive effect on re-employment if they come at early phases of an unemployment spell, but that the positive effect vanishes after an unemployment duration of 15 months or more (Müller and Steiner 2008).

Data on the sanctioning practices of the local offices responsible for the administration of the social assistance scheme are not available. All we have is a number of voluntary surveys among the municipalities which chose to respond to occasional questionnaires. A 1996 reform of the social assistance scheme required the local offices administering the scheme to curtail the benefits for those who refuse a suitable job offer by at least 25 %. Probably as a consequence of this new pressure, the number of people pushed into assistance to work programs increased from some 20,000 in the early 1980s to above 400,000 by 2000 according to these surveys (see table 10 in section 3.1). Surveys for 2002 and 2004 reported that 15 % or 23 % of the claimants respectively had either refused suitable work, did not participate in work programs or had withdrawn their benefit application completely. The sanction rate for these two years was reported as 22 % and 12 % respectively (Fuchs and Troost 2003, 2004).

³⁵ If the new and frequently imposed sanctions for *failure to give notice* and for a *delay in registering unemployed* were ignored, the share of the sanctions for *declining a suitable job offer* would go up to about 10 % and hence roughly correspond to the levels prior to the reform.

³⁶ For a tabular summary of the results of available studies see the working paper by Wörz (2011).

The new unemployment benefit II introduced by the Hartz reform enacted new more specific sanctioning instruments which were tightened again in 2007. Since the new UB II scheme is also associated with a completely new routine regarding the recording of sanctions, it is not possible to draw comparisons with the sanctioning rate under the old social assistance scheme relying on voluntary surveys. Sanctions now apply if the unemployed does not sufficiently cooperate with the authorities, for example by not actively searching for work or by declining a suitable job offer. Sanctions are imposed flexibly. The first sanction reduces the standard rate of the benefit by 30 %, the second one reduces it by 60 %, and the third one denies the entire standard rate for a normal duration of three months.³⁷ As in the system of unemployment insurance (unemployment benefit I), there is also a set of milder sanctions with a 10 % cut of the standard rate in case of a failure to report sufficiently to the agency. Table 8 shows how sanctions developed since 2006. The rate of sanctions in effect at a certain day is rather low and never surpassed 3 %. The total number of annually imposed sanctions is much higher, however, and indicates a rather thorough supervision of claimants. The milder sanction for insufficient reporting is the predominant type, accounting for 57 % of all sanctions in 2009.³⁸

Table 8: Sanctions to the unemployed: recipients of unemployment benefit II

Year	Total no. of newly imposed sanctions (thousands)	No. of sanctions effective on a certain day (thousands)	No. of UB II recipients with at least one sanction (thousands)	Sanctions (column 3) in % of all UB II recipients capable of work
2006		139.5	103.6	2.0
2007	784.4	180.2	130.8	2.6
2008	764.9	163.7	131.4	2.7
2009	732.6	153.1	126.9	2.6

Source: Bundesagentur für Arbeit, 2010: Arbeitsmarkt 2009, p. 109.

Harsher sanctions apply to younger people below 25 years. In their case, the standard rate is cut totally already with the first sanction (for a maximum duration of three months). Food vouchers may be given instead, but there is no obligation to do so. In case of a repeated sanction, the entire benefit – i.e. including accommodation and heating – can be withdrawn. First evaluations arrived at the result that younger

³⁷ Bundesagentur für Arbeit, 2010: Arbeitsmarkt 2009, p. 46.

³⁸ Other sanctions were imposed because of the decline of a suitable job offer (100,659) because of not respecting integration pact agreements (128,733), and because of unspecified other reasons (86,755 – Bundesagentur für Arbeit 2010: Arbeitsmarkt 2009, p. 109).

people are not only sanctioned more harshly, but also more often, as the sanctioning rate of younger people below 25 years is three times higher than the one for older beneficiaries. One reason is that younger recipients are more intensively supervised by the employment agencies (Götz et al. 2010; Schreyer and Götz 2010). In sum, the Hartz reforms clearly combined novel forms of counselling and support with tougher activating pressures. The next sections examine what aggregate effects this complex compound of new measures had on the economy at large and on the working and nonworking poor who are in receipt of benefits.

3 The impact of the reform on employment, poverty and escape rates from poverty

3.1 Outcome indicators: The development of employment, unemployment, and relative income poverty and the emergence of the new working poor combining income from work with social transfers

The official German position – disseminated by the Federal Ministry of Labour as well as by the Federal Employment Agency – is that the Hartz reforms have successfully contributed to the recent turnaround in German labour market developments. The employment rate, which used to hover around 65 % – practically identical with the EU-15 mean – , has recently surpassed the target of 70 % defined by the EU Lisbon summit and is now (2009) five percentage points higher than the EU-15 average (see figure 1).³⁹ At the same time unemployment went down and long-term unemployment decreased considerably (see table 9).⁴⁰ The impressive growth of employment was not accompanied by shrinking income poverty rates, however. Indeed the poverty rate in German official statistics (based on the microcensus) has been rather stable hovering around 15 % in recent years.⁴¹ Part of the reason why relative income poverty rates remained stable is that the growth in employment was accompanied by a decrease in the number of quality jobs which are full-time and covered

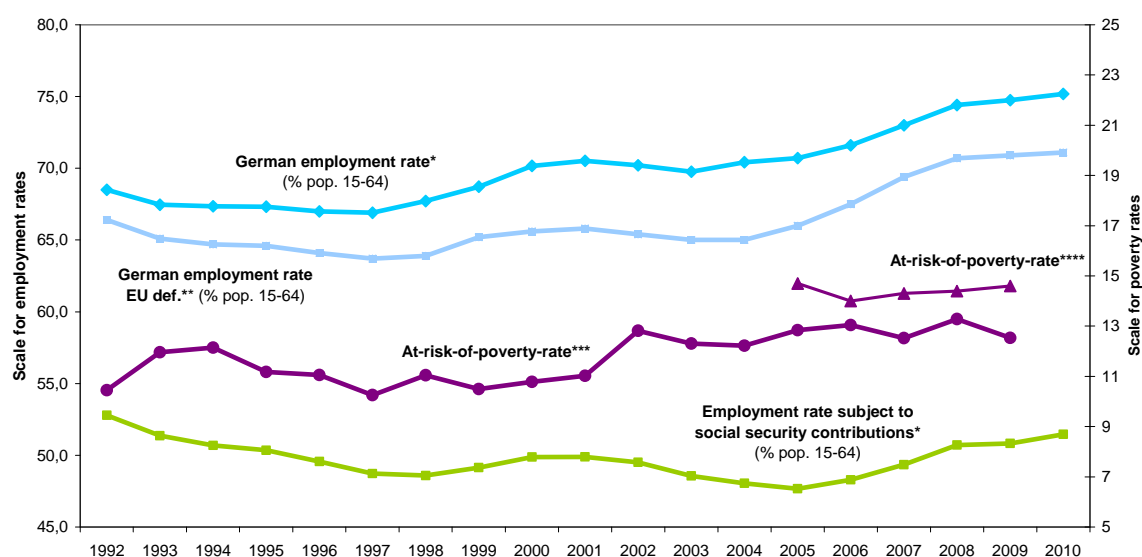
³⁹ This is based on the statistical annex in Employment in Europe 2010. Employment rates based on the figures for total employment in German official statistics would even be higher (and include people outside the age range 15-64).

⁴⁰ For unclarified reasons OECD data on long-term unemployment deviate considerably from the much lower German figures.

⁴¹ The relative income poverty rates based on the socio-economic panel and published by the DIW are based on smaller sample sizes and have recently been subject to considerable revision.

by social insurance. This form of so-called standard employment has fallen from 25.8 million jobs in 1992 to 22.1 million in 2009, a decrease of 14 %. Even including those in part-time employment, the number of jobs with social insurance coverage decreased by 1.6 million since 1992. Once corresponding to three quarters (77 %) of all jobs in 1992 (including the self-employed), jobs with compulsory social insurance coverage now account for only two thirds of all positions (68 % in 2010).

Figure 1: Employment, employment subject to social security contributions, and relative income poverty (60 % threshold) in Germany, 1992 -2010



Sources: *Federal Employment Agency 2010: Arbeitsmarkt in Deutschland. Zeitreihen bis 2009, Analytikreport der Statistik. **Eurostat: <http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&init=1&plugin=1&language=en&pcode=tsiem010>; ***Poverty rate: SOEP monitor 1984-2009 (based on monthly income), ****Mikrozensus www.amtlische-sozialberichterstattung.de

The widening gap between the total number of jobs and conventional standard jobs was closed by the growth of various forms of “non-standard” or “atypical” employment. As table 10 illustrates, these basically consist of six types with varying degrees of proximity to the traditional standard employment. It must be noted, however, that the various types reported in official statistics are not mutually exclusive, and thus do not add up to 100 % in the sense of a meaningful total number of atypical employment situations.⁴²

- First, there is a growing number of people who are covered by social insurance but only work *part-time*. Their number more than doubled since the early 1990s and is now above 5 million, corresponding to 13 % of all positions.

⁴² A recent estimate came to the conclusion that about one third of all dependent employment jobs are atypical if double counts are eliminated (Brehmer and Seifert 2008).

Table 9: The development of unemployment and long-term-unemployment, 1980–2010

	1980	1985	1990	1995	2000	2005	2010
Unemployment (in thousands)	889	2,304	1,883	3,612	3,890	4,861	3,238
Unemployment rate							
- % of labour force	3.3	8.2	6.4	9.4	9.6	11.7	7.7
- % of civilian dependent labour force	3.8	9.3	7.2	10.4	10.7	13.0	8.6
- (OECD unemployment rate: % of labour force 15–64)	(3.2)	(7.2)	(4.9)	(8.2)	(7.8)	(11.3)	(7.8)
Long-term unemployment in thousands	105	665	513	1,125	1,454	1,759	1,053
Long-term unemployment							
- % of unemployed	12.9	31.0	29.7	31.1	37.4	36.2	32.5
- (OECD: % of unemployed)		(48)	(47)	(49)	(51)	(53)	(46)
- % of labour force				2.9	3.6	4.2	2.5
- % of civilian dep. labour force				3.2	4.0	4.7	2.8
- (OECD: % of labour force 15–64)		(3.4)	(2.3)	(4.0)	(4.0)	(6.0)	(3.6)
Average duration in weeks*	27.5	49.9	57.2	58.1	66.9	63.4	56.9

Source: Bundesagentur für Arbeit: Arbeitslosigkeit im Zeitverlauf. Mai 2011, T 1.1. T 2.1; Bundesagentur für Arbeit: Arbeitsmarkt in Deutschland – Zeitreihen bis 2010. Tabelle 7.2; Amtliche Nachrichten der Bundesanstalt für Arbeit: Arbeitsmarkstatistik 1990 und 1986. Übersicht 42, eigene Berechnungen (Umrechnungsfaktor von Monaten in Wochen: 4.3); OECD: Incidence of unemployment by duration.

* Average duration based on duration among stock of unemployed rather than duration among leavers.

- Second, there is a fairly stable number of *temporary workers* with fixed-term contracts. These now correspond to roughly 7 % of total employment.⁴³
- Third, we find a growing segment of *agency workers*. Based on a number of deregulating steps in legislation – which extended the maximum length of assignments from originally 3 months, to 6, 12, and 24 months, until the Hartz reforms abolished the limitation completely –, the number of agency workers grew almost fivefold since 1995 and now amounts to more than 800,000. However, this is still only around 2 % of the total workforce.

⁴³ The proportion of fixed-term contracts is particularly high among young academics, where more than one third of those aged 20–30 have fixed-term contracts (Grau 2010).

- Fourth, more than 7 million people now work in so-called *mini-jobs* in which they cannot earn more than 400 € per month and in which they are only partly covered for purposes of social insurance. Since mini-jobs can be added to other forms of employment, the number of people relying exclusively on mini-jobs is smaller than the total number. Close to 5 million people work exclusively in mini-jobs, corresponding to 12 % of total employment.⁴⁴
- Fifth, there is the growing number of people who *augment* their low earnings with the unemployment benefit II following the Hartz reform. The roughly 1.4 million people with such an arrangement correspond to 3.4 % of all jobs.
- Finally, there are roughly 300,000 people whom the employment offices have *assigned* to participate in special works programs (designed to get them used to some labour force attachment). Since people working in such assigned jobs usually work for a maximum of 30 hours per week with a remuneration of around 1 € per hour, the term “One euro jobs” is frequently used.⁴⁵ Since similar programs had existed already before the Hartz reforms, their number has remained fairly stable during the past two decades.⁴⁶

Since the Hartz reforms aimed at activating the unemployed and at allowing new combinations of minimum income supports and earnings from work, the growth in the number of non-standard jobs can be regarded as an intended effect of the reforms. If the main intended effect was to boost the employment rate, an important side effect was that the low-wage sector – which used to be small in Germany in comparative perspective – has expanded considerably in recent years. The percentage of the employed population in the low-wage sector – defined as paying less than two thirds of the median annual wage – increased from 16 % in 1998 to 21.5 % ten years later. As Germany moved on par with the British level (21.2 %), Korea (25.4 %), the United States (24.5 %), and Canada (22.0 %) are the only countries left in OECD statistics with bigger low-wage sectors than Germany (OECD Database on Earnings Distribution).⁴⁷

⁴⁴ The Hartz II reform of 2003 also created an additional category of “midi-jobs” which pay 400-800€ per month and are subject to special social insurance contribution rules. How this category overlaps with the category of “*sozialversicherungspflichtig Beschäftigte*” in official statistics remains to be clarified.

⁴⁵ People with such assignments are not counted as unemployed, because they are considered to participate in special training programs (*Maßnahmen*).

⁴⁶ There were no regular official statistics on participants in the old social assistance. The respective information is based on voluntary surveys among the municipalities in which not all local communities participated.

⁴⁷ Kalina and Weinkopf (2008: 451) report a similar increase based on data of the German socio-economic panel from 15 % in 1995 to 22 % in 2006.

Table 10: Forms of non-standard employment in Germany (in thousands)

	2010	2005	2004	2000	1995	1990
Part-time jobs with social insurance coverage (<i>Sozialversicherungspflichtige Teilzeitstellen</i>)	5,389	4,364	4,311	3,929	3,459	2,396
Temporary workers with fixed-term contracts (<i>Befristet Beschäftigte</i>)	2,700 (08)	3,075	2,478	2,744	2,388	2,431 1991
Agency workers (<i>Leiharbeiter</i>)	806	453	400	339	176	
In minor employment (<i>Mini jobs</i>)						
- Exclusively with mini jobs	4,916	4,747	4,803	4,052		
- Total with mini jobs	7,310	6,492	6,466			
Augmenters combining work with unemployment benefit II (<i>Aufstocker</i>)	1,382	878	(149)	(146)	(109)	.
Public works (1 Euro Jobs) (<i>Arbeitsgelegenheiten</i>)	308	305	.	(403)	(200) 1996	(110) 1993

Sources (by rows): (1) Bundesagentur für Arbeit (Zeitreihen bis 2010); (2) Keller and Seifert, 2007: 13 + Grau, 2010; (3) Keller and Seifert, 2007; Mai, 2008; Bundesagentur für Arbeit (Januar 2011); (4) Bundesagentur für Arbeit (Zeitreihen bis 2010), and „Sozialpolitik aktuell“: Beschäftigte in Mini-Jobs 2003–2009; (5) Bundesagentur für Arbeit: (April 2011, September 2007) and Bruckmeier/Graf, 2008, + Table 2 above; (6) Bundesagentur für Arbeit (Förderstatistik); Sozialbericht 2001: 190; Lamping and Schridde, 1999; Alber, 2003.

Our own analyses based on the GSOEP confirm these developments.⁴⁸ The left graph in figure 2 demonstrates a substantial rise in low-wage employment in recent years.⁴⁹ In 2000, only 19 % of all employed persons earned less than two thirds the median hourly wage, but in 2009 this share had risen to 23 %.⁵⁰ If low pay is defined in terms of monthly rather than hourly earnings, the numbers are higher, but the overall trend is quite similar. Most of the increase in low pay occurred around 2005, the year when the fourth Hartz reform went into effect.

It is important to note that having a job in the low-wage sector does not necessarily imply joining the ranks of the working poor (as defined by the yardstick of relative income poverty). For three reasons earning a low wage and having to live from it are two separate shoes. *First*, low wages frequently serve as a supplement to other forms of income, because a considerable portion of all minor jobs is performed by pupils, students, or pensioners who do not have to live from the wage alone.⁵¹ *Second*, recipients of low wages frequently live in a joint household with other income earners so that their earnings represent only part of the household income. Recent research showed in fact that only half of all earners of low wages live without another earner in the household and that more than half of them live in households above the 60 % poverty threshold (Göbel, Krause and Schupp 2005). Other research showed only one third (35 %) of those who held atypical jobs to be single earners in households (Wingerter 2009: 1092).⁵² *Third*, as the growing number of augmenters shows, the state increasingly steps in to increase low wages with transfer income from the unemployment benefit II.

⁴⁸ For further information on the GSOEP, see Wagner et al. (2007).

⁴⁹ All of our analyses are restricted to individuals aged 20 to 55 who are not currently in education. Thus neither changing patterns of (early) retirement nor increasing rates of atypical employment among students affect our results. Individuals are classified as working if they self-report as being employed (full-time, part-time, or marginal employment) and also report positive labour earnings. Following the OECD definition, we consider earnings as low pay if the hourly wage (or monthly earnings) is less than two thirds of the median. The GSOEP provides two basic types of income information, the first one referring to current income (i.e. in the month of or prior to interview), the second one referring to annual income in the calendar year before the interview. A major advantage of the current income measures for our purposes is that they can be readily matched with other types of information (e.g. on working hours or household composition) which are available only for the month of the interview. However, information on current income is only available for labour and disposable income, but not for total market income which, in addition to labour income, includes income from private transfers and assets. Our analysis of poverty rates before and after government transfers and taxes in Section 3.2 therefore uses the annual income data.

⁵⁰ The aggregate proportions reported in the graph hide substantial differences by gender and between Western and Eastern Germany, with low pay being much more common among women and in the Eastern part of the country.

⁵¹ Vgl. Brenke, Karl and Johannes Ziemendorff, 2008: Hilfebedürftig trotz Arbeit? – kein Massenphänomen in Deutschland. DIW-Wochenbericht 75 (04), 2008: 33-40.

⁵² Atypical employment was here defined as consisting of the following categories: part-time work with less than 21 hours per week, mini or midi jobs, temporary work, or agency work.

Figure 2: Prevalence of low pay and in-work benefits



Source: GSOEP, own calculations. Total N= 91,563.

The growing share of augmenters is receiving a lot of attention in current German public debates where those on the political left argue that earnings from work should be sufficiently high to allow people to live independently from minimum income support. That the importance of augmenters has grown is not only revealed by the administrative data reported in the table above, but also reflected in the GSOEP data. As the right graph in figure 2 shows, the growth in low-wage employment went hand in hand with an increase in the proportion of workers drawing social benefits (either in the form of unemployment compensation – *ALG I* – or of means-tested benefits – *ALH*, *ALG II*, *HLU*). Among workers with low hourly wages, the share receiving public benefits more than quadrupled from roughly 4 % to a peak of 17 % in 2008. Among those with higher earnings, the share of benefit recipients also increased somewhat, but peaked at barely more than two % in 2007.

The question then is to what extent relative income poverty can be prevented by the new mix of earnings and in-work benefits and if the working poor themselves perceive the mounting pressure to be economically active predominantly as alienating controls or as a form of social inclusion and empowerment. These issues are dealt with in the last two sections.

3.2 Poverty among people inside and outside the labour market and the impact of public transfers

To what extent has the substantial growth of low-wage employment and of in-work benefits contributed to a reduction in income poverty? We probe into this issue by comparing the economic situation of workers with low earnings and of the non-working population with low incomes. Figure 3 displays the recent trends in pre- and post-transfer poverty rates for individuals who did not work at all in a given calendar year and for individuals who worked at least 7 months.⁵³ It shows that the non-working group faces much higher poverty risks than the working group both before and after taxes and transfers. Over time, poverty rates before transfers have risen for both groups.⁵⁴

A comparison of pre- and post-transfer poverty rates reveals that the taxes and transfers of the German welfare state lift many of those with low market incomes out of poverty, particularly those who are below the more stringent (40 and 50 %) poverty lines. However, one in five non-employed persons remains below the 50 % line, and one in ten is not even helped across the 40 % threshold by transfers.⁵⁵ The buffering effect of public transfers has weakened over time for the non-employed, while remaining stable or even increasing for members of the workforce. This may be illustrated by the figures for the 60 % threshold. Between 2000 and 2008, the poverty rate of non-working individuals' rose from 38 to 54 % before and from 25 to 41 % after transfers. This implies that the welfare state decreased the income poverty rate by 36 % in 2000, but by only 25 % in 2008.⁵⁶ By contrast, for working individuals, poverty before transfers rose from 5 to roughly 8 % between 2000 and 2008, while poverty after transfers rose from 4.5 to roughly 5 %. In their case the poverty-reducing effect of the welfare state amounted to only 10 % in 2000, but to

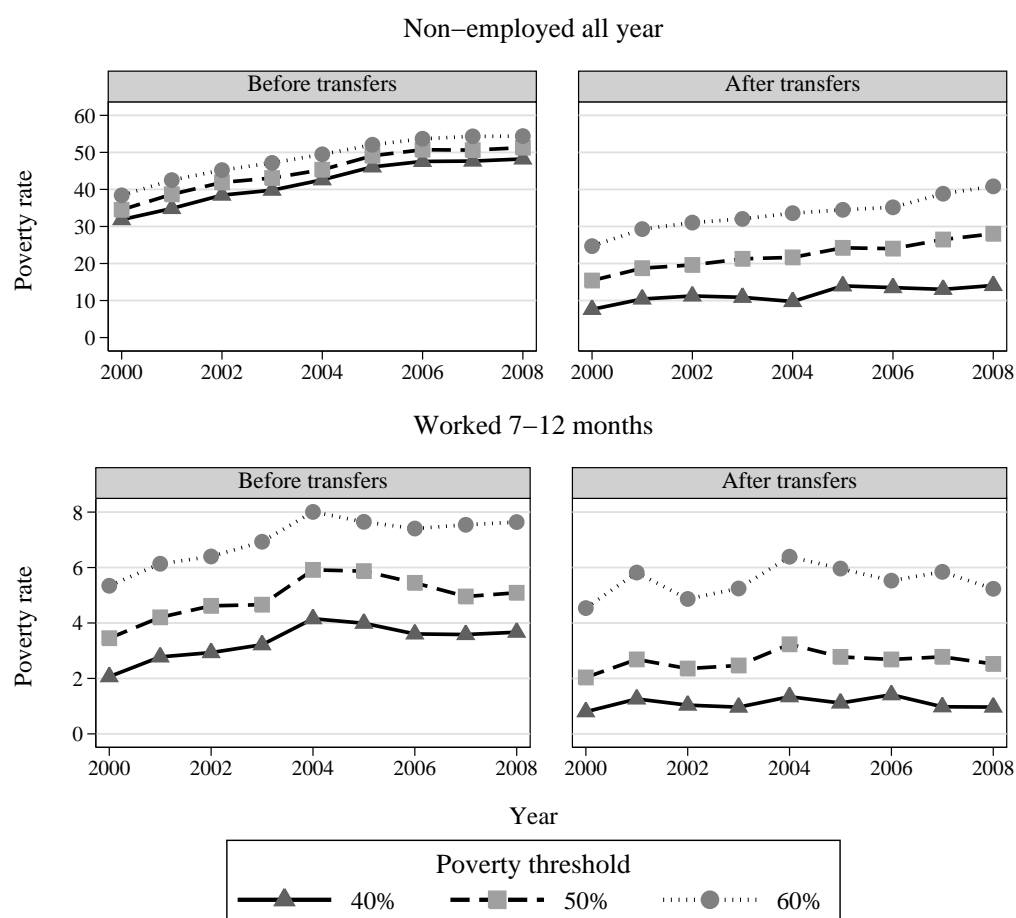
⁵³ As discussed above (see note 49), we use information on annual income rather than income at the time of interview for this analysis, because information about pre-transfer income is not available in the latter case. Hence we also adapted our definition of employment accordingly and now differentiate by the number of months an individual worked in a given calendar year. This results in somewhat fuzzier boundaries between our categories (because some individuals worked only part of the year), but ensures a better match between the employment and income measures. For reasons of space we here focus only on the two polar types, neglecting the intermediate group of people working between 1 and 6 months.

⁵⁴ Further analyses suggest that a sizeable portion of the increase for the non-working group is due to the fact that non-employed persons increasingly tend to live with a partner who is also not employed. Among employed persons, the rising incidence of low pay seems to be the main driver of growing pre-transfer poverty.

⁵⁵ It is presently unclear to what extent this may be related to the growing incidence of disqualification periods imposed by the job centres as sanctions.

⁵⁶ Taking 2001 – rather than 2000 when post-transfer poverty was quite low – as the baseline, one still finds an increase from 43 to 54 % before transfers and an increase from 29 to 41 % after transfers.

Figure 3: Poverty rates before and after public transfers and taxes



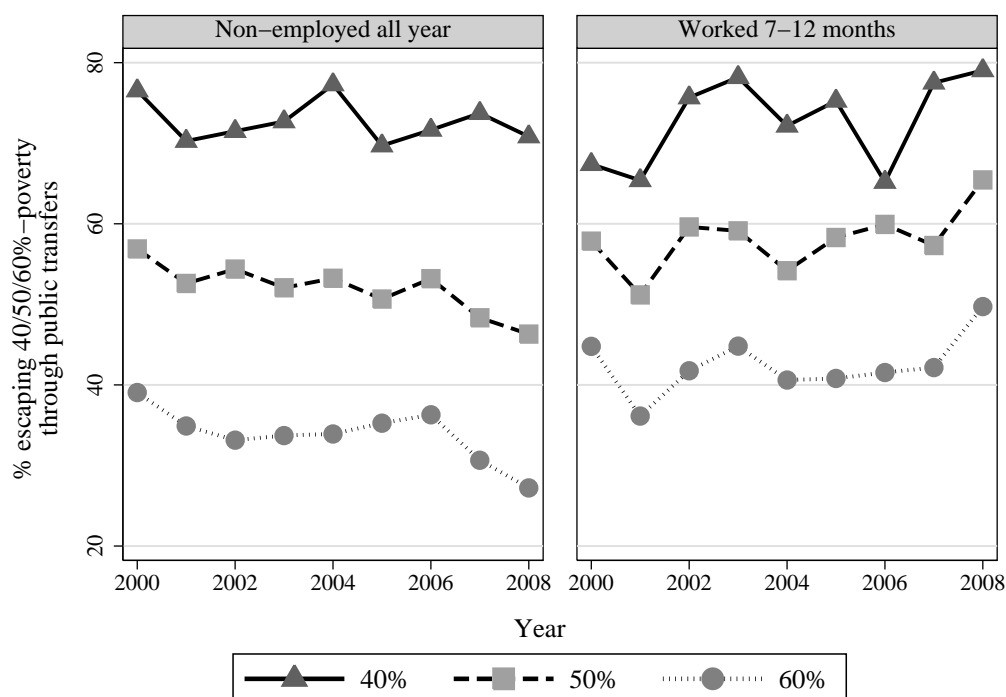
Source: GSOEP, own calculations. Total N: 96,056. Non-employed all year: 14,556. Worked 1-6 months: 5,119. Worked 7-12 months: 76,381.

37 % in 2008 after the Hartz reform. This suggests that working persons with low market incomes were winners, whereas the non-working poor were the losers of the reform.

Figure 4 further supports this interpretation by depicting for each of the three poverty thresholds which proportion of non-working and working individuals “escape” poverty through public transfers. An escape rate of 50 % means that half of those with pre-transfer income below the respective poverty line have incomes

above this poverty line after transfers.⁵⁷ At least with respect to the 50 and 60 % thresholds it becomes evident that the share of non-working individuals who are lifted out of poverty by public transfers has declined between 2000 and 2008. By contrast, escape rates for those in employment seem to have slightly increased.

Figure 4: Proportion escaping poverty through public transfers



Source: GSOEP, own calculations. N (non-working/working): 40 % threshold: 5,224/2,071. 50 % threshold: 5,699/3,188. 60 % threshold: 6,247/4,663.

⁵⁷ Note that escape rates for different thresholds are *not* based on mutually exclusive groups, that is, individuals with pre-transfer incomes below the 40 % line were also included in the calculation of the 50 and 60 % escape rates and so forth. The somewhat higher escape rates for working individuals may therefore partly reflect that pre-transfer incomes are higher within this group. Unfortunately, more fine-grained distinctions were not possible due to small sample sizes.

4 Empowerment or alienation? How the working poor compare to the non-working poor

We now analyze how the working poor compare to the non-working poor in various dimensions of quality of life.⁵⁸ First, we look at the economic situation. In addition to income, we consider the standard of living, based on ten questions asking whether a household owns certain goods (e.g. a colour TV) or engages in certain practices (e.g. inviting friends for dinner). Our summary score of material deprivation counts the number of goods (practices) a household does not own (or engage in) for financial reasons. Then we examine if the working and non-working poor differ in terms of social integration and participation by looking at regular participation in four leisure time activities and at membership in work-related and non-work-related organizations. Finally, we compare how satisfied the working and non-working poor are with various life domains, based on an 11-point scale that ranges from 0 (completely dissatisfied) to 10 (completely satisfied).⁵⁹

Table 11 shows that substantial differences in material well-being divide the working from the non-working poor. On average, needs-adjusted income is about 10 % lower among the non-working poor and their poverty tends to be “deeper” so that a larger fraction of those with incomes below the 60 % threshold fall below the more stringent 40 and 50 % thresholds. The non-working poor are also more likely to have been poor already in the previous year, so that poverty tends to be more lasting in their case. Finally, the non-working poor score substantially higher on the material deprivation measure. Compared to the working poor, they lack about one additional item out of a list of ten. All of these differences are statistically highly significant.

⁵⁸ Throughout this section poverty is defined in terms of the 60 % threshold. All information now refers to the time of the interview.

⁵⁹ Appendix Table A1 reports how the working and non-working poor compare with respect to key socio-demographic characteristics that serve as controls in our multivariate analyses below. It shows that the non-working poor more are more likely to live in Eastern Germany, have lower levels of education, are more likely to have a recognized disability and to self-rate their health as poor or bad. They are also more likely to be single and considerably less likely to have a partner who is working. There are no clear differences with respect to age, gender composition, or the number of children in the household

Table 11: Income, poverty depth and material deprivation

	Non-working poor (60 % threshold)	Working poor (60 % threshold)
Equiv. disposable income (in 2009 Euros)	647.3	713.8
% with income < 50 % of median	59.9	38.8
% with income < 40 % of median	26.6	13.3
% poor at previous interview (60 % line)	69.2	52.1
Material deprivation (# of items lacking for financial reasons)	3.5	2.5

Source: GSOEP own calculations. All differences significant at the 1%-level (standard errors corrected for clustering at the household level). N (non-working/working): Income and poverty rates: 6,293/3,546. % poor in t-1: 5,472/3,053. Material deprivation: 2,476/1,392.

Table 12 shows which fraction of the working and non-working poor participates in various leisure time activities on a regular basis. To put these numbers into perspective, we also report how big the respective differences are when we compare those in the bottom and the top quartiles of the income distribution. Despite their greater time constraints from paid work, the working poor report higher participation rates for all activities. Whilst smaller than the differences between the top and bottom income quartiles, all of the differences between the working and the non-working poor are statistically significant at the 1%-level. Hence, the working poor are more likely to attend cultural events, to actively participate in sports, to engage in voluntary work, and to join associations.

Table 12: Regular participation in leisure activities and organizational membership

	Non-working poor	Working poor	Bottom quartile	Top quartile
Leisure activities				
“High” culture (theatre, classical concerts)	3.2	5.6	5.0	18.3
“Pop” culture (cinema, pop concerts)	12.6	18.2	16.4	33.3
Active sports	19.4	27.7	26.0	59.0
Volunteer work/political engagement	7.9	13.2	11.5	20.7
Observations ^a	3,645	2,113	12,464	20,493
Membership				
Work-related (trade unions, works councils)	5.9	12.7	11.9	29.7
Not work-related (environmental groups, sports clubs)	8.5	17.4	13.5	32.8
Observations ^a	1,778	1,048	6,602	10,472

Source: GSOEP, own calculations. All differences significant at the 1%-level (standard errors corrected for clustering at the household level).

^a Number of observations for top and bottom quartile differ because income quartiles and poverty thresholds were constructed for the whole adult population, while analysis is restricted to 20-55 year old individuals who are not in education.

Table 13, finally, shows that the working poor are more satisfied than the non-working with practically all aspects of their lives. The sole exception is their degree of satisfaction with leisure time which is more limited for them. The higher domain-specific satisfaction levels also translate into greater satisfaction with life as a whole. There are also some noteworthy gender differences in the association of employment with satisfaction. For overall life satisfaction, the difference between the working and non-working poor is almost twice as large for men as for women. This may partly be explained by income differences between households (where non-working women are more likely to have a working partner than non-working men), but it presumably also reflects that paid work is still more central to men's identity than to women's.

Table 13: Overall and domain-specific satisfaction levels

	Men		Women		Income groups	
	Non-working poor	Working Poor	Non-working poor	Working Poor	Bottom quartile	Top quartile
Life as a whole	5.0*	6.2*	5.6*	6.2*	6.1*	7.3*
HH income	3.0*	4.3*	3.6*	4.3*	4.4*	7.3*
Standard of living	4.7*	5.9*	5.2*	5.7*	5.8*	7.6*
Flat/Housing conditions	6.3*	6.8*	6.6*	7.0*	6.9*	7.9*
Health	5.9*	6.6*	6.1*	6.6*	6.5*	7.1*
Family life	6.6	6.8	7.0	7.1	7.1*	7.6*
Leisure time	7.1*	6.1*	6.6+	6.3+	6.5	6.6
Sleep	6.5	6.4	5.9	6.4	6.4*	6.9*
Observations ^a	2,549	1,468	3,584	2,003	21,978	36,334

Source: GSOEP, own calculations.

* Indicates that difference between non-working and working men, non-working and working women or bottom and top quartile is significant at the 1%-level.

+ Indicates significance at the 5%-level (standard errors corrected for clustering at the household level).

^a Number of observations is lower for satisfaction with standard of living, family life, and sleep which are not available for all years. Number of observations for top and bottom quartile differ because income quartiles and poverty thresholds were constructed for the whole adult population, while analysis is restricted to 20-55 year old individuals who are not in education.

It is tempting to interpret our results as evidence for the virtues of activation policies which appear to be strongly in line with what people want. However, it is unclear to what extent we are dealing with selection effects that might reverse the causal order. In other words, we do not know if people are different because they work, or if they work, because they are different. Multivariate statistical analysis allows us, however, to control for some of the differences that distinguish the working from the non-working poor in addition to employment. For reasons of space we limit our following analysis to overall life satisfaction. We furthermore restrict it to

the subgroup of men where we find stronger positive effects of employment on psychological well-being.⁶⁰

Table 14 shows a series of pooled OLS regressions of general life-satisfaction.⁶¹ Model 1 only includes a dummy for the presence or absence of work for pay, and a full set of dummies for survey year. The coefficient estimate on employment corresponds to the unadjusted difference in Table 13 and is highly significant. Models 2 to 4 add three blocks of control variables. Model 2 adds basic socio-demographic characteristics: region of residence, age, education, migration background partnership status, and number of children. Model 3 additionally includes a measure of self-rated health and officially recognized disability status. Finally, Model 4 adds two measures of the standard of living, i.e. equivalised household income and the index of material deprivation.⁶² Attenuating the effects of employment on well-being, the controls work in the expected direction.⁶³ For example, the effect of paid work on life satisfaction decreases from 1.18 in Model 1 to 0.64 in Model 4. Observable differences in the composition of the working and non-working poor can thus explain about 45 % of the satisfaction bonus associated with employment. However, the persistent effect of 0.64 is still large and roughly equivalent to the effect of a 500 € increase in monthly income.

In sum, the effect of employment on life satisfaction is remarkably robust and has survived our regression analysis fairly unscathed.⁶⁴ Hence our analysis suggests that there are beneficial effects of employment beyond its mere impact on financial

⁶⁰ Unfortunately, the questions from which we construct our measure of material deprivation are only available for four years (2001, 2003, 2005, 2007). However, deprivation scores tend to be quite stable, with about 60 % of individuals experiencing no change in material deprivation and roughly 20 % experiencing a change of one item (in either direction) over a period of two years. We therefore decided to impute the deprivation score using the observed scores from adjacent years: For 2002, 2004, and 2006, we averaged the values from the two adjacent years. Observations from 2000 were assigned their 2001, and observations from 2008 and 2009 were assigned the 2007 values. Coefficient estimates on the deprivation score change very little when we include the imputed values (rather than only the observed ones), which suggests that our imputation performs quite well.

⁶¹ We present OLS results for ease of interpretation. Ordered logit models yield very similar results.

⁶² Because the marginal effect of income on life satisfaction declines as income rises, one would usually prefer to use a non-linear transformation such as the natural logarithm of income. However, the linear specification was used here because the sample is very homogeneous in terms of income and indeed slightly outperforms the logarithms specification in terms of explained variance.

⁶³ The relatively weak effects of education may seem surprising, but can likely be attributed to the fact that we are looking at a very specific sub-group, i.e., the poor. As for the positive effect of official disability status, it is important to note that self-rated health status is held constant. The effects of official disability status indeed become negative and (almost) reach statistical significance when we drop self-rated health from the model.

⁶⁴ We also estimated fixed effects models (results not shown) to control for time-invariant unobserved characteristics such as personality traits and results were very similar. For example, in the fixed effects version of Model 4 (i.e. in an FE model with the time-varying predictors included in Model 4) the estimated difference in overall life satisfaction between working and non-working poor men is 0.67 which is almost identical to the pooled OLS estimate of 0.64.

well-being. However, job quality is an important factor mediating the relationship between employment and overall life satisfaction. This is illustrated by Model 5 which includes an interaction term between working for pay and job quality – as captured by the respondent's self-reported satisfaction with his work, again measured on an 11-point scale ranging from 0 to 10. For those who are completely dissatisfied with their job, employment actually reduces life satisfaction (the highly significant "main effect" of working in Model 5 is -1.16). The estimates imply statistically significant positive effects of employment on life satisfaction for workers with job satisfaction scores of five and above. About 80 % of working poor men report job satisfaction levels in this range. An important dimension of job quality is, of course, remuneration. Model 6 includes an interaction between being at work and earning a low hourly wage. It shows that the satisfaction bonus associated with employment is significantly smaller for men with low pay, even when we control for household income and material deprivation.

These findings suggest that the satisfaction bonus associated with employment may have declined in recent years. We have seen in section 3 that the Hartz reforms were accompanied by substantial growth of low-wage employment and our data also show that self-reported job satisfaction has decreased among the working poor: In 2000–2004, roughly 17 % of poor working men reported low job satisfaction scores between 0 and 4. In 2005–2009, this share was 22 %. Model 7, which allows the effect of employment on well-being to differ between the pre-Hartz-IV era (2000–2004) and the post-Hartz-IV phase (2005–2009), indeed shows that, net of controls, the well-being gain associated with employment was substantially lower after the Hartz reforms (by more than a third according to these estimates).⁶⁵ Finally, Model 8 which includes all three interaction terms suggests that decreasing job satisfaction and rising incidence of low pay partly explain why the well-being gains associated with employment have declined. When controlling for job satisfaction and low pay, the "Post-Hartz IV" interaction is reduced by about a third and no longer statistically significant. Showing that the quality and pay of jobs matter also, these results cast a somewhat more critical light on recent activation policies.⁶⁶ Sustainable activation policies should therefore be accompanied by efforts to promote decent-quality employment. If activation leads to declines in average job quality (e.g. through weakening the bargaining position of the unemployed), welfare gains are smaller than sug-

⁶⁵ This is calculated as follows: $-.28/.78 \times 100 = -36\%$.

⁶⁶ It must be noted that the coefficient estimates for the "Post-Hartz IV" interaction are somewhat sensitive to changes in variable definitions and model specification. While generally remaining negatively signed, the interaction term in Model 7 is substantially weaker and mostly statistically insignificant when we employ sample weights, expand the analysis sample by employing more generous income thresholds (e.g. 70 % of the median), and/or use the GSOEP's alternative time-of-interview income variable which does not do certain corrections for underreporting of household income (detailed results available on request). The interactions between employment and the job quality measures are very robust, however.

gested by “hard” indicators of labour market performance such as unemployment or employment rates.

5 Conclusion

The Hartz reforms which went into effect around 2005 entailed – if not caused – a massive growth in German employment and especially in low-wage employment. As the low-wage sector expanded, the number and proportion of workers who combined earnings from work with social transfers increased. While relative income poverty could not be reduced substantially, more people were activated to enter the labour force and to draw new in-work benefits. Part of this activation stems from growing pressures by the administration of the job centres which applied new forms of sanctions in greater frequency coupled with various new forms of support.

Our analyses suggest that most people prefer work over welfare and perceive having a job as an important and enriching form of social inclusion. There are three caveats, however. First, our analyses do not really clarify if those who work are more satisfied and more civically engaged because they are working, or if the causal order is reversed so that those who are more satisfied and have better networks find access to employment more easily. The second caveat is that we do not really know if it is the pull of attractive jobs or rather the push of more tightly scrutinizing welfare agencies that draws people into work (or which exact combination of these two factors). Whether it is the improved chances to augment incomes through a combination of earnings and social transfers or rather the tougher sanctions if job offers are refused – it does look evident that people near the poverty line are now more willing to make concessions and to accept job offers even if the jobs they get are not of high quality. The third caveat is that such concessions cannot go too far without damaging the positive effects of employment on well-being that most of our analyses have shown. Jobs below a certain pay and quality level do not serve socially inclusive and quality of life enhancing functions to similar degrees as better jobs do.

The question then remains what social and political significance the growing importance of low-wage employment and in-work benefits has. For policy pundits on the German left it signifies the bankruptcy of the market economy which proves incapable of providing sufficient numbers of jobs with earnings from which to make a living. For others more to the centre, it signals an effective activation of the social state in a situation where those at the bottom of the skill distribution have

growing difficulties to find jobs that look profitable from the employers' perspective while making work pay sufficiently for the workers.

Our analysis suggests that the policy debate should not only focus on the intended effects of the reform, but also on some of the under-discussed side effects. What makes in-work benefits attractive is that they appear to be a win-win situation for the state, the workers, and the employers alike, allowing the first one to make savings in transfers, the second one to achieve social inclusion in addition to a higher disposable income compared to transfers or earnings alone, and the third one to reap the fruits of cheap wages that make the employment of low-skilled workers more attractive. Yet there are also some negative side-effects which deserve greater attention. First, wage subsidies that are not flanked by a minimum wage are likely to function as a moral hazard which employers may exploit, because they are given an incentive to underbid even the conventional market value of labour, as they can now trust that the tax-payer will pay the difference. Second, in-work benefits and benefits linked to sufficient efforts to find work make the employers the crucial gatekeepers of social entitlements. If losing or not accepting a job also means losing social benefits, the employers' side in the class cleavage is considerably strengthened, as fighting for one's rights in the workplace requires more courage, and the incentive to join unions is weakened. Transforming an unconditioned right to minimum subsistence into a conditional right depending upon the willingness to accept any job that is being offered, and abolishing or emasculating the criteria of suitability that used to protect job seekers amounts to a considerable re-regulation of labour relations that strengthens the position of employers while weakening the position of unions and workers. Before they follow the American model of work-conditioned benefits wholeheartedly, European policy makers should reflect how far they want to go on this road and how compatible it would be with the normative idea of a European social model according to which labour markets should be embedded in a context of social dialogue and of welfare state entitlements.

Table 14: Life satisfaction of poor men, 2000–2009

	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7	Model 8
Working	1.18** (0.09)	1.04** (0.09)	0.83** (0.08)	0.64** (0.08)	-1.16** (0.17)	0.83** (0.11)	0.78** (0.11)	-0.98** (0.19)
Working X job satisfaction					0.30** (0.02)			0.29** (0.02)
Working X low hourly wage						-0.30** (0.11)		-0.12 (0.10)
Working X 2005–09 (after Hartz IV)							-0.28* (0.14)	-0.16 (0.13)
Eastern Germany		-0.24* (0.12)	-0.35** (0.11)	-0.36** (0.11)	-0.31** (0.10)	-0.33** (0.11)	-0.36** (0.11)	-0.30** (0.10)
Age		-0.12** (0.04)	-0.08* (0.04)	-0.08* (0.04)	-0.09* (0.04)	-0.08* (0.04)	-0.08* (0.04)	-0.09* (0.04)
Age (squared)		0.00+ (0.00)	0.00+ (0.00)	0.00+ (0.00)	0.00+ (0.00)	0.00+ (0.00)	0.00+ (0.00)	0.00+ (0.00)
Vocational degree		0.17 (0.13)	0.10 (0.12)	0.02 (0.12)	0.01 (0.11)	0.02 (0.12)	0.02 (0.12)	0.02 (0.11)
Tertiary degree		0.14 (0.22)	-0.01 (0.20)	-0.06 (0.20)	-0.01 (0.19)	-0.05 (0.20)	-0.04 (0.20)	0.00 (0.19)
Migration background		0.00 (0.14)	-0.02 (0.13)	-0.05 (0.13)	-0.02 (0.12)	-0.05 (0.13)	-0.04 (0.13)	-0.02 (0.12)
Married partner		0.33* (0.14)	0.27* (0.13)	0.17 (0.13)	0.16 (0.13)	0.17 (0.13)	0.17 (0.13)	0.17 (0.13)
Unmarried partner		0.23+ (0.14)	0.20 (0.12)	0.14 (0.12)	0.14 (0.12)	0.15 (0.12)	0.15 (0.12)	0.14 (0.12)
# of children (0–18)		0.14** (0.05)	0.09+ (0.05)	0.10* (0.05)	0.09* (0.04)	0.09* (0.04)	0.09* (0.04)	0.09* (0.04)
Health: good			-0.45** (0.14)	-0.43** (0.14)	-0.42** (0.14)	-0.43** (0.14)	-0.43** (0.14)	-0.42** (0.14)
Health: satisfactory			-1.32** (0.15)	-1.28** (0.15)	-1.17** (0.15)	-1.27** (0.15)	-1.28** (0.15)	-1.17** (0.15)
Health: poor			-1.82** (0.18)	-1.72** (0.18)	-1.53** (0.18)	-1.70** (0.18)	-1.72** (0.18)	-1.52** (0.18)
Health: bad			-2.89** (0.23)	-2.81** (0.23)	-2.64** (0.23)	-2.80** (0.23)	-2.80** (0.23)	-2.62** (0.23)
Slightly disabled			0.14 (0.18)	0.09 (0.17)	0.10 (0.17)	0.08 (0.17)	0.08 (0.17)	0.10 (0.17)
Severely disabled			0.35+ (0.19)	0.31 (0.20)	0.28 (0.20)	0.31 (0.20)	0.30 (0.20)	0.27 (0.20)
Equivalised income (/100)				0.13** (0.03)	0.11** (0.03)	0.12** (0.03)	0.12** (0.03)	0.11** (0.03)
Deprivation: # of items missing				-0.09** (0.02)	-0.08** (0.02)	-0.09** (0.02)	-0.09** (0.02)	-0.08** (0.02)
Constant	5.22** (0.12)	7.65** (0.76)	7.83** (0.71)	7.28** (0.71)	7.40** (0.69)	7.35** (0.71)	7.25** (0.71)	7.41** (0.70)
Observations	3504	3504	3504	3504	3504	3504	3504	3504
R ²	0.08	0.12	0.22	0.24	0.28	0.24	0.24	0.28

Source: GSOEP. All models include year dummies. Cluster-robust standard errors (person-level) in parentheses.

+ p < .10, * p < .05, ** p < .01; Reference categories: not working; Western Germany; no vocational/tertiary degree; no migration background, no partner; self-rated health: very good; no disability.

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Appendix

Appendix Table A1: Socio-demographic characteristics by poverty and employment status

	Non-working poor	Working poor	Non-working non-poor	Working non- poor
% Eastern Germany	34.0	28.6	17.2	16.9
% Female	54.8	55.5	74.1	44.4
Age	38.9	39.9	39.0	40.3
% without vocational or university degree	38.9	27.5	24.5	10.5
% Single	53.3	48.1	21.6	30.8
% with non-employed partner	31.1	29.9	10.6	14.7
% with employed partner	15.5	22.0	67.8	54.5
# of children (≤ 18)	1.0	1.1	1.1	0.7
% slightly disabled ($< 50\%$)	2.9	2.1	3.0	2.7
% severely disabled ($\geq 50\%$)	9.7	3.8	11.2	2.5
% rating own health as poor/bad	27.7	15.9	19.8	10.1
Actual work hours	0.0	32.3	0.0	39.2
Contracted work hours	0.0	30.8	0.0	36.1
Observations	5,345	2,948	15,457	79,121

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