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## **Path Breaking, Path Shifting, and Path Dependence**

**The new German regime of 'Basic Income Support for Jobseekers' and the struggle between centralisation and devolution**

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## 1 Introduction

As of 2005, Germany merged two benefits for workless people into a new flat-rate benefit financed mainly from the federal budget. This path-breaking abolishment of unemployment assistance, the ‘Bismarckian’ type follow-on benefit after exhaustion of unemployment insurance eligibility, was justified as a precondition for creating ‘one-stop’ services. However, using social assistance as the model for the new benefit made the reform path shift towards the legacy of municipal relief. Instead of ‘joining up’, the new regime of ‘basic income support for jobseekers’ (BIS) is being delivered in three different organisational models none of which is fully integrated into the federal public employment service. Furthermore, the Federal Constitutional Court has recently declared the currently prevalent model of consortia formed between municipalities and the Federal Agency for Work incompatible with German federalism. Both in legal and in political terms, the question is again open how a devolution of employment services would be possible without their fragmentation.

The paper is organised as follows:

In chapter 2, the so-called ‘Hartz’ reforms will be reviewed and explained with special emphasis on their fourth step. Chapter 3 explores in more depth the merger of previously two benefits that is at the core of ‘Hartz IV’. Chapter 4 carries this analysis on to the reform’s institutional and governance aspects, arguing that the diverse regime logic of the previous benefits prevented the intended uniform and ‘joined-up’ solution sought by the architects of the reform. Chapter 5 highlights a recent ruling by the Federal Constitutional Court that has exacerbated the governance dilemma of basic income support. The conclusion in chapter 6 goes on to contrast the current constitutional impasse with a hypothetical reform that would have had the desired effect of labour market policy activation without path breaking and the resulting unintended shifting onto a new dependent path.

## 2 Key elements of the German labour market policy reforms

### 2.1 Historical and political background

Ever since the short-lived post-war era of full employment ended, which was around 1975, (West) German unemployment has grown more strongly during each downturn of the business cycle than it decreased during subsequent upturns. It is not so much the risk of *becoming* unemployed that would have increased considerably, but rather the probability of *remaining* in unemployment for a long time – in many cases, until retirement (Knuth & Kalina 2002) – that has massively grown (Erlinghagen & Knuth 2004). Between 1990 and 1993, German unification led to the destruction of roughly 40% of the jobs that existed in East Germany before, thus aggravating the unemployment problem of Germany as a whole. As compared to the 1980s, exits out of unemployment into re-employment declined since the 1990s, and they became increasingly insensitive to the business cycle. The share of unemployed persons in new hires decreased, and unemployment hysteresis grew: In 2000, those 20% of individual

unemployment spells that had lasted one year and longer accounted for about 65% of the total days spent in unemployment (Karr 2002).

The ‘New Economy’ boom brought the German unemployment rate of 12.7% (1997) only down to 10.3% (2001), according to the national administrative count.<sup>1</sup> Whereas Germany’s position with regard to employment and unemployment rates remained close to EU-15 average, comparison with individual European partners raised awareness in Germany that some other countries (e. g. the UK, Denmark, Sweden, the Netherlands) experienced considerable improvements while Germany was standing still. Around the turn of the century, the feeling had widely spread that something was going fundamentally wrong about the way the system of wage replacements for the unemployed, the Public Employment Service (PES), and the active labour market policies it delivered were supposed to connect the unemployed to the labour market.

Against this background, in the beginning of 2002 criticism by the Federal Audit Bureau of misleading and ‘massaged’ PES placement statistics rapidly developed into a political scandal. The PES, with some 90,000 employees, was condemned for being the country’s single largest public authority and yet unable to deliver effective placement services because too few of its staff were actually working on the customer frontline, resulting in frontline caseloads of between 600 and 800. In the run-up to federal elections due in the autumn of that year, the ‘placement scandal’ called for immediate political action. The government (then still the first of two successive Social Democratic & Green Party coalitions) appointed a commission of renowned individuals from business, consultancies, trade unions, politics, and academia headed by then Human Resource Director of *Volkswagen*, Peter Hartz. The commission’s official assignment was to draw up a master plan for reforming the PES according to the principles of New Public Management in order to enable it to deliver ‘Modern Services on the Labour Market’ – the title of both the Commission and its report (Hartz Commission 2002). The Commission, however, broadened its ambitions towards actually making suggestions for reducing unemployment by two million within three years. After the commission had presented its proposals and the incumbent coalition had been re-elected on the promise of following them, the major part of the commission’s scheme was implemented in four consecutive legislative steps which took effect between January 2003 and January 2005.

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<sup>1</sup> Internationally comparable figures are 9.1% (1997) and 7.4% (2001) (European Commission 2005). Besides, even standardised comparisons are biased because relevant countries of reference tend to have much higher proportions of their working-age populations assigned to benefits not related to unemployment, namely to benefits justified by incapacity to work (cf. Grubb & Miyamoto 2003; Erlinghagen & Knuth 2008).

## 2.2 Key elements of the 'Hartz' reforms as a whole

From an analytical perspective, the reforms associated with the name of Hartz can be categorised into five elements:

- (1) Modernising the governance, controlling and customer management of the Federal Agency for Work (*Bundesagentur für Arbeit*), a body of public law under tripartite governance<sup>2</sup> and traditionally responsible for administering unemployment benefits, counselling and job placement services, and implementing active labour market policies<sup>3</sup>;
- (2) Introducing some new instruments of active labour market policy, and fine-tuning others;<sup>4</sup>
- (3) Once again, after many times before, overhauling the tax and social security contribution privileges for 'small jobs'<sup>5</sup>;
- (4) Reforms of the benefit system for workless people:
  - a) Cuts of the maximum periods of eligibility for contribution-based unemployment benefits for older workers with long contribution records from 32 to 18 months, thus bringing them closer to the general standard of 12 months<sup>6</sup>;
  - b) Reshaping of the benefit system for those workless people who have exhausted their contribution-based benefit claims, or have failed to earn such, by merging two previous benefits administered by the municipalities and the PES, respectively, into one;

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<sup>2</sup> The board is made up of representatives of employers and trade unions plus representatives from the Federal Government, the *Bundesrat* (the second parliamentary chamber which represents the Länder) and of the association of municipalities.

<sup>3</sup> It should be noted that the trilogy recommended by the OECD (2001) – placement and counselling, payment of unemployment benefits, and management of labour market programmes – have been in one hand in Germany since the beginnings of a national PES in 1927. 'Active' measures, by contrast, have always been mostly delivered by third parties, most of them non-profit organisations or public bodies. The arrival of private for-profit providers and of competitive tendering is a relatively recent development.

<sup>4</sup> Subsequent evaluation has shown that hardly any of the instrumental innovations proposed by the Hartz Commission had positive effects, whereas some of the incremental improvements smuggled into the reform legislation by the Ministry's administration did have positive effects (Bundesministerium für Arbeit und Soziales 2006; Eichhorst & Zimmermann 2007).

<sup>5</sup> 'Mini-jobs' or 'marginal part-time jobs' exempt from social security contributions and with low flat-rate taxation originally were a reaction to labour shortages in the 1960s. The idea was to attract additional female labour without interfering with the male breadwinner model that had just been consolidated through the social security and tax reforms of 1956/57. Until today, 'mini-jobs' aren't stepping stones out of unemployment (Fertig & Kluwe 2005; BMAS 2006). It was only through the Hartz Commission that they were mistakenly drawn into the context of active labour market policy.

<sup>6</sup> This was not part of the Hartz Commission's proposals but added in March, 2003 as part of what the Schröder government called 'Agenda 2010'. Meanwhile, there has been a partial roll-back by the current conservative-led government. For persons becoming unemployed at the age of 58 or more and having paid unemployment insurance contributions for at least 48 months before, the maximum eligibility is now 24 months. The maximum went from 32 to 18 to 24 months. It is characteristic for the current political situation that the Christian Democrats manage to shame the Social Democrats for their neo-liberal reforms by introducing symbolic corrections that catch much public attention but actually affect only few.

- (5) Through this merging of benefits attempting to create ‘unified single gateways’ called ‘*Job-Centers*’ for all unemployed and jobseeking persons, *however failing to achieve this goal* for reasons which will be reflected in this paper.

The remainder of this paper will concentrate on topics (4) b) and (5) because these are the ones most relevant to the governance of labour market policy.

### 2.3 The nexus between activation, institutional restructuring, and benefit reform

Germany had already attempted to catch up with the European paradigm shift from merely ‘active’ to ‘activating’ labour market policies and towards ‘contractualism’ in its twofold meaning<sup>7</sup> through a reform developed and debated in 2001 and taking effect as of January, 2002. Through a bill called *JobAQTIV*<sup>8</sup>, concepts like employability, profiling, individual action plans and customers’ discretion were introduced, the latter through the issuing of vouchers for private job broking services and for training courses. This reform did not get a chance to take root but was virtually ‘run over’ by the placement statistics scandal (see p. 4). The Hartz Commission could and did build on the spirit and ideas of the ‘activation’ discourse but might not fall short of producing suggestions impressively going beyond.

In the government’s assignment to the Commission, benefit reform and the creation of a one-stop centre had not figured as an immediate goal but only as a further consideration for the medium term (Hartz et al. 2002: 16). The Commission, however, put this issue at the centre of its considerations. The integration of services was not only seen as a necessity for overcoming institutional fragmentation and overlap, but also for innovation through synergies between the more immediately labour-market oriented competencies of the PES and the more ‘holistic’ approaches of municipal social services. Individual assessment or ‘profiling’, case management through frequently recurring contacts with supposedly one and the same personal adviser, and specified ‘back-to-work-agreements’ (*Eingliederungsvereinbarungen*) were the key elements of what the Commission envisaged as ‘modern services on the labour market’. Taking on board the tradition of social assistance implied a much more complex definition of the problem of ‘worklessness’ (or of poverty despite work) than was previously prevalent in the regime of unemployment insurance. The ensuing more comprehensive activation strategies would have to address not only the individual but also the whole family or ‘community of needs’ (see p. 11 for explanation of this concept).

According to a notion almost universally accepted in Germany, the institutional merging of services previously delivered separately by the municipalities and the local branches of the Federal Agency for Work (the PES) was only possible by merging the two tax-funded benefits that existed for those without contribution-based entitlements to

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<sup>7</sup> Contractualism is used here in the two meanings of ‘contracting out’ (using private placement services) and ‘basing the relationship with customers on a quasi-contract’ (individual action plans).

<sup>8</sup> Activation, Qualification, Training, Information, Placement (*Vermitteln*).

unemployment insurance. Exploring the ‘regime logic’ of these two benefits will help to understand the scope of the merger, the path dependencies evoked by it, and the current constitutional impasse it produced.

### 3 The benefit reform

#### 3.1 The previous benefit system

Until the end of 2004, Germany had three benefits relevant to workless claimants:

- (1) Contribution-based unemployment benefit (*Arbeitslosengeld*), defined as a percentage of former net income (60% or 67% for unemployed persons without or with dependent children respectively), without means-testing but of limited duration of normally 12 months<sup>9</sup>;
- (2) Subsequent to the exhaustion of the eligibility period for (1), there was tax-funded unemployment assistance (*Arbeitslosenhilfe*) at a lower percentage of former net income (53% and 57% respectively), open-ended but means-tested;
- (3) The third tier was tax-funded social assistance (*Sozialhilfe*), flat rate, open-ended, means-tested, and open to all persons in need and unable to support themselves – i.e., not restricted to people regarded or registered as unemployed.

Benefits (1) and (2) were dependent on availability for work and, since 1998, on actively seeking work, and they were both administered by the PES within a uniform ‘regime’ of acceptability of job offers, of sanctions, and of instruments of active labour market policy. Benefit (3), by contrast, emerging from the older tradition of parish and local relief, was administered and financed by the municipalities (counties and the larger cities which are independent of counties). Increasing difficulties of labour market entry as well as increasing precarisation and volatility of working lives had led, in tier (3), to growing caseloads of people of working age and able to work – which was not the kind of personal situations for which the system of social assistance had been designed when it was modernised in 1962. Where benefits of type (1) and – more often – type (2) were below subsistence level because previous earnings from which they were calculated had been low, those concerned might have to supplement their payments by claiming additional social assistance, especially if they had families in which they were the only breadwinner. Therefore, these customers had to visit two offices, neither of which would take full responsibility for their integration into employment.<sup>10</sup>

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<sup>9</sup> During the 1980s, longer durations of up to 32 months for older people with long contribution records were introduced as means of pre-retirement. For repeated changes of maximum periods of eligibility see footnote 6.

<sup>10</sup> According to the figures cited in the Hartz Commission’s report, this problem of institutional overlap applied to only 7% (270,000) of the persons then registered as unemployed. However, it figured as the central justification in the Hartz Commission’s report (Hartz et al. 2002: 126) and the subsequent legislation (Bundesregierung 2003: 96ff.) for integrating the benefit system. When the reform took effect, the number of persons who had actually received both benefits was established as actually only 210,000 (Kaltenborn & Schiwarov 2006).

The mainstream discourse contended that unemployment assistance and social assistance, since they both were tax-funded and means-tested benefits paid predominantly to people out of work, constituted an anachronistic duplication (cf. Berthold et al. 2000), and international assessments tended to follow this view (cf. Adema et al. 2003). It was generally overlooked that these two benefits belonged to two different social policy regimes and that the very meaning of ‘means-testing’ was quite different in the one as compared to the other. This difference of ‘regime’<sup>11</sup> will be emphasised here because the explanation of why the intended institutional streamlining failed hinges on this concept.

### 3.2 Unemployment assistance as an extension of the ‘Bismarckian’ unemployment insurance regime

Though funded from taxes, the gateway into *unemployment assistance* was the previously possessed but now exhausted eligibility for contribution-based unemployment benefits.<sup>12</sup> Calculated as a percentage of former earnings, unemployment assistance was a *wage replacement, not a poverty relief*. As a wage replacement, it was paid at the end of the month, just like wages are paid after the work has been done. Unemployment assistance may then be understood as the tax-funded extension of an unemployment insurance scheme following Bismarckian principles of universal contributions and linear relationships between earnings<sup>13</sup>, contributions and benefits. Where other countries tend to mix wage-related contributions and tax revenue in the funding of their unemployment benefit schemes, which is most prominent in the so called ‘Ghent system’ of unemployment insurance existing in Belgium and in Scandinavian countries, Germany kept the two sources apart and allocated them to different stages of people’s unemployment careers. From the point of view of the contribution payer this made little difference: By paying unemployment insurance contributions, they bought themselves into a scheme that guaranteed relative, albeit after 12 months decreasing, status maintenance – which was perhaps unique by international standards<sup>14</sup> in that it was open-ended.

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<sup>11</sup> A ‘social policy regime’ is defined here by distinct rules and mechanisms of funding and of granting benefits, by definitions of social situations and groups that would qualify for the benefit, by institutionalisation in a bureaucracy of its own with its own staff and career patterns, and by a set of rights and obligations governing the relationship between (potential) benefit recipients and the bureaucracy (Knuth 2006).

<sup>12</sup> There once was a ‘direct’ gateway into unemployment assistance for new entrants and re-entrants into the labour market. ‘Direct’ unemployment assistance was calibrated with regard to a hypothetical income depending on a person’s skills level. Introduced in times of labour shortage and intended as a job-seeking allowance for new entrants or re-entrants into the labour market, justification for this kind of benefit became questionable when drawn over long periods. Between 1976 and 1999, this was abolished step by step, thus contributing to the growth in the numbers of social assistance claimants.

<sup>13</sup> Actually, there is a cap on the earnings base used to calculate both the contribution and the wage replacement. High earners thus pay lower contributions when calculated against their total income, and in case of unemployment they will receive benefits at lower net replacement rates.

<sup>14</sup> Among the countries participating in the Peer Review, the same is to be found only in Austria.



For recipients of unemployment assistance, sanctions, e.g. for not accepting a suitable job offer, would be of the same logic as in unemployment benefit: The benefit would be completely suspended for a certain period under the assumption that the claimant was not really unemployed because he or she was not searching or not available for a job. Like during receipt of unemployment benefits, claimants of unemployment assistance would have contributions paid for them to health and care insurance as well as to pension funds. Payments to the latter were calculated as if unemployment assistance was their contributable income, thus earning pension increases of roughly 28% compared to when they were working. Rent subsidies (*Wohngeld*) were available under the same rules and conditions as for any other lower income family, but in a separate administrative process in which the PES was not involved.

When establishing claims for unemployment assistance, means testing only served as a *limitation* to eligibility. A person would be individually entitled to unemployment assistance by virtue of being unemployed and having paid contributions, but then payments might be reduced (even to zero) because of the financial situation within the family precluding neediness.<sup>15</sup> However, where own means were too small to be taken into account, the full amount paid was not gauged to the needs of the family but to the former earned income of the individual. Likewise, the obligation to actively seek work and to overcome unemployment was only on the individual claimant, not on other family members with whom he or she might be sharing the benefit. In a family living according to the *male breadwinner model*, which is still stronger in Germany than in most European countries (cf. Pfau-Effinger 2004), depending on unemployment assistance would reduce income levels but not necessarily interfere with established family and gender roles.

### 3.3 Social assistance as a regime of poverty relief

In the regime of social assistance, by contrast, the absence of sufficient means within a household was the fundamental *justification* of eligibility, which was established irrespectively of employment history or contribution record. Flat-rate payments consisted of components for each household member without regard to earlier income or living standards. Sanctions would consist of lowering the benefit or giving food vouchers, but considered to be the last resort of subsistence, the benefit would not be withheld completely. As a system of relief, social assistance would be paid in advance, in contrast to wage replacements which were paid in arrears. Full costs of 'adequate' housing plus heating costs would come on top of the benefit, excluding, of course, the household claiming social assistance from the kind of rent subsidies other low-income individuals and families would be entitled to. The aim of social assistance was poverty relief, not status maintenance. No social security contributions would be paid for the claimants; health care would be directly covered as needed. Administered by the

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<sup>15</sup> Obviously, given unequal earning opportunities for men and women, unemployed women would far more often be excluded from receiving unemployment assistance by virtue of their partner's income than vice versa.

municipalities, social assistance was not part of the labour market regime as such, and so the grounds for claiming were not unemployment but neediness. Low earners, especially with families, could claim supplementary benefits even though not unemployed. It seems that the political endorsement of a 'merger' between this regime and unemployment assistance was motivated by expectations that its holistic, familialistic and 'life-world' oriented approach would have the potential to solve employability problems of the long-term unemployed which the Federal Agency for Work was unable to address, focussing solely, as it did, on the individual and his relation with the labour market.

Another feature of the social assistance regime supposedly attractive to policy-makers was that all adult family members were obliged to utilise any working ability and opportunity they might have in order to secure subsistence for themselves and their dependents, or in order to at least reduce their neediness and thus the benefits paid to them. Albeit 'dormant', i.e. not enforced vigorously and on large scales, there was always a 'work first' element inherent in the regime of social assistance, where the acceptability of a job was not limited by considerations of labour market regulation (e.g. collective agreements, 'going rates') but only by personal ability and caring responsibilities within the family.

Finally, in coincidence with the public contempt for the Federal Agency for Work as a 'mega-bureaucracy', the view was widespread that at least some municipalities were doing a better job than the Agencies for Work when it came to connecting their social assistance clients to the labour market. As a matter of necessity, the larger cities with high social assistance caseloads had gradually built up labour market services of their own, and in doing so they were much less constricted by legal regulations and entirely free from any centralistic controlling of the kind exerted by the Federal Agency for Work. In such an environment, some innovative and skilful individuals in leading positions managed to earn reputations for 'their' cities as good performers in labour market services. Actually, exactly because of the absence of central controlling, there was no reliable database, let alone rigorous evaluation. All that is known beyond a host of case studies are repeated surveys conducted by municipal associations among their members (cf. Fuchs 1994, 1999, Fuchs & Troost 2001) which were more input than outcome oriented.

### **3.4 The new regime of basic income support for jobseekers**

As of January 1, 2005, unemployment assistance as well as social assistance for those considered 'able to work' has been replaced by a new benefit called 'unemployment benefit II' (UB II).<sup>16</sup> Unlike suggested by the wording, the regime in which the new benefit is embedded comes much closer to the principles of social assistance just

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<sup>16</sup> Whereas 'UB II' is the technical – and misleading! – term for the benefit for adults able to work, the acronym 'BIS' (basic income support for jobseekers – the official title of the relevant legislation) will be used in this paper when referring to this social policy regime as a whole.

explained than to those of unemployment benefit proper. The intention to ‘borrow’ so extensively from the social assistance regime had not been explicit in the report of the Hartz Commission, presumably because those of its members who were affiliated to the trade unions would otherwise have withdrawn. It was Chancellor Schröder who, in his memorable television speech introducing his ‘Agenda 2010’ in March 2003, announced that the level of the new benefit would be ‘closer to social assistance than to unemployment assistance’. The issue of ‘regime’, i.e. of the rules and principles attached to the benefit, was only very selectively debated with regard to the acceptability of jobs offered and to the judicial branch that should be responsible for disputes. Aside from those two points, the implications of ‘borrowing’ from social assistance were not publicly addressed and presumably unclear to many of the decision-makers involved.

In order to characterise the new regime of ‘basic income support for jobseekers’ (BIS), only the following points must be added to what has already been said about social assistance:

- The concept of ‘family’ or ‘household’ has been broadened through replacing it by the *‘community of needs’*. Wherever partners of different or the same sex are living together with children or have been living together for more than one year even without children, they will be considered to be a ‘community of needs’ where one bears responsibility for the other. In assessing own means, the whole ‘community of needs’ will be taken into account. On the other hand, the traditional principle of inter-generational family subsidiarity was somewhat restricted in comparison to social assistance so that now parents are no longer responsible for children above 25 years and children no longer for their parents.
- Any ‘community of needs’ with *at least one member of working age and considered ‘able to work’* now falls into the regime of BIS. Individuals unable to work yet not qualifying for a disability pension or any other contribution-based benefit have remained in a residual system of social assistance, unless they belong to a ‘community of needs’ with one member ‘able to work’.
- *‘Ability to work’* is defined as “being able to work for at least three hours per day under normal conditions of the general labour market” or “being expected to become able to do so in the foreseeable future”.<sup>17</sup> Both the temporarily ill and those not available because of caring responsibilities (lone parents of young children) are considered ‘able to work’ though not required to seek jobs for the time being.

The abovementioned features are all very much within the regime logic of social assistance. So then what remains of the ‘Bismarckian’ unemployment insurance regime, except for the name ‘unemployment benefit II’?

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<sup>17</sup> These definitions are taken from the legal regulations for disability pensions: The medical criteria for qualifying for a disability pension have been transformed into criteria for defining the target group of labour market oriented activation.

- As a reminiscence of the earlier principle of status maintenance, there is a temporary supplement for those who have received a contribution-based unemployment benefit before entering UB II, which is paid on top of UB II for two years. For a single person, the supplement is a maximum of 160 € during the first and of 80 € per month during the second year. Since immediate passages from unemployment benefit proper to UB II are much less frequent than expected,<sup>18</sup> this supplement is not being paid to many claimants.
- Contributions to health, long-term care and pension insurance are being paid for recipients of UB II. As for health insurance, this does not really make a difference<sup>19</sup> since doctors' bills were covered directly in the previous system of social assistance. With regard to contributions to the national pension scheme, the improvement for former recipients of social assistance is minimal since contributions paid for them are equivalent to those which would be due if they were earning 205 € per month, resulting in monthly contributions of 40 €.<sup>20</sup> In comparison to unemployment assistance this is a harsh cutback, since contributions were then paid as if recipients were still earning 80% of their former income.
- Legal disputes concerning the basic income support for jobseekers are being handled by the social security courts, as is the case for unemployment insurance, but unlike social assistance for which the administrative courts are responsible. As a result, the social security courts are now bursting with cases.
- Finally, most of the many instruments of active labour market policy legally designed for recipients of contribution-based unemployment benefit are now also legally available for recipients of UB II (which is an improvement only for the former recipients of social assistance, as these instruments formerly applied to recipients of unemployment assistance anyway). However, in the tradition of social assistance, there is a general clause allowing all services and measures necessary for integrating claimants into working life, so that there does not really seem to be a need for any legally prescribed toolbox.<sup>21</sup>

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<sup>18</sup> Direct transition from the upper to the lower benefit account for not more than 11% of the inflows (Bach et al. 2008), indicating how much the two regimes have become separated.

<sup>19</sup> It does make a difference for the health insurance funds, which are loath of the new customers with high health risk and low contribution payments.

<sup>20</sup> Compared to the provision that was in effect during 2005 and 2006, this is a cutback of roughly 50%. Compared to claimants of unemployment assistance prior to 2005, pension increases earned during unemployment have dropped to 30% of the previous level. A full year with contributions of this magnitude will earn additional monthly pension entitlements of 2.19 €. By contrast, a full year of employment at an average income level will earn an additional monthly pension entitlement of 26.13 €.

<sup>21</sup> Currently the Federal Agency for Work, driven by criticism from the Federal Audit Bureau, is trying to restrict this flexible use of the budget for active measures and to press all interventions into the legally prescribed mold. This is part of the struggle for centralisation or decentralisation.

## 4 Institutional set-up of the regime of basic income support: the making of a governance dilemma

### 4.1 Political compromise creates a large-scale experiment

The Hartz Commission as well as the government in its first draft legislation had envisaged that the Federal Agency for Work should administer the basic income support for jobseekers in parallel to its traditional task of administering unemployment insurance. The municipalities were compelled to assist the Agency with social and other concomitant services only until the end of 2006. As from 2007, the local Agencies for Work would be free to buy such services from the municipalities or from other non-profit or for-profit providers.

The outcome of two controversial rounds of legislation each involving the arbitration procedure between the two chambers, the *Bundestag* and the *Bundesrat*, was quite different:

- (1) In fiscal terms, the federal government is now responsible for income support, while the municipalities are responsible for the larger part of housing and heating costs.<sup>22</sup>
- (2) In institutional terms, the original responsibility (the guarantor role) for administering income support and labour market related services (like job placement, active measures) lies with the Agencies for Work, while the municipalities are responsible for administering housing costs and concomitant social services (e. g. psycho-social, drug abuse, and indebtedness counselling plus childcare provisions).
- (3) However, at the operational level (the service provider role), Agencies for Work and municipalities are compelled to form ‘consortia’ (*Arbeitsgemeinschaften*) in order to pool their efforts and jointly administer the aforementioned services. This ‘togetherness’ means more than co-location or co-ordination: The two organisations are forming a unitary legal authority displaying ‘one face to the customer’ and issuing uniform legal acts about the two benefits concerned.
- (4) For a period declared as ‘experimental’ and extending until 2010, 69 municipalities<sup>23</sup> have been licensed to administer the new benefit and activation regime alone. The experiment is being scientifically evaluated with regard to which

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<sup>22</sup> In order to let the municipalities enjoy the alleviation from previous costs that was promised to them, the Federal Government shares roughly one third of the housing and heating costs. The assessment and distribution of this federal refund to the municipalities – inevitably via the treasuries of the *Länder* – is an issue of continuous quarrel. The settlement for 2007 foresees that municipalities in general will receive 31.2% of their outlays, while in Rhineland-Palatine and in Baden-Württemberg they will receive 41.2% and 35.2%, respectively. This odd pattern has resulted from a compensation deal for unresolved conflicts in the battlefield of tax redistribution between the *Länder* in general. The establishing of an explicit nexus between the financing of BIS and the fiscal redistribution mechanisms may turn out to be a difficult legacy for the future.

<sup>23</sup> 69 is the number of delegates of the *Länder* in the *Bundesrat*, which reflects the relative weight of the *Länder* in the German population. Therefore, the number of 69 appeared to offer an *a priori* solution for the allotment of options to the *Länder*.

organisation is delivering more effective services<sup>24</sup>, and after that there must be a new legislative decision on the institutional set-up.

- (5) For 21 territories for which neither license for full municipal responsibility was applied for and granted nor an agreement on the formation of a consortium was reached, responsibilities according to (2) are now fulfilled separately.

Out of 439 regional units, consortia have been formed in 351, their number being slightly higher because in some territories there is more than one. Since the regional compounds of the 178 district organisations of the Federal Agency for Work and the 439 German municipalities do not match and even occasionally overlap, this makes for complex regional structures. Berlin has created a consortium for each of its twelve districts, two counties have created two consortia each, while some other counties have united in forming border-crossing consortia, thus adding up to 455 organisational units administering the new benefit (IAW 2006a).

Though the local Agencies for Work are partners of the consortia, there is a clear tendency within the consortia to develop into organisations of their own which only use staff and facilities of the partners forming them. So, instead of the desired ‘single gateway’ or the uniform ‘Job-Centre’, Germany now has two separate regimes as before, but the second tier has become much larger. Public Employment Services in Germany now have two tiers, the second of which comes in three variants. In the 21 territories with ‘separate fulfilment’ not only two gateways exist, but the majority of workless people actually have to visit both of them in order to collect their means of subsistence.

#### **4.2 Why is this institutional outcome so different from the reformers’ intentions?**

On the level of politics, the answer seems simple: Party majorities in the *Bundestag* (the German Parliament) and the *Bundesrat* (the representation of the *Länder*) were different, as they often are. The Christian Democrats wanted to demonstrate their strength, and some Christian Democratic leaders like the Minister President of Hesse had a strong preference for municipal workfare-type policies. Hesse had introduced a bill that would have given the municipalities alone full responsibility for administering income support and ‘services on the labour market’ for unemployed persons without contribution-based benefit claims, and, incidentally, the 16 *Länder* would have gained far-reaching legislative powers regarding the details of discharging this responsibility. This shows how the reform, beyond mere party rivalry, became deeply enmeshed in the power struggle between the Federal State and the *Länder*.

But then, why did ‘Hartz IV’ so fully become a matter of ‘concurrent legislation’, thus giving the *Bundesrat* veto power over key elements of the government’s proposals? Without being able, not being a lawyer, to fully explore the constitutional legal implications, the author suggests that the crucial reason for falling into the traps of

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<sup>24</sup> For intermediate results see IAW 2007, infas et al. 2007, ZEW et al. 2007, and ISG 2007.

German federalism was the government's endeavour to 'merge' unemployment assistance with social assistance. Borrowing so massively from the principles of the regime of poverty relief infringed on municipal prerogatives and thus on the legislative powers of the *Länder*. In other words, if the government would have contented itself with simply transforming unemployment assistance from a wage replacing to a flat-rate benefit (like, for example, the ASS in France) and extending its family component in such a way as to render supplementary social assistance unnecessary, it appears unconceivable how – and why! – the *Bundesrat* should have prevented that.<sup>25</sup> So it seems that it was the 2<sup>nd</sup> Schröder administration's preference for certain regime elements of poverty relief<sup>26</sup> as a template for labour market policies that made it miss its purported target of creating a single gateway for all jobseekers.

Finally, carrying the analysis onto the level of vested interests potentially affected by the draft legislation, it must be observed that the government's plans had thrust both municipalities and their professional staff employed in social assistance administration into deep uncertainty. For if the local Agency for Work, from 2007 on, would have decided not to buy social services from the municipality, then professional careers would have been at stake, and the municipality affected would have had a redundancy problem – under the legal framework of the German public service without proper means to solve such a problem. In this way, the red-green coalition estranged its own followers which it had in large city administrations.

### 4.3 'Hartz IV' as a radical reform

All in all, these changes from wage replacement to a regime of poverty relief were of a fundamental nature for those roughly 2 million persons receiving unemployment assistance at the end of 2004. They are also far-reaching for those about 26 million employed contributors to unemployment insurance who can now, in the case of becoming unemployed, expect a status-maintaining wage replacement for no more than 12 – or at most 24 – months. Without unemployment assistance as an extension to unemployment benefit, Germany's balance between contributions and benefits in cases of unemployment appears quite unfavourable by international comparison.<sup>27</sup> An implicit goal here was to increase incentives for long-term unemployed to take up low wage jobs. This goal was neither spelled out in the Hartz Commission's report nor in the

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<sup>25</sup> It should also be reminded here that there once was a 'direct' entry into unemployment assistance (see footnote no. 12). By re-opening this for those who were able and willing to comply with the Federal Employment Agency's job search regime, which at the time was being re-enforced through the other parts of the Hartz legislation, employable recipients of social assistance could have been transferred into Federal responsibility.

<sup>26</sup> Namely the principles that any job is acceptable even below the collective agreement or the 'going rate', the 'activation' of all family members of working age and able to work, and that any reduction of neediness through work is desirable even if it does not end unemployment – which would require employment of at least 15 hours per week.

<sup>27</sup> This has been somewhat corrected by lowering the contribution rate from 6.5 to 4.2% as of January 1, 2007.

government's justification for its draft legislation 'Hartz IV', but it was present in the political and academic discourse.

As a result of the benefit reform, of the currently positive economic situation, of the shortening of the maximum periods of eligibility for insurance-based unemployment benefit, and finally because of the multiplication of customers in the regime of basic income support where now formerly inactive partners become targets of activation, unemployment insurance 'as we knew it' has become marginal in quantitative terms. In April, 2008, only 21% of workless customers were still served in the regime of 'insurance' while the vast majority was assigned to the regime of basic income support (see Table 1).

**Table 1: Customers of working age and 'able to work' in the two regimes, April 2008**

	<b>unemployment insurance / PES proper</b>	<b>basic income support for jobseekers &amp; consortial or municipal jobcentres</b>
registered as unemployed but not entitled to a benefit	433	by definition referred to PES proper
unemployed and receiving benefit	616	2,385
receiving benefit but not counted as unemployed	322	2,769
customer total	1,371	5,154
<b>customer share</b>	<b>21%</b>	<b>79%</b>

Source: [http://www.pub.arbeitsamt.de/hst/services/statistik/200804/ama/rechtskreisvergleich\\_d.pdf](http://www.pub.arbeitsamt.de/hst/services/statistik/200804/ama/rechtskreisvergleich_d.pdf)

Since *consortia* have been formed in 80% of the territorial units (which are responsible for even 85% of the 'communities of needs' to be served – IAW 2006b), the outcome of the reform in terms of activation and integration into employment will be largely shaped by this type of service organisation. However, the legal nature of a consortium is quite difficult to describe even in German (cf. Trümner 2005; Blanke & Trümner 2006), let alone in English, a language unburdened with certain subtleties of German public law. Having their own direction and governance structures and being able to issue legal acts, the consortia are legal entities of their own<sup>28</sup> (albeit of theoretically and juridically contested nature) and thus much more strongly integrated than, e.g., the French or Belgian *maisons d'emploi*, the Swedish co-operation centres or the Finnish LAFOS. On the other hand, just like in Denmark (except for the pilot jobcentres), employees seconded into the consortia are maintaining their employment relationship with their original organisation. This implies separate bodies of employee representation, different collective agreements, different job grading and pay, different working time patterns

<sup>28</sup> Most of them were set up as consortia of public law, a new invention brought about by the parliamentary compromise. In some cases, the partners founded a limited company of private law.



etc. Obviously, such a consortium is quite difficult to manage (Czommer, Knuth & Schweer 2005; Wiechmann et al. 2005), which hinders their performance. They are torn between influences from local government, central bureaucracy and federal politics and policies (Ombudsrat 2006). – With regard to the licensed municipalities, the Federal Government lacks direct control of their performance since, following the general constitutional pattern, the supervision of municipalities is a prerogative of the *Länder*.

By highlighting the epochal significance of the reform I do not mean to say that status maintenance, and more specifically for unlimited durations like in unemployment assistance, has in the past been supportive for the smooth functioning of the German labour market (Eichhorst et al. 2006). However, it was a typical German or ‘Bismarckian’ tradition that dates back to the introduction of unemployment insurance and a national PES in 1927. The breaking away from this tradition changed the feeling of social security, which explains why the reform was so poorly accepted (Eichhorst & Sesselmeier 2006) and why it had repercussions on the timing and the outcome of federal elections in 2005.

Whereas the German self-perception was – and still is – that of ‘inability to reform’ and of an existing ‘reform clog’,<sup>29</sup> (Kitschelt & Streek 2003; Sinn 2003), a comparison of activation policies in Europe since 1990 reveals that Germany was the *only* country that attempted to implement a structural benefit reform and a fundamental governance reform simultaneously – and without allowing for any transitional period.

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<sup>29</sup> ‘Reformstau’ was elected ‘phrase of the year’ in 1997.

**Figure 1: Benefit and institutional/organisational reforms in European comparison**

benefit reforms				institutional/organisational reforms
(1) none	(2) <b>gradual:</b> eligibility requirements, maximum duration, benefit levels	(3) <b>structural:</b> benefit types abolished or newly created, merger of benefits		
UK 2002-2006 Norway 2006-2010	Denmark 1993-2010	<b>Germany 1.1.2005</b> Netherlands 1996-2006	(A) <b>structural:</b> merging, splitting up, privatisation of social services	
Finland Belgium	Sweden 2007ff. Austria 2007-2010 France 2001-2007		(B) <b>gradual:</b> internal restructuring, new co-operations, creating add-on organisations for special tasks	

The attempt of policy-makers to break away from path-dependence (Pierson 2000 and 2004) without really bothering to understand the evolutionary paths they were tampering with explains why the reform resulted in institutional arrangements that were not intended by the architects of the reform and why they have turned out not to be sustainable.

## 5 Jobcentre reform in constitutional deadlock

Soon after the reform, five counties led by the association of county administrations appealed against the reform at the Federal Constitutional Court. Whereas the fiscal aspects of their complaint were rejected, they were successful in challenging the constitutional basis for the consortia, thus throwing the preponderant mode of governance of the predominating regime of working-age benefits into an apparently hopeless dilemma.

- (1) The *consortial jobcentres* may not continue to operate beyond 2010, according to the Federal Constitutional Court ruling of December, 2007. Key justifications for this ruling are that (a) the constitution does not foresee 'joint administrations' between the Federal State or its agencies and municipalities, (b) the obligation for municipalities, in the law on basic income support for jobseekers, to enter such a joint venture is violating their right of local self-government, and (c) that administrative responsibilities of the Federal State and the *Länder* (municipalities

here understood to be part of the *Länder*) must be kept separate and fulfilled with own organisation and staff of either level.

- (2) A generalisation of the competing model of *comprehensive municipal responsibility* for delivering BIS is no longer possible since the constitution was amended in the course of the ‘reform of federalism’ in 2006. This reform, striving to disentangle responsibilities of the different levels of government, introduced a clause precluding any federal legislation that would delegate new responsibilities to the municipalities. The implications of this clause for the ongoing experiment with alternatives models of delivering BIS were apparently overlooked by the legislators, even though the problem had been highlighted by one of the experts in the parliamentary hearing (cf. Fuchs 2006).
- (3) According to the Federal Constitutional Court, the legislator now has a choice to either have BIS delivered through a *purely federal administration* (which in practice would be the Federal Agency for Work), without participation of the municipalities, or to delegate responsibility for BIS to the *Länder*. Letting the latter possibility aside for a moment, the assumed constitutional acceptability of a fully federal system of BIS has not remained unquestioned. The constitution foresees federal bodies of public law to be responsible only for institutions of ‘social insurance’. A key feature of the introduction of BIS was the abolition of unemployment assistance, the follow-on benefit that emulated insurance principles (see 3.2). But can a system of basic income support and concomitant social services be considered a system of ‘insurance’? Municipalities resisting full federalisation would be very likely to put this question to test in yet another procedure before the Federal Constitutional Court. They would be motivated to do so by the loss of financial resources and local political visibility, and by problems of redundancy under conditions of full employment protection for many staff concerned. Consequently, full federalisation may be the tacit preference of federal policy makers, as it was in the process of the original Hartz legislation (see 4.1), but it is not a safe alternative.
- (4) *Delegation of responsibilities for BIS to the Länder* is the key to potential involvement of the municipalities on constitutionally unquestionable grounds. However, this would not be a guarantee for further devolution to the municipalities. The 16 *Länder*, if becoming responsible for BIS, would be free to organise services according to their own political will, in potentially 16 different fashions. This may or may not involve the municipalities, and it may involve them in regionally different degrees and forms. – Such undesirable structural fragmentation would however be a small problem compared to the fiscal and human resource implications of devolution. The federal state would not be prepared to remain directly financially responsible for a system in whose controlling and steering it would have no say. The *Länder* would have to assume responsibility for BIS in exchange for a higher share in VAT which is the tax category shared by the federal state and the *Länder* in proportions variable through legislation. By accepting such a deal, the *Länder* would assume the full financial risk of future increases of caseloads. Until now the *Länder* appear not to have become inspired by entrepreneurial optimism that, under their

own skilful governance, future caseloads might decrease so that the *Länder* treasuries would reap the gains. Consequently, the *Länder* are j reluctant to assume responsibility for BIS, and federal legislators are loath to devolve this responsibility. The latter must also be concerned about redundancy in the Federal Agency for Work as a result of giving the larger part of the Public Employment Service out of federal hands.

To sum up, alternatives to the current and legally unsustainable governance system of BIS (1) are either equally unconstitutional (2), or they bear new constitutional risks (3), or they lack support by a majority of political forces (4) – which may also be said for (2) and (3). The ‘Hartz IV’ reform has lead into a constitutional deadlock. In theory, it would be conceivable to legalise the consortial jobcentres or other presently precluded models by amending the constitution once again. However, this would require majorities of two thirds in both chambers and thus a very high degree of consensus not only with regard to changing the constitution again but also with regard to the model of BIS governance for which the change of the constitution would be paving the way. Such a consensus is very unlikely to evolve, given the multitude and over-crossing of ideological affinities of political parties, the rivalry between the federal state and the *Länder* built into the federal system, the diversity of interests between big cities and rural counties, and the interests in self-perpetuating of large organisations involved.

In the absence of fundamentally new solutions at the constitutional and legislative level, the recent ruling by the Federal Constitutional Court will render void the legal base of the consortia by the end of 2010. At the same time, the experimental delegation of full responsibility for BIS to 69 municipalities will expire. The system will then fall back to its default state in which the Federal Agency for Work is responsible for income support and employment services and the municipalities responsible for housing allowance and social services. Customers would then receive two separate legal acts out of two legally independent hands – after two parallel procedures of means testing supposed to follow the same criteria but without guarantee for congruent outcomes. The physical maintaining of ‘one stop’ services in the form of shared offices and the co-ordination of two personal advisors managing different aspects of the same case would depend on the good will of the parties concerned.

In an attempt to make the best of an impossible situation, the Federal Ministry for labour is now advertising the ‘Co-operative Jobcentre’ as the model of the future. The 21 districts that defied the law by neither applying for the ‘municipal option’ nor entering a consortium are now hailed as the heralds of the future. By contrast, frontline administrators who have successfully gone through the impossible process of forming a consortium are pressing lawmakers to change the constitution once again so that they would be allowed to continue operating jointly and to counterbalance the Federal Employment Agency’s relentless centralism by local political influence.

It would probably be legally acceptable to incentivise such co-operation by moral or financial premiums, thus giving the future ‘co-operative jobcentres’ a status similar to the French *maisons d’emploi*. It would however be ruled out, for the constitutional reasons outlined above, to make such co-operation mandatory as in the Danish

jobcentres. Furthermore, whereas in Denmark the two partners in the co-operative jobcentres are responsible for *different* groups of clients, insured versus uninsured, the partners of the German co-operative jobcentres would be responsible for different services and benefits to the *same* uninsured clients who would have to deal with two bureaucracies. This result, though legally and politically almost inevitable, would nevertheless be grossly unacceptable to the concerned and interested citizens.

- In a professional perspective, it seems obvious that services at best loosely coordinated are sub-optimal, to say the least.
- In a customer perspective, a system that is already highly complex and difficult to work through will become more intransparent through institutional split.
- In a historical perspective, the creation of '*one face to the customer*' was the central promise of the Hartz reforms. The abolition of unemployment assistance was justified as an adequate price to be paid for the merging of the services of the Federal Agency for Work and the municipalities. In the first round of parliamentary compromise, the goal of 'one stop for *all* job seeking customers' had to be given up in favour of creating a largely separate new regime for those without unemployment insurance entitlement. If, as a result of political inability to respond to the Federal Constitutional Court ruling, every non-insured customer would now have to face *two* bureaucracies, institutional cleavage would affect a multiplicity of individuals compared to the situation before the reform<sup>30</sup>, and the justification for a benefit reform that had more losers than winners would be de-legitimised.

## 6 Conclusion

The 'Hartz IV' reforms have refuted the widespread notion that Germany is unable to reform. Quite contrary, it proved able to decide and to implement the most radical labour market policy reform in Western Europe. What really appears to be lacking, however, is *reflexive governance*, understood here as an in-built capacity of the political system to respond to changing social realities, the manifold interdependencies between different systems of social protection and between different policy fields, and the constitutional order.

The path-shifting departure from the 'Bismarckian' paradigm of social insurance, the creating of a new benefit regime involving extensive borrowing from the regime principles of municipal poverty relief, while simultaneously taking responsibility for needy families with at least one member 'able to work' and supposed to be activated away from the municipalities, has thrown the new regime of 'basic income support for jobseekers' in a constitutional no man's land. A social policy path dependence – i.e. that the federal state should be responsible for nation-wide schemes of social insurance whereas the municipalities should be responsible for poverty relief of their inhabitants –

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<sup>30</sup> 5 million (see Table 1 on p. 16) instead of previously 10,000 individuals (see footnote 10 on p. 7).

has come to clash with a constitutional governance path dependence – i.e. that the municipalities are ‘contained’ by the *Länder*, that there can normally be no direct transaction between the federal state and the municipalities and that responsibilities between the federal state and the *Länder* must be kept strictly apart except in the few fields where the constitution explicitly declares joint responsibilities. The lack of reflexivity of the German system of governance appears to be indicated by the fact that a *blending* of responsibilities in the field of labour market policies and a constitutional move towards a clearer *separation* of responsibilities were enacted simultaneously without at all broaching the issue of this obvious contradiction.

This blunder could have been avoided by a higher awareness of the mechanisms of path dependence. Unemployment assistance could have been reformed in its own right instead of abolishing it. Institutional overlap and disincentives of taking up work could have been removed by introducing a bottom just slightly above the level of social assistance and by making the benefit degressive so that the bottom would have been reached after two years. This reformed unemployment assistance could have been opened at the bottom level for all recipients of social assistance willing to actively seek work and to conclude a back-to-work agreement, and the change-over would have been incentivised by the slightly higher benefits and the prospect for better employment services. In terms of the resulting benefit structure, this hypothetical reform would have been very much the same as ‘Hartz IV’. However, the institutional outcome would have been very different. It would not have come to anybody’s mind to challenge the Federal Employment Agency’s responsibility for unemployment assistance even though it never was a ‘social insurance’ proper, simply because the Agency had always been responsible for a benefit known by this name. And the municipalities would never have complained of losing social assistance customers and of being rid of the financial burden they were on municipal budgets; quite the contrary, they would have encouraged their clients to enter the rank and file of the jobseekers. Financial incentives to belong to the category of the jobseekers plus intense activation starting immediately on entering the system would have kept the deadweight of customers impossible to activate out of unemployment assistance and in social assistance.

Against this hypothetical scenario – which was never discussed – it stands out that it was the ignorance about the different regime logics and path attachments of two apparently overlapping tax-funded and means-tested benefits that created the present German governance dilemma in labour market policies. It may be that in unitary central states different government services can be ‘joined up’ relatively easily. However, policy makers operating in environments of multi-level governance and a polycentrism of democratic power are better advised to enact social policy reforms within the boundaries of existing responsibilities. Otherwise there is a high risk that considerations and unresolved conflicts with regard to the overall distribution of power, resources and burdens will get the upper hand over the specific policy field that is supposed to be reformed.

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