

BOOK REVIEW

Redesigning the Welfare State: Germany's Current Agenda for an Activating Social Assistance, edited by Hans-Werner Sinn et al. (Northampton, MA, Edward Elgar Press, 2006, 204 pp., \$95.00 (U.S.))

reviewed by Dieter Sadowski†

Given the increasing mobility of capital and labor, many industrialized countries today face strong pressures on their low-wage earners, but in Germany their unemployment rate has been particularly high—and increasingly so over the last few decades. Hans-Werner Sinn and four of his collaborators at the ifo-Institute, an important voice among German economic research institutes, put forward the hypothesis that this social and economic disaster is not just caused by the globalization of competition, but that the system of welfare benefits itself is a major cause of the evil. They concentrate on this single element of the welfare state, social assistance, and highlight a reform proposal that the ifo-Institute introduced into the public debate in 2002, comparing it to similar international endeavors and attempting to evaluate “ex ante” the far-reaching reforms of the Schröder administration, the so-called *Hartz Reformen* from 2005, in light of their own proposal. At the time they completed the manuscript, this was a brave goal, because even now conclusive empirical studies about their impact are inevitably not yet available. This book is explicitly meant “as a contribution to the public debate on economic policy that offers workable solutions for a new surge in employment and growth in Germany” (p. 6). It concedes its normative underpinnings from the very beginning; an outspoken style presents its messages clearly and leaves no doubt about the authors’ conviction of presenting a valid diagnosis and proposing a superior solution.

The first chapter presents statistical figures on the level and development of low-wage and low-skill earner unemployment in both West and East Germany. It points out that the burden of reunification aggravates the crisis, but does not cause it. In Germany, social assistance was conceived “as a wage-replacement scheme, securing some minimum level

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of income for needy people and protecting against risks such as loss of work and the resulting poverty.” In Germany as elsewhere it is held that the higher the level of social assistance, the smaller the wage dispersion, because social assistance serves as reservation wage. If, for instance, in a family with one earner and two children living in West Germany, social assistance and housing benefits amount to approximately 62% of the average net wage, then those household heads with a productivity less than 48% of the average should not find a job—assuming wages are set in line with individual productivity; in East Germany with its higher benefit levels this threshold would be 60% of the average (p. 22).

Removing false incentives of social benefits therefore is at the heart of the Ifo-Institute’s reform proposal. After recounting how the political agenda had changed under Schroeder, with a new left-wing party coming into being opposing these changes, the third chapter lays out in detail the three-part reform proposal “Welfare to Work”:

- Wage subsidies that are calculated so that, with full-time work at a typical wage rate for low-skilled individuals, the sum of wages earned and state support would lead to a household income that is higher than social assistance in the old system.
- Defining a minimum level of benefits that makes unemployment financially unattractive.
- Offering publicly organized employment for those who cannot find work in the regular labor market.

If the income of a household increases by more than a Euro for every Euro earned—and the wage tax credit is promptly paid out, then there should be a strong incentive to leave unemployment. Limits on the duration of benefits, previously unknown in Germany, should likewise induce job searching efforts. If unions, in addition, allowed new low-wage groups to be covered in collective agreements to make wage tax credit accessible for their members, that would also foster employment and induce “a supply-side growth spurt for the entire economy” (p. 42).

What is new and still controversial in Germany, is well known abroad. The authors give a concise overview of the Earned Income Tax Credit in the United States, the Child Tax Credit and the Working Tax Credit in GB, and the French “Prime pour l’Emploi.” They also stress that Negative-Income-Tax proposals, “Bürgergeld” in its new German version, increase existing entitlements instead of replacing them and therefore would strain public budgets and taxpayers too much, as the marginal tax burden in Germany is, at 65%, already the highest internationally—according to the authors (pp. 44, 65).

Community services or workfare had long been anathema in Germany, because of the Nazi abuse of *Zwangsarbeit* (forced labor). An historical

sketch, however, shows that workfare programs were first introduced in the United States in the early 1980s, and by now are familiar in Great Britain, Denmark, the Netherlands, and to some extent in other European countries (pp. 75–78).

The next two chapters are of interest mainly to political scientists—the fourth chapter gives an account of the slow and difficult path to the Hartz-Reformen initiated by a red-green government—and the last one to evaluation specialists, who might find pleasure in checking the quality of the ex ante evaluation of the Hartz reforms.

With hindsight, some measures from the “*Hartz Reformen*” did not (yet?) produce the expected or desired results; whether the same will be true for the reform of the long-term unemployment benefits is still to be seen. Whoever wants to influence current policy making, it is true, has to be fast and to make himself heard. Although Sinn et al. here clearly focus on one instrument only, it would have been helpful to look at available evidence with other attempts to create *Combi-wages*, such as so-called *Minijobs*, where the subsidies for jobs not paying more than €400 come as reduced fees for social health and retirement insurance. Displacement effects are among the least desired consequences of wage subsidies, whatever form they may take. Yet it seems that only relatively small numbers of unemployed were brought into work via *Minijobs* despite a strong increase of their number after the reform in 2003. The vast majority of those new jobs are held by workers who were formerly employed under normal conditions, or by students or retired persons.¹ Local experiments with *Combi-wages* have not lived up to any high expectations either.

Perhaps a wider frame of reference could help. With reference to U.S. data at least, Acemoglu and Shimer argue that higher unemployment insurance *increases* labor productivity, encourages workers to seek higher productivity jobs, and encourages firms to create such jobs.² Furthermore, Freeman defies the labor market mechanics in many deregulatory texts, hinting at the scant success supply-side policies can register so far.³ In 2006, we can observe a visible increase in regular jobs subject to social security, and this is a major one. The internationally comparable German unemployment rate in April was 6.4%, down from 8% a year before, below France’s 8.1% and not so far above Britain’s 5.5%. On this basis, it would be rash to dismiss Sinn et al.’s theorizing, we just have to do more differential

1. Torsten Brandt, *Bilanz der Minijobs und Reformperspektiven*, 59 WSI MITTEILUNGEN 446 (2006), available at http://www.boeckler.de/pdf/wsimit_2006_08_brandt.pdf.

2. Daron Acemoglu & Robert Shimer, *Productivity gains from Unemployment Insurance*, 44 EUR. ECON. REV. 1195 (2000).

3. Richard B. Freeman, *Labour Market Institutions Without Blinders: The Debate over Flexibility and Labour Market Performance* (NBER Working Paper # 11286, April 2005), available at <http://www.nber.org/papers/w11286>.

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diagnoses—and as to the longer term consequences of current German reforms, more patience is needed.