

# An Evaluation of the “Hartz Reforms” in Germany

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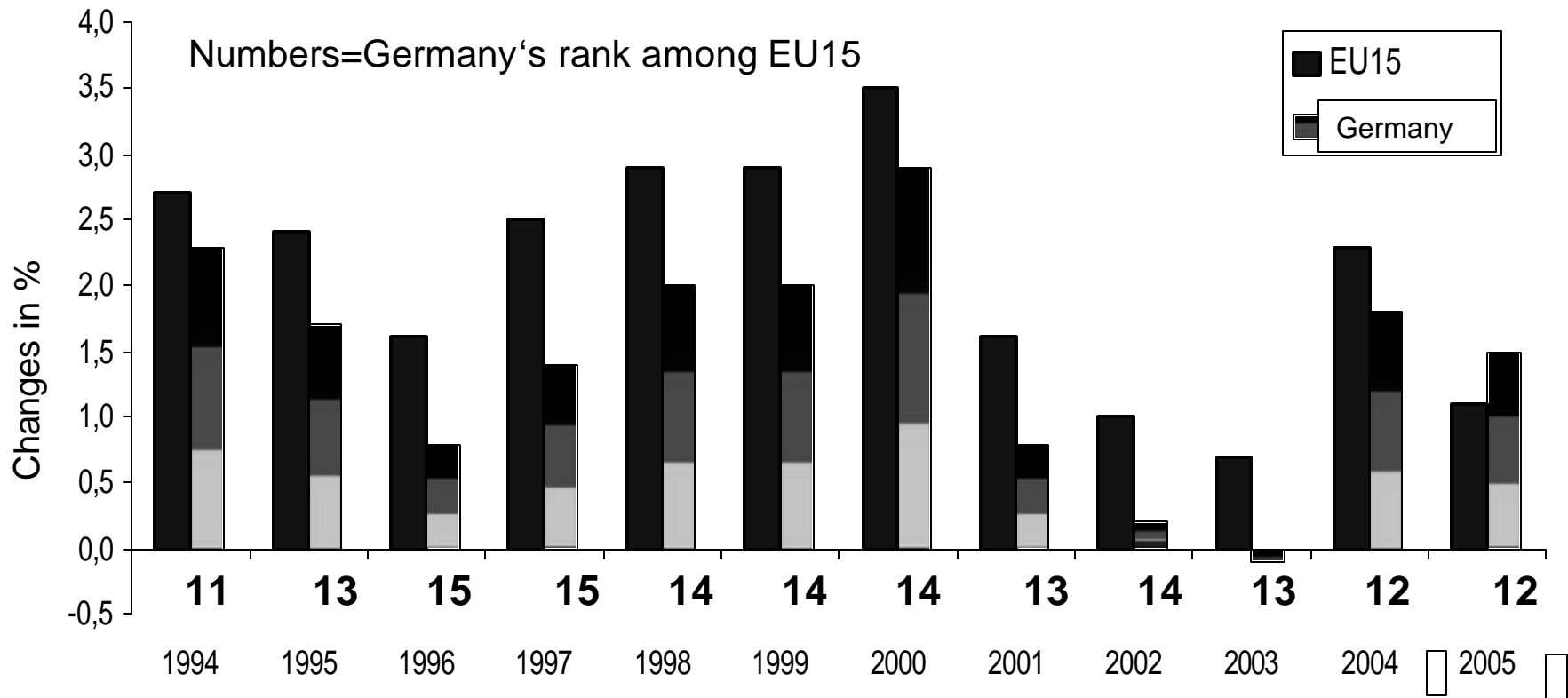
# Outline

- ① **Slow growth and high unemployment in Germany**
- ② **Failed policies of the past**
- ③ **Chronology of reform policy until 2005**
- ④ **Preliminary results of first extensive evaluation**
- ⑤ **New government – new policy?  
Outlook and perspectives**

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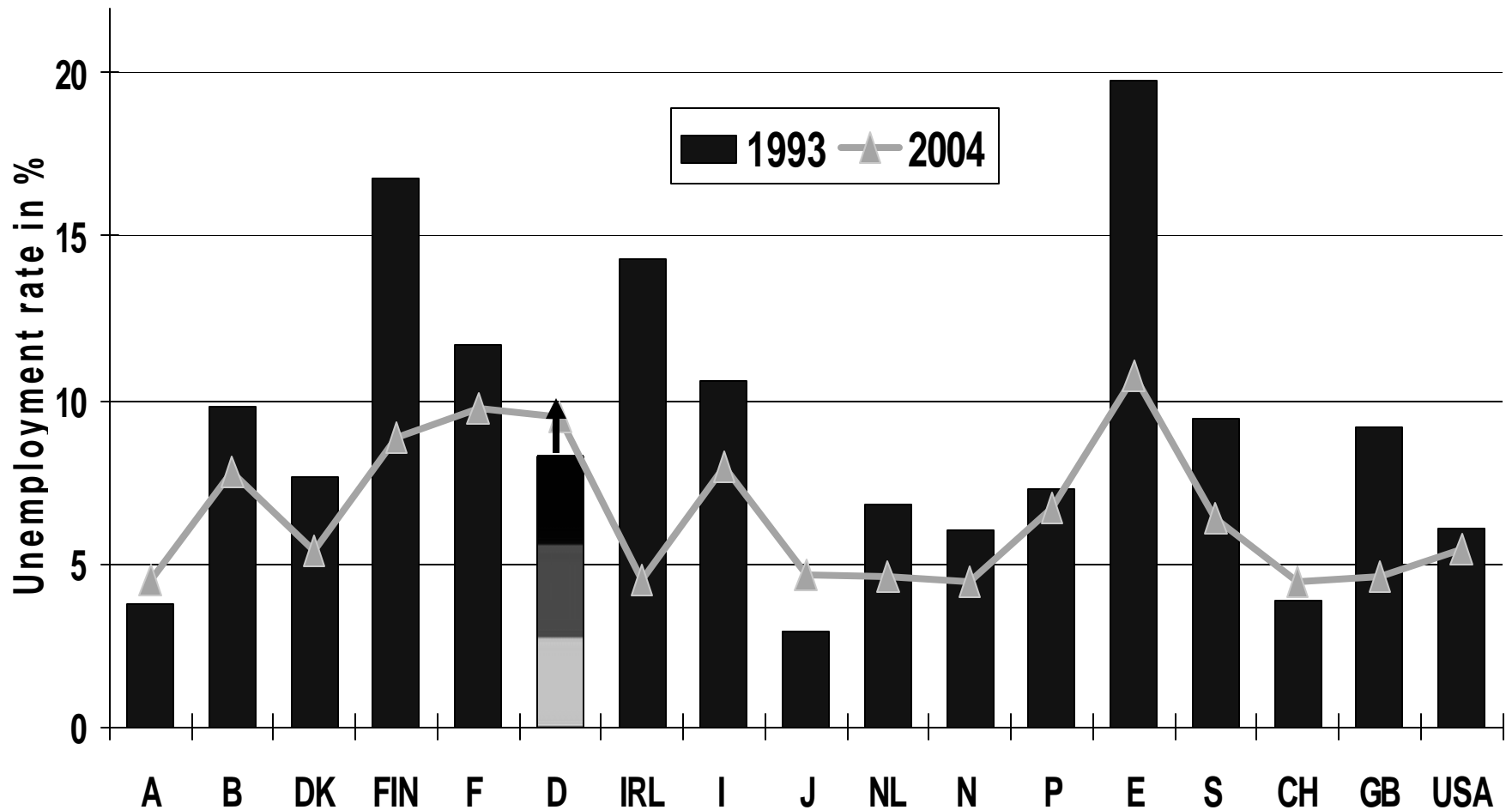
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# Real GDP growth in D and EU15: Particularly slow growth in Germany

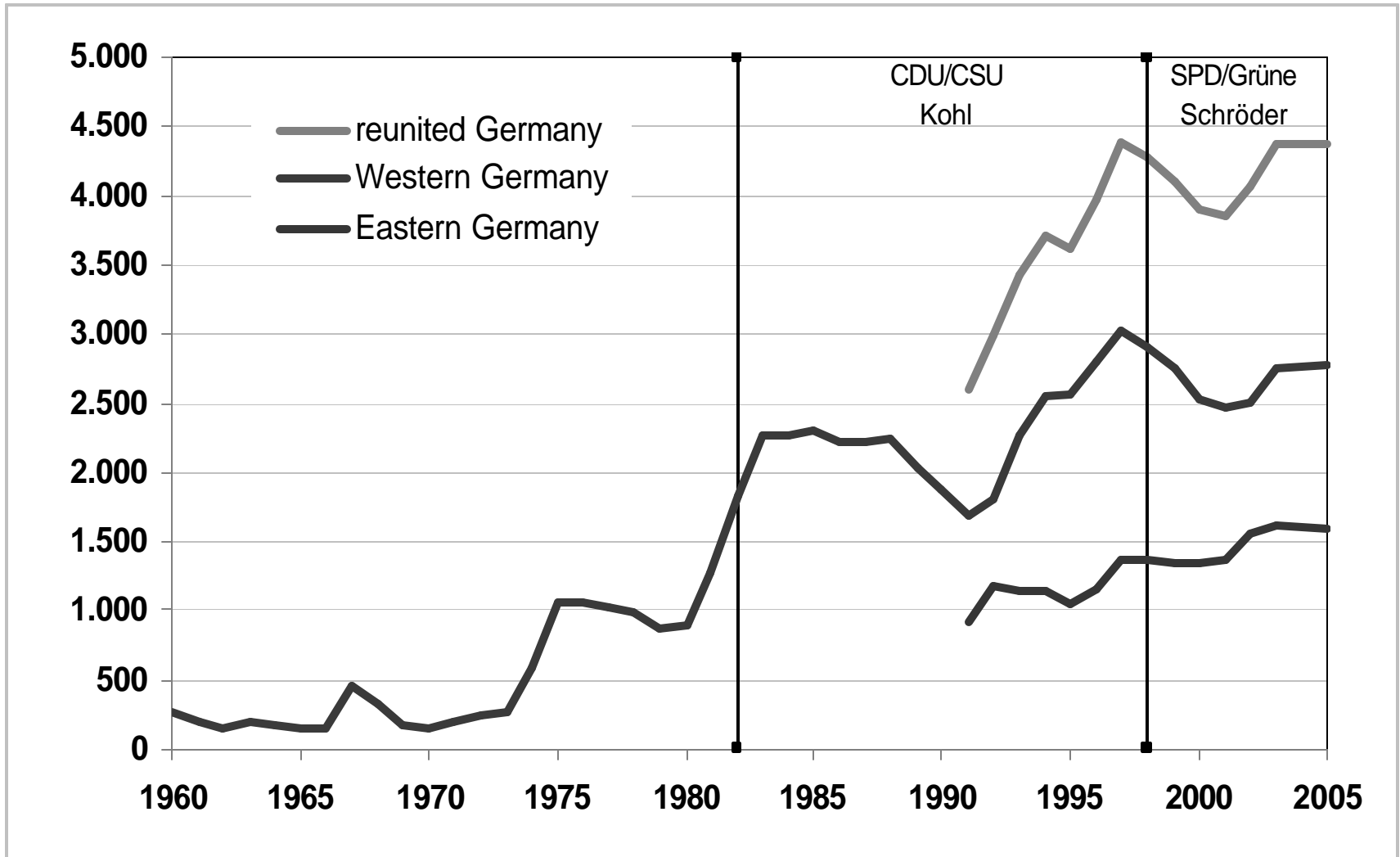


2004 and 2005: Forecasts by DIW Berlin

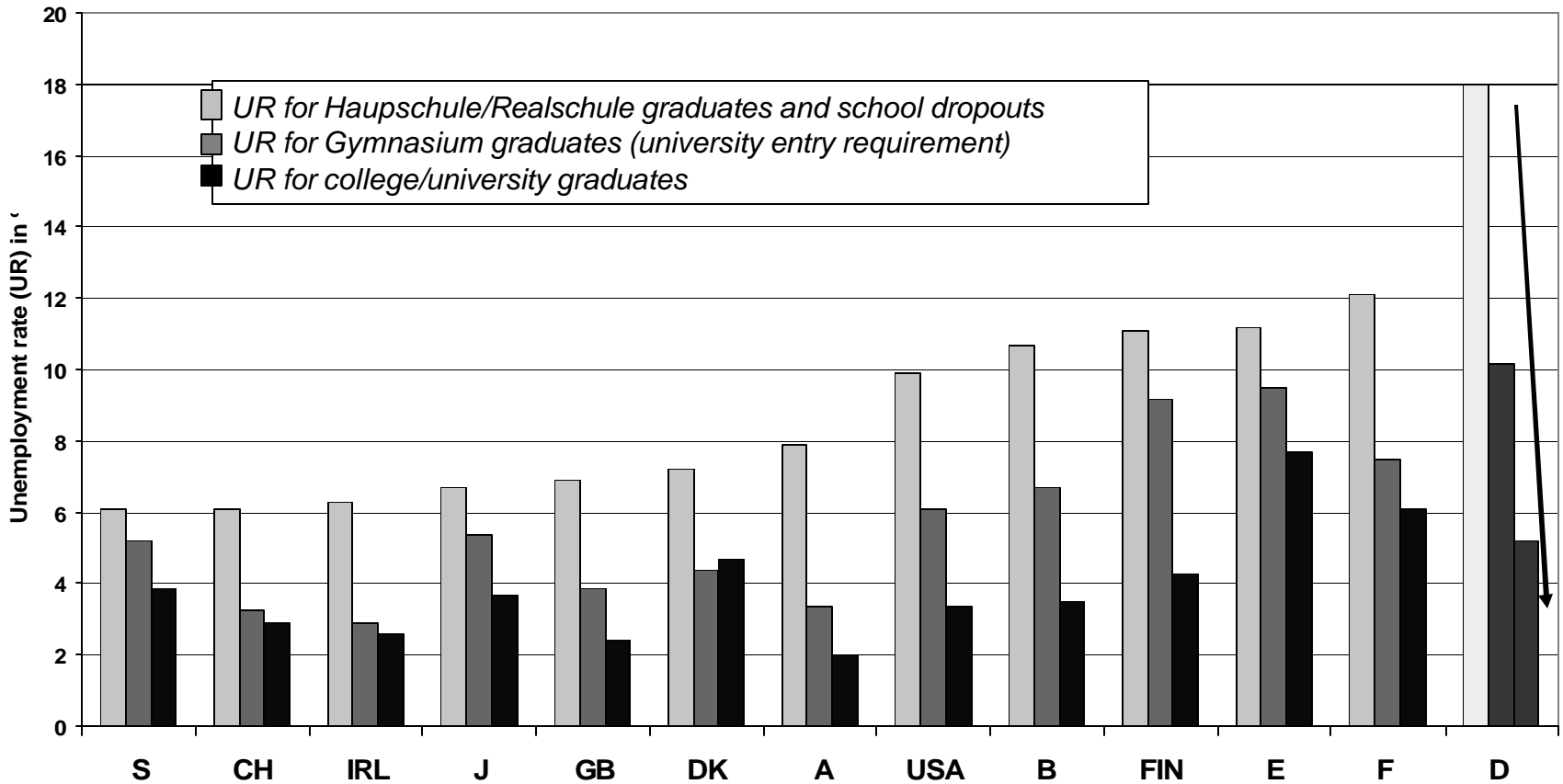
# Unemployment in international comparison: Germany's performance is cause for concern



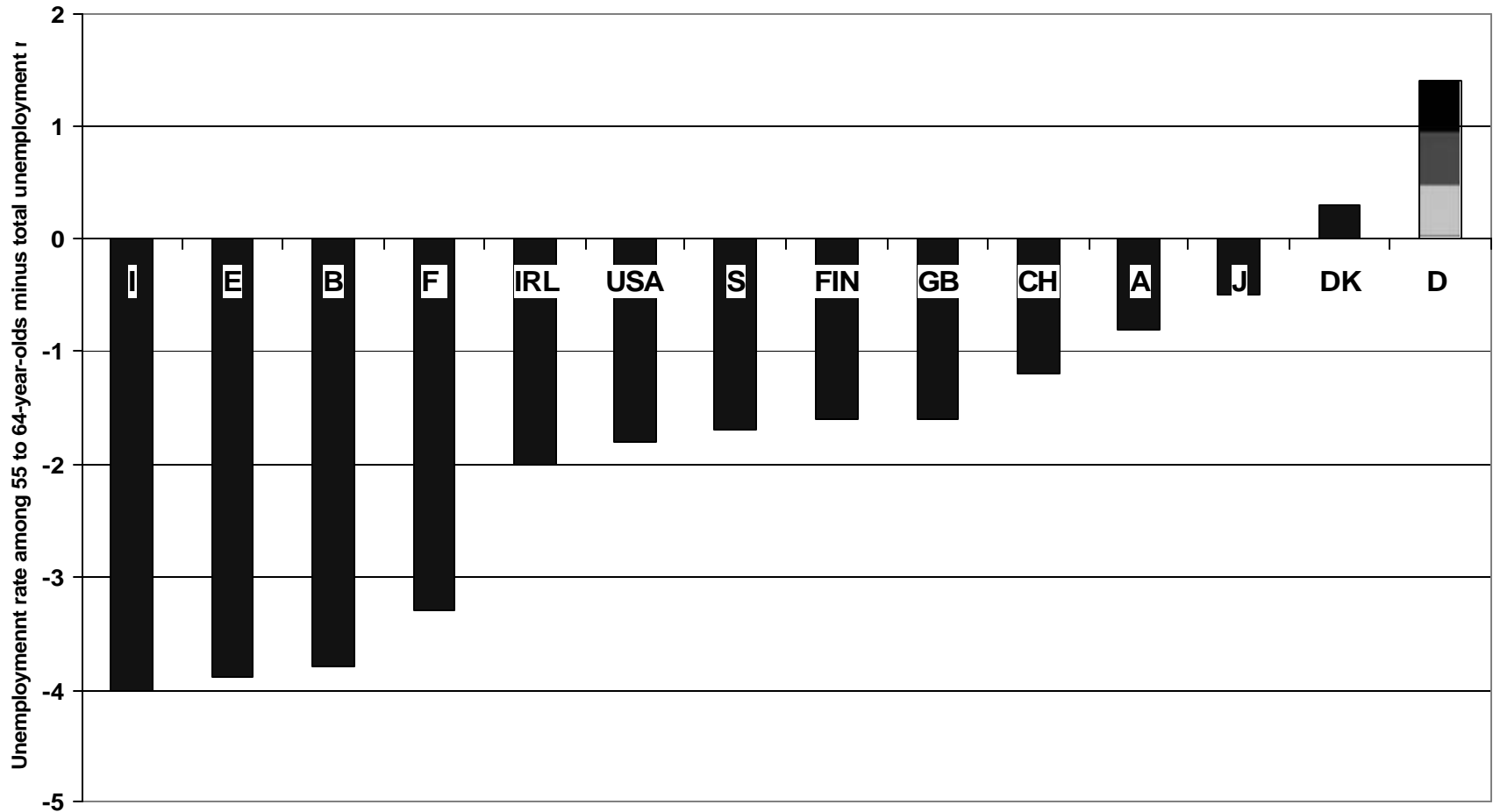
# Development of unemployment in Germany



# Unemployment in Germany: Largely a problem of the low-skilled



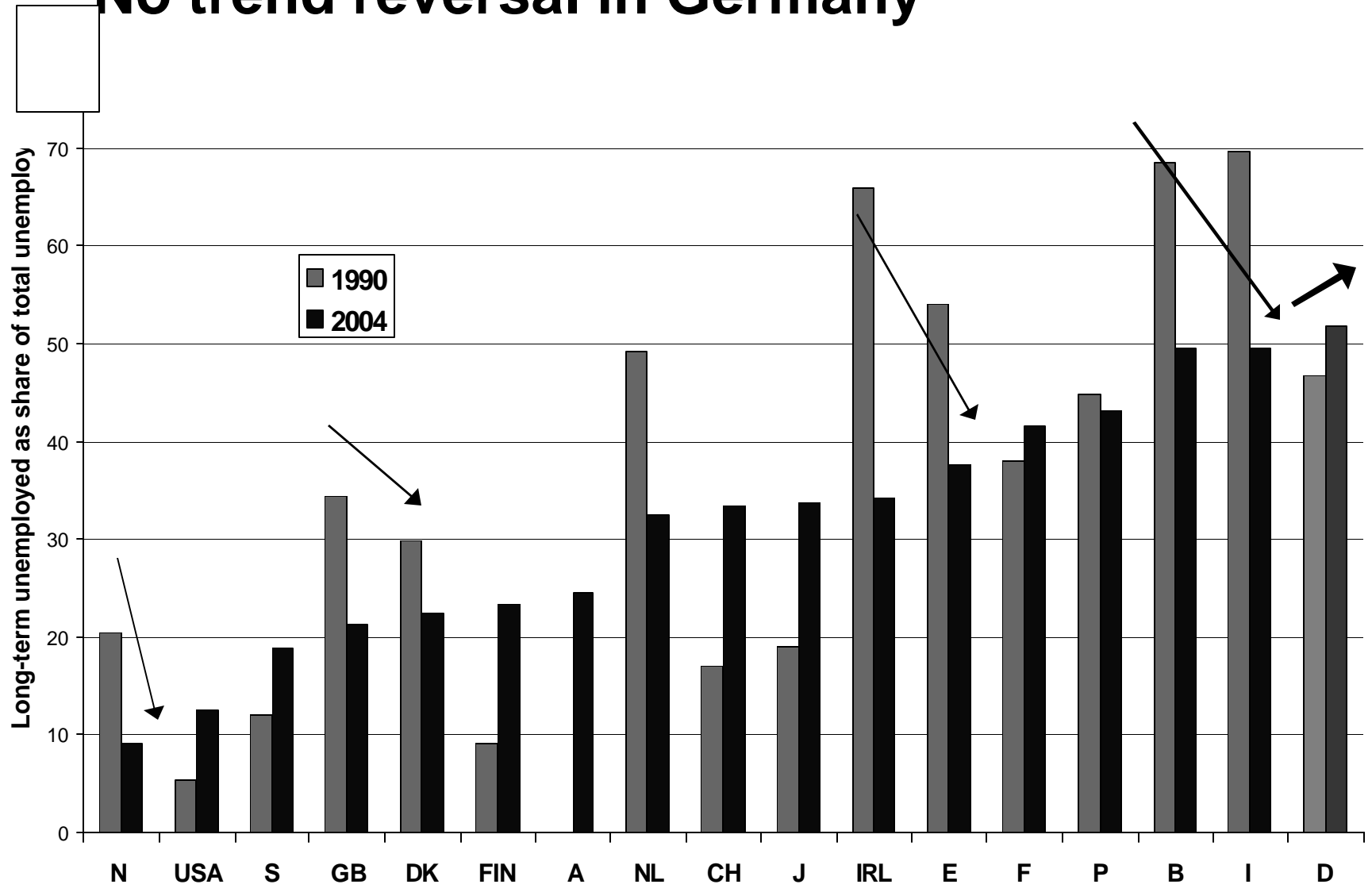
# Unemployment in Germany: Older workers disproportionately affected







# Long-term unemployment: No trend reversal in Germany



Source: OECD



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# How has Germany tried to cope with unemployment in the past?

- Extension of maximum duration of unemployment compensation to up to 32 months for elderly (benefit level: 60-67% of previously earned net income)
- Introduction of generous early retirement programs
- Introduction of so-called transfer companies (prolongation of maximum duration of unemployment compensation by another 24 months)
- Public employment programs that led to renewed eligibility for unemployment compensation (especially in Eastern Germany)
- Unlimited eligibility for unemployment aid (up to 57% of previously earned net income, but means tested)

# Fatal consequences ...

- Rising implicit minimum wages
- High unemployment rates of the elderly
- High unemployment rates of low-skilled workers
- High long-term unemployment rate
- Rising labor cost due to a rise in social contributions (especially with regard to financing a large part of reunification cost via social insurance)
- Strong bargaining position of the unions

➔ **Germany's unemployment problems are caused by structural problems**

➔ **A boom of the business cycle will not at all be sufficient to fight high unemployment figures**

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# Chronology of reforms

- February 2002: Establishment of the Commission “Modern Labor Market Services”  
Members: business executives, unions, crafts associations, politicians, scientists (no economists!) = “Hartz Commission”
- August 2002: Presentation of findings and implementation decision by federal government
- Implementation in four acts
  - 1st and 2nd act – Jan. 2003 (“Hartz I + II”)
  - 3rd act – Jan. 2004 (“Hartz III”)
  - 4th act – Jan. 2005 (“Hartz IV”)
- Extensive scientific evaluation of labor market policies incl. provision of individual data; final report in fall 2006, preliminary report is available
- Comparable European evaluation efforts only in Sweden and Switzerland

## Hartz I – start of reform (2003)

- Early **registration** mandated even for impending unemployment
- Stricter rules for taking up “**reasonable**” employment (e.g. relocation without family ties now considered reasonable)
- **Benefit reduction**: In cases of rejected job offers, burden of proof now with the job seeker, not the job center
- **Reorientation of further training**: Training vouchers, certification of training service providers etc.
- **Programs targeted at the elderly**: (e.g. firms who hire workers above age 55 need not contribute to unemployment insurance; longer temporary contracts allowed)
- **Personal Service Agencies (PSA)** as a “vitalizing” element in job placement

## Hartz II – promotion of employment (2003)

- Unemployment offices turned into **job centers**  
Goal: new self-conception as a common point of contact for both unemployed workers and social welfare recipients
- Introduction of the **Ich-AG (“I Inc.”)** start-up assistance
- “Mini jobs“ – **changed additional earnings limits** for transfer recipients
- Government sponsoring of **household-related services**;  
easy registration of household help, which is then insured



## Hartz III – minor changes (2004)

- Merging of job creation programs (ABM) and structural adjustment programs (SAM)
- Stronger focus of ABM on reintegration prospects of the unemployed
- Employment services restructured and renamed
- Short-time work transfers are paid to employers during corporate restructuring programs (evaluation by DIW/IZA)
- Uniform entitlement to unemployment assistance (previous six-month special entitlement for draftees/conscientious objectors and seasonal workers abolished; ABM participation no longer creates additional entitlement)



## Hartz IV – key reform of the labor market (2005)

- Merging of long-term unemployment assistance with social welfare transfers – inclusion of fit-to-work individuals previously not registered as unemployed
- Provision of public utility jobs for fit-to-work transfer recipients (“One-Euro Jobs”)
- Further tightening of “reasonableness” clause (sub-union wages and “standard regional wages” must now be accepted); otherwise transfers may be cut; reintegration contracts
- Introduction of “entry assistance” as a financial incentive to take up employment



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# Evaluation results I: Reform of job placement by federal agency and communities

- + reform of organizational structure shows initial success; restructuring of Federal Labor Agency (BA) launched
- + BA starts to shift focus from social policy to labor policy: decisions no longer based on social needs alone, but increasingly on labor market prospects
- however: reform stalled halfway, still conflicting interests of BA and communities over allocation of problem groups
- organizational problems: customer satisfaction with BA services not yet improved

# Evaluation results II:

## Reorientation of labor policy instruments

### + INTEGRATION ASSISTANCE:

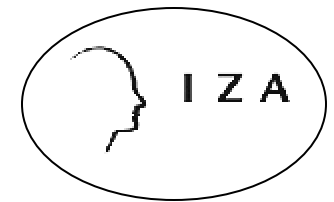
- one of the most important instruments
- used more efficiently than in the past
- positive effect on job prospects found

### – JOB CREATION PROGRAMS:

- previous negative assessments confirmed
- detrimental effect on reintegration prospects
- abolishment called for

# Evaluation results III: Reorientation of labor policy instruments

## + FURTHER OCCUPATIONAL TRAINING



- findings of IZA long-term evaluation remarkably positive
- other studies refuted: short-term assessment yields negative results but fail to account for the measurable long-term catch-up process of participants
- reform has led to substantial efficiency gains: “lock-in” effect decreasing
- medium-term integration success can be improved by continuing reforms

# Evaluation results IV: Reorientation of labor policy instruments

## + / – START-UP ASSISTANCE (“I INC.”):

- positive assessment mainly attributable to free-riding effects
- share of short-term unemployed in the evaluation about 50% (in this group start-up success is likely without financial assistance)
- modification of this instrument necessary in order to support only “true” business start-ups

# Evaluation results V:

## Reorientation of labor policy instruments

### – / + JOB PLACEMENT VOUCHERS:

- basically positive assessment of concept: free choice of placement service provider through vouchers issued to the unemployed
- however: so far no measurable improvement of integration prospects, same unemployment duration without voucher (competing study finds opposite result)
- no activation effect found (only 10% of vouchers used)
- information on providers' competence still lacking



# Evaluation results VI:

## Reorientation of labor policy instruments

### + / – COMMISSIONING THIRD PARTIES WITH INTEGRATION PROGRAMS:

- conflicting evaluation results: on the one hand evidence of failure of this instrument (reason: Federal Labor Agency tends to shift bad risks to external service providers)
- on the other hand evidence of earlier labor market integration as a result of these programs
- in any case, innovation competition between providers must be enhanced

# Evaluation results VII:

## Reorientation of labor policy instruments

### – PERSONAL SERVICE AGENCIES:

- “flagship” of labor market reform turns into disaster despite wide availability of this offer
- number of PSA employees far below expectations
- contrary to temp agencies, prospects of turning job into permanent employment are weak
- absorbability of firms in this segment apparently lower than expected
- evaluation shows that PSAs have worsened integration prospects of unemployed
- reasons still unclear: “bad risks”, union-wage requirement, slow economic growth?

# Assessment of the evaluation results

- As could be expected, evaluation results are ambiguous: no “breakthrough” yet, but visible progress
- Despite criticism, long-term effects of Hartz reforms should not be underestimated: first courageous reform approach after years of political idleness
- Note: current results of evaluation are only preliminary
- Many programs are too “young” for a reliable judgment

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# Substantials of the labor market reform to stay

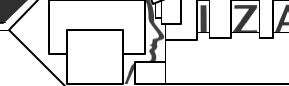
- Reduction of maximum duration of unemployment compensation to 18 months for elderly
- Reduction of transfer measures to 12 months
- Public employment programs do no longer lead to a renewed eligibility for unemployment compensation
- Unemployment aid has been cut down to the level of welfare payments
- Work requirement for recipients of unemployment aid
- Elimination of rules for reasonableness of job offers for recipients of unemployment aid

# Potential impact of the reform on the long run

- Decline of implicit minimum wages
- Higher integration rates for older workers
- Higher integration rates for low-skilled workers
- Decline of long-term unemployment rate
- Decline of labor cost, since transfer recipients turn into tax payers and payers of social contributions
- Weakening of the bargaining power of the unions (Siemens, Daimler-Chrysler, General Motors)

# Policy proposals of the Grand Coalition

- budget consolidation primary objective
  - subsidy reduction (not consistent enough)
  - VAT increase in 2007 to compensate e.g. for reduced contributions to unemployment insurance
  - corporate tax reform in 2007
  - debate on “combination wage” rehashed (useless)
  - layoff protection: probation period extended to 2 years maximum, but no fundamental reform (severance pay)
  - decision to raise retirement age to 67 over medium term
  - health reform postponed
- ➔ overall concept not yet convincing



## What else must be done?

- promote courageous and efficiency-oriented restructuring of job placement, reduce bureaucracy
  - implement workfare to improve incentives to take up work (social transfers require reciprocity in the form of public utility tasks; stronger motivation to seek regular employment)
  - firm-level agreements should supersede union agreements
  - no overregulation through minimum wages
  - expansion of low-wage sector through service agencies and deregulation of the welfare sector
  - meet shortage of high-skilled labor and demographic change with well-targeted immigration rules
- ➔ reform of federalism as the “mother of all reforms”





# Deutschland – was nun?

## Economists present reform concepts



Published in 2006  
with contributions to:

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- ✓ Labor Market
- ✓ Pensions
- ✓ Health
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- ✓ Family
- ✓ Immigration
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