



# Germany's Welfare State

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Why the Welfare State?

The Welfare State as Competitor

The German Malaise

German Unification

Agenda 2010: Schröder´s Reforms

Minimum Wage or Minimum Income?

Conclusions

# Why the Welfare State?

# Reasons for the welfare state

- Social peace, less crime
- Democratic power
- Career insurance (solidarity)
- Encourage risk-taking

*But also negative  
work incentives*

# A comparison

	Chile	Germany
Self-employment	25%	11%
Gini coefficient	0.55	0.34
Social transfers/GDP (health, education, old age)	15%	31%

# Government income support (as percentage of total income)

	Chile	Germany
1. decile	26%	98%
2. decile	8%	81%
3. decile	5%	66%

42 % of German adult  
population live primarily  
on government transfers.  
(47 % in east Germany)

# The Welfare State as Competitor



# The replacement strategy

## Early retirement

Minimal pension cuts, 58 years

## Unemployment benefit I

60-67 % replacement rate

## Unemployment benefit II (and social assistance for handicapped)

### Flat rate

Family with two children: \$ 2300

Single: \$ 1000



Private economy



The welfare state



Private economy



The welfare state



Private economy



The welfare state



Private economy



The welfare state

# Replacement wages as jobkillers

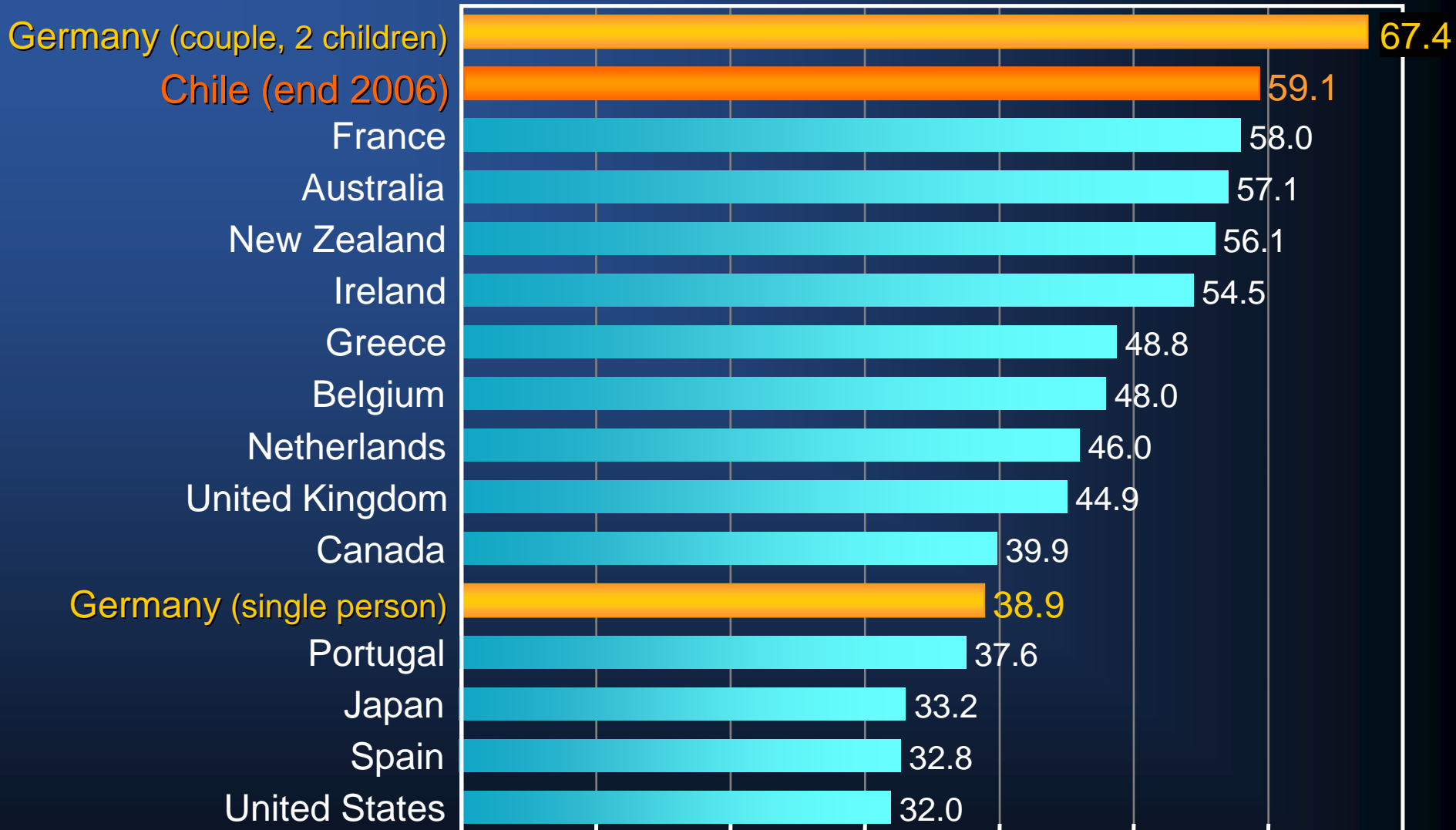
Employee: wage must be higher than replacement wage

Employer: wage must be lower than productivity

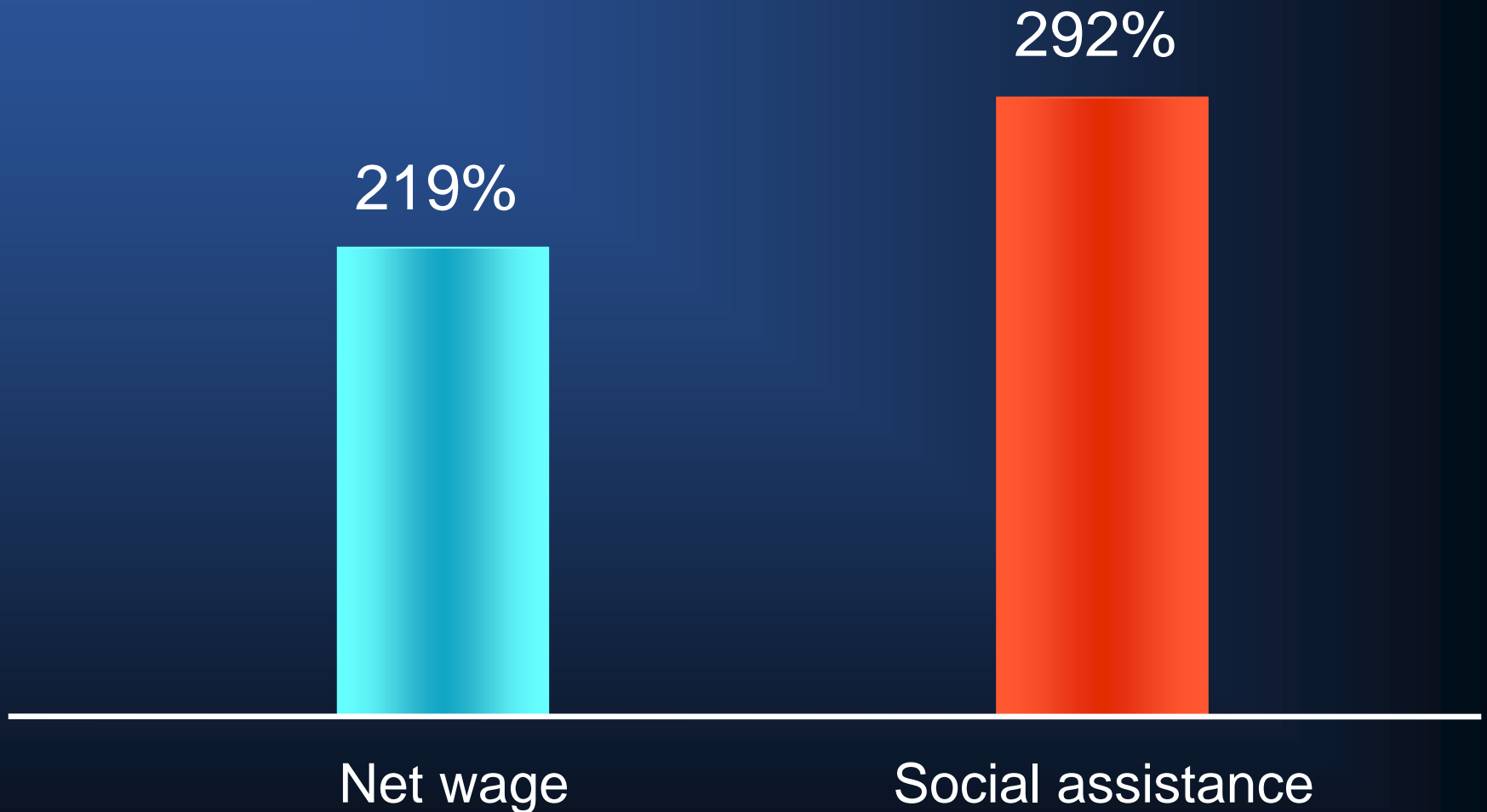
Result: No jobs for those whose productivity is lower than the replacement income

# Minimum wage/median wage

%



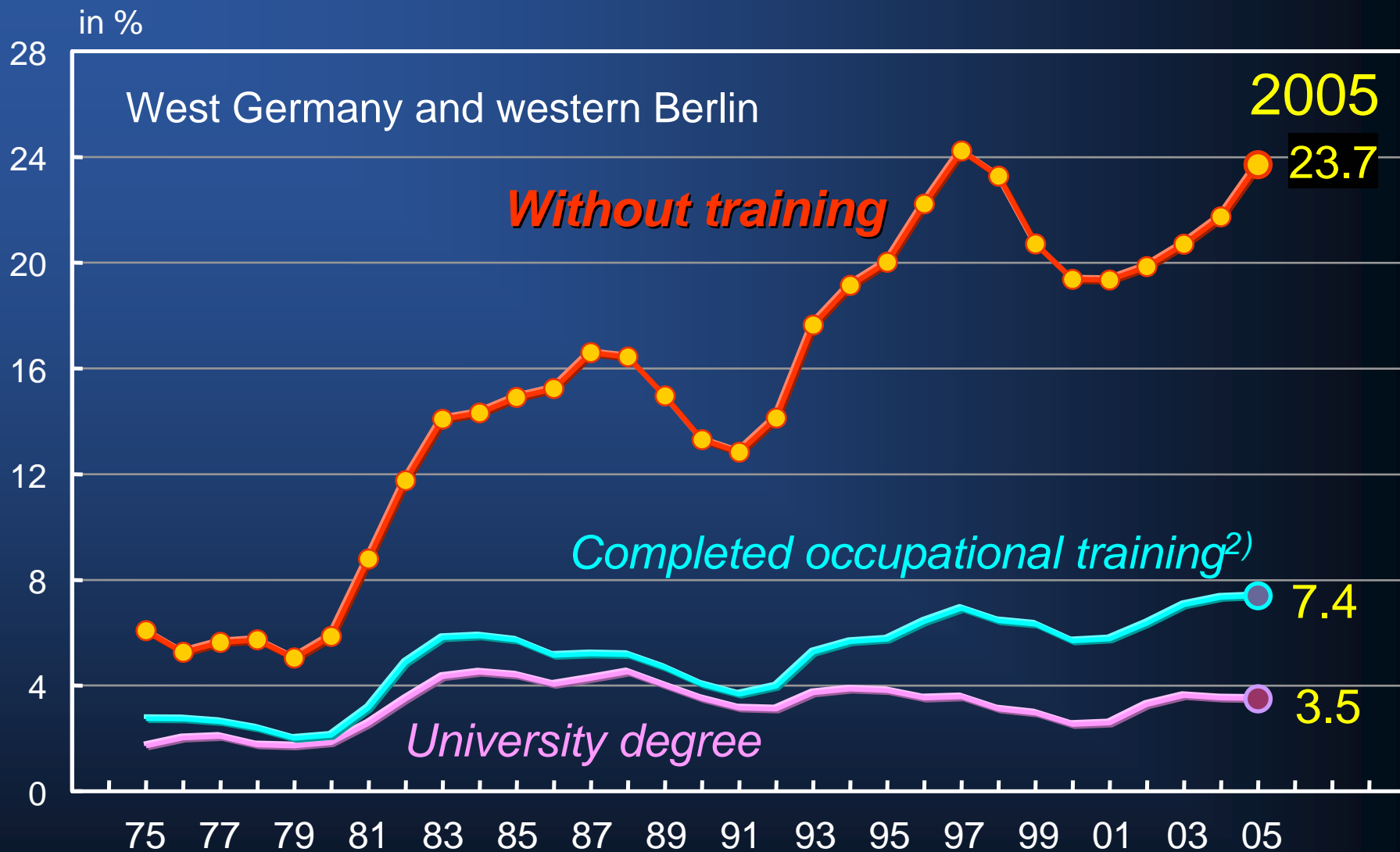
# Increase 1970 – 2004





# The German Malaise

# Qualification-specific unemployment rates<sup>1)</sup>



1) Unemployed in % of civilia labor force (excl. trainees) with same qualification, men and woman.

2) Completed occupational training: within firm training, occupational school, special master's and technical.

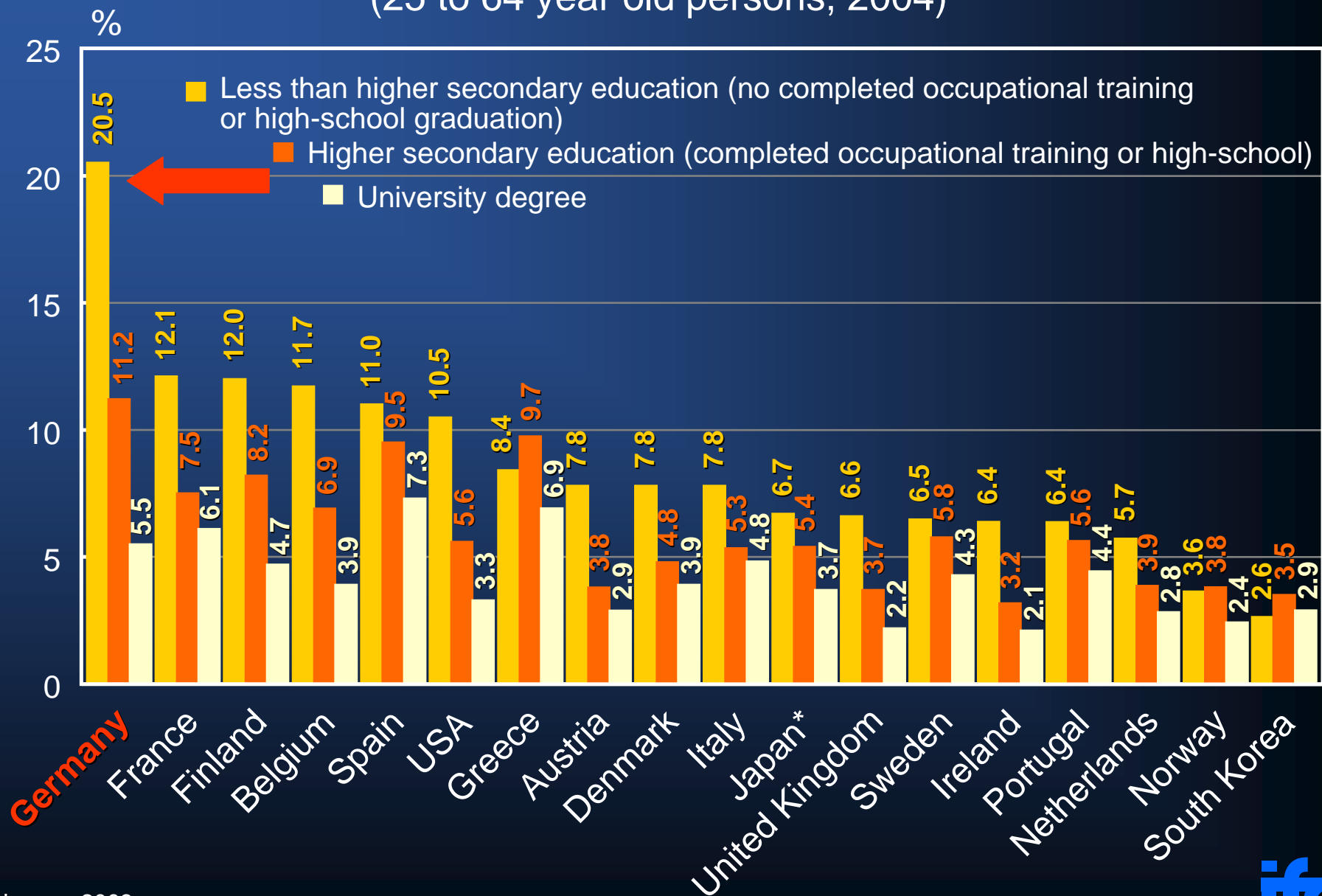
Source: Institut für Arbeitsmarkt- und Berufsforschung der Bundesanstalt für Arbeit (IAB-Forschungsbericht

Nr. 9/2007, Anhang 1a.

October 10, 2007

# International comparison of qualification-specific unemployment rates

(25 to 64 year old persons, 2004)



\* Japan: 2003.

Social assistance as job  
killer for low-skill workers

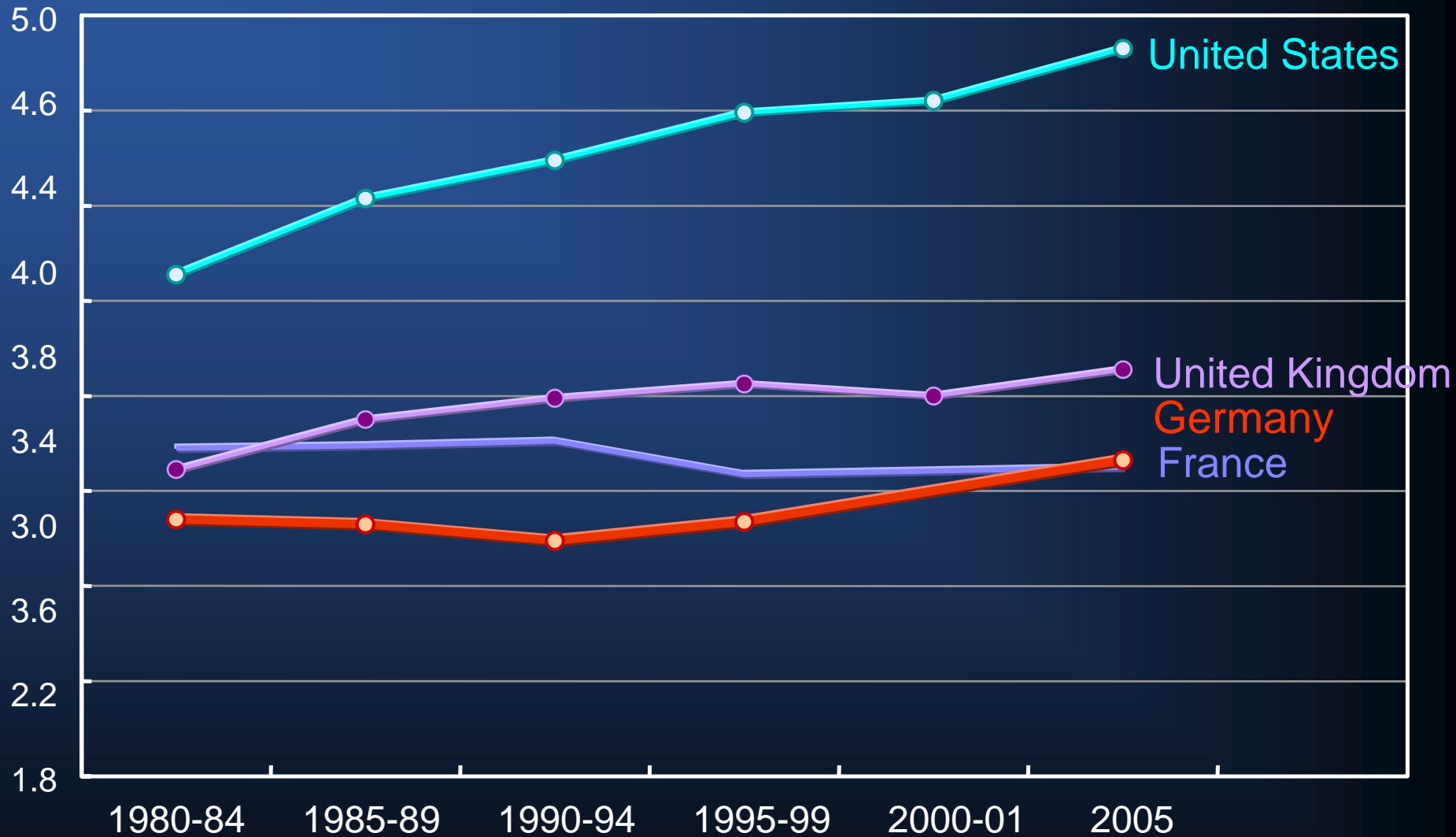
The accordion effect



Social assistance/  
unemployment  
benefit II



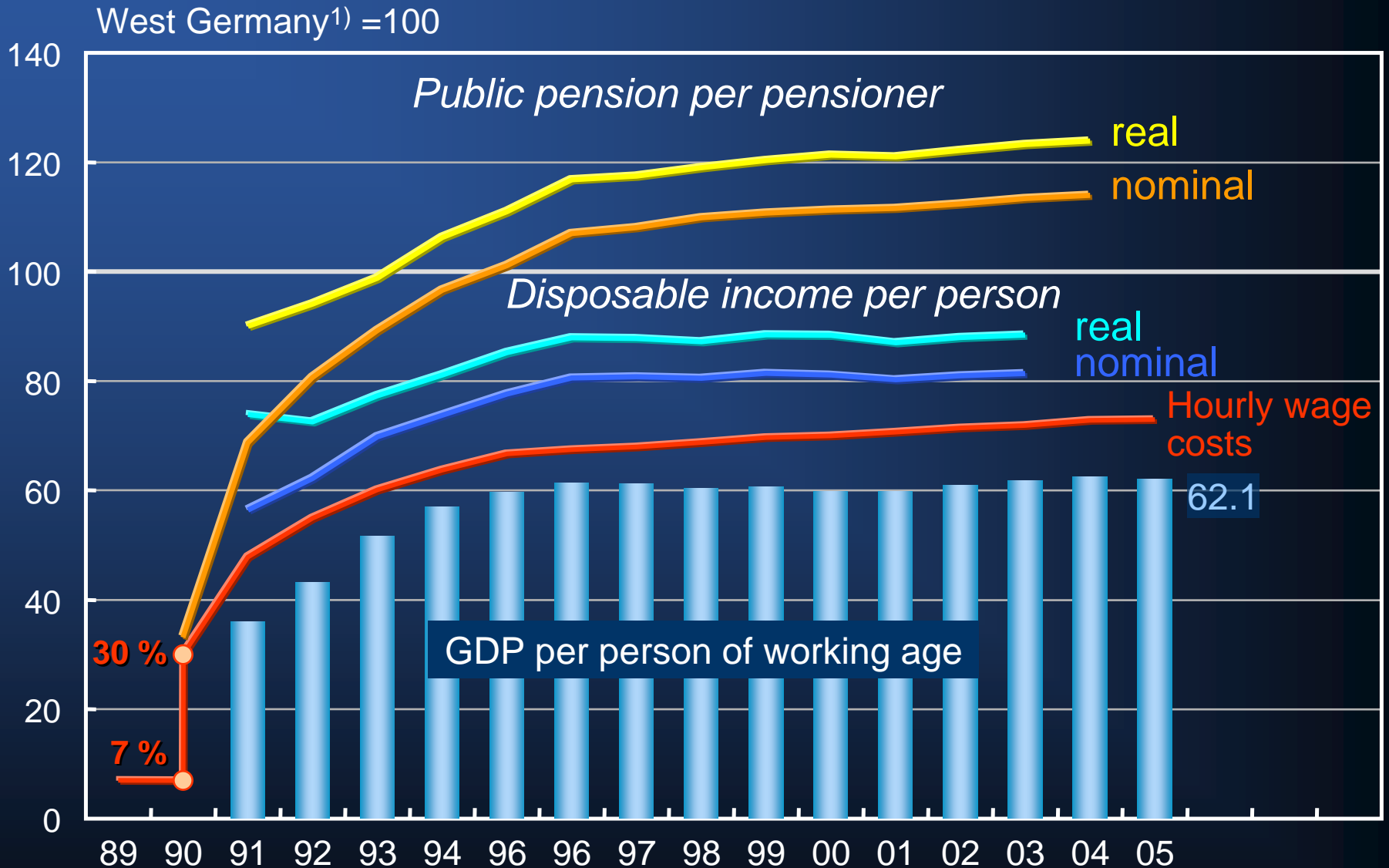
# Earnings dispersion<sup>1)</sup> in selected countries 1980 – 2005



1) 9 / 1 decile ratios for the gross earnings of full-time employees.

# German Unification

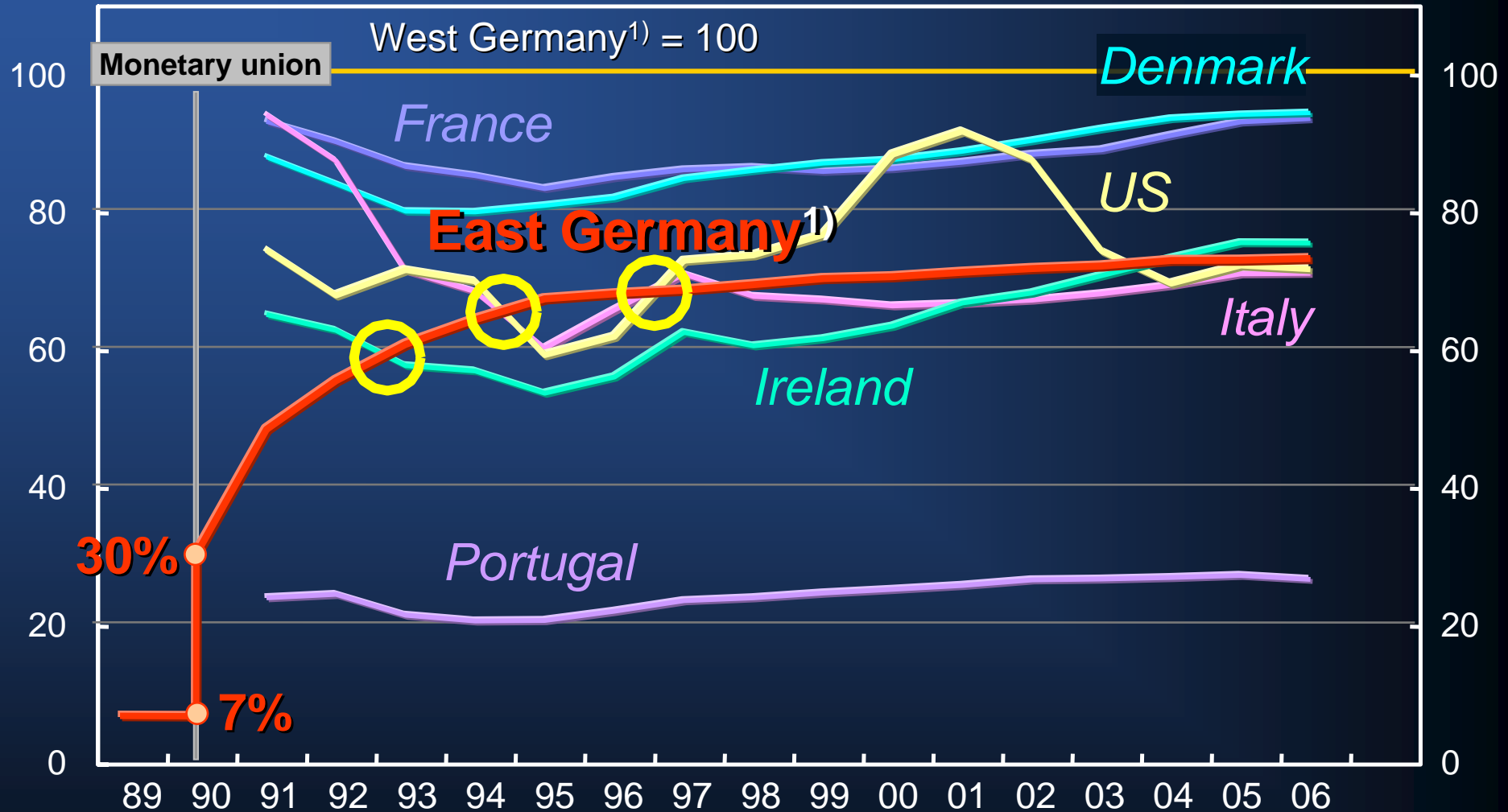
# Productivity and income in eastern Germany



1) West Germany including west Berlin, east Germany including east Berlin; regional differentiation of Berlin: Ifo Institute estimates.

Sources: Statistisches Bundesamt; Arbeitskreis Volkswirtschaftliche Gesamtrechnungen der Länder, Länderergebnisse, Reihe 1, Tabelle 1.1 and Tabelle 13 (March 2006), Reihe 1, Band 5, Tabelle 5.2 and Tabelle 5.2 (2) (May 2006); purchasing power: Ifo Institute calculations.

# Hourly wage costs in the private sector relative to West Germany



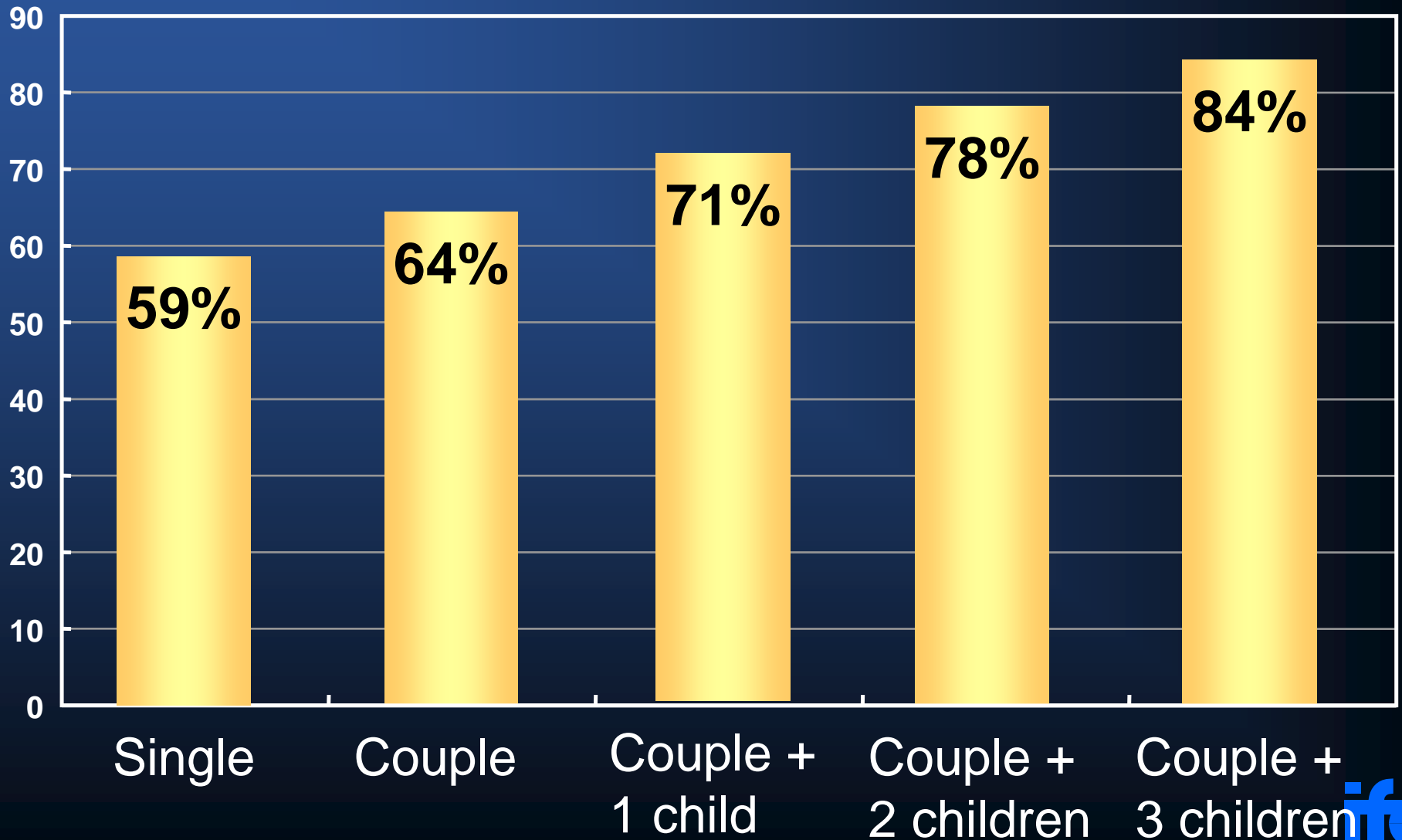
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Why?

# Implied relative minimum wage in the East

Social assistance, Net wage 5 euros per hour

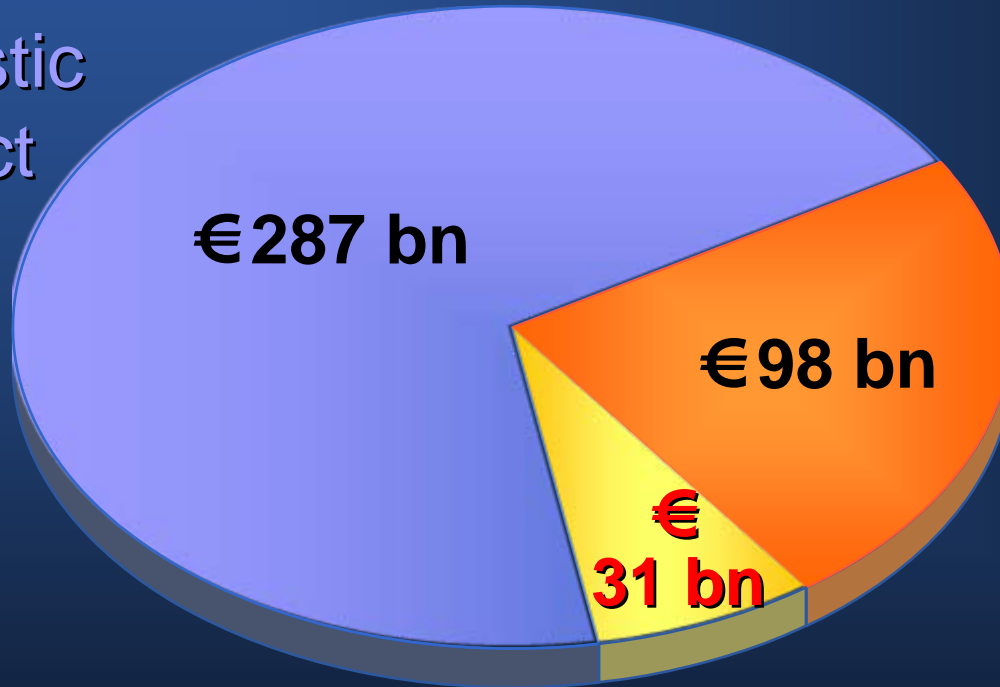


# Dutch disease

# East Germany<sup>1)</sup> 2006

Absorption<sup>2)</sup> € 416 billion euros

Gross  
domestic  
product



**Public  
transfers**

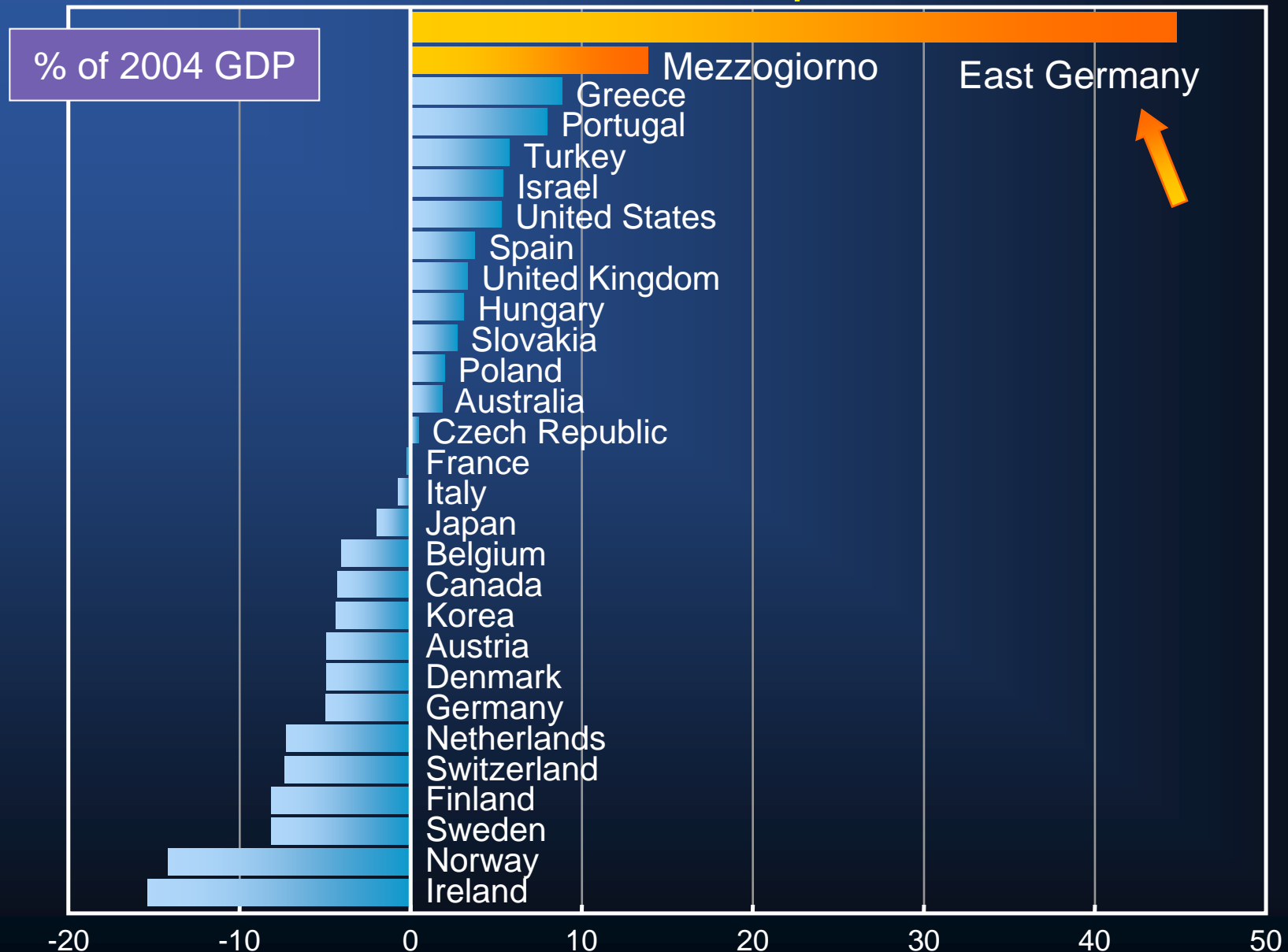
*Excess absorption =  
Trade deficit =  
129 billion euros*

**Capital imports**

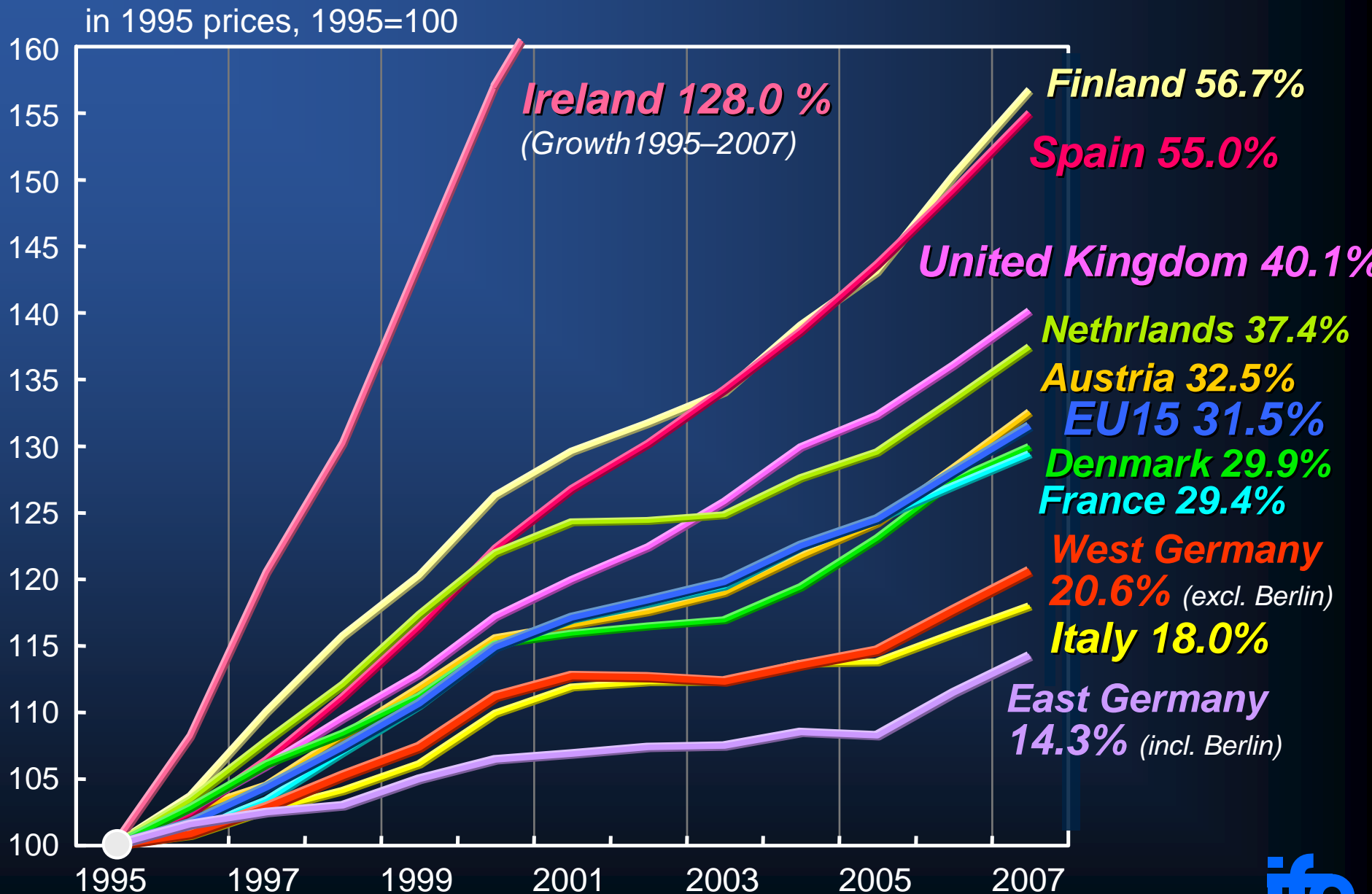
1) West Germany including west Berlin, east Germany including east Berlin;  
regional differentiation of Berlin: Ifo Institute estimates.

2) Private investment, public sector spending on goods and services, private  
consumption (national accounts).

# Excess absorption (trade deficit) international comparison



# Real gross domestic product in selected EU countries



# The Agenda 2010: Schröder's Reform

# Agenda 2010

(since 2005)

- *More money for work, less money for idleness.*
- Elimination of unemployment assistance and reform of social aid system



Since maximum of unemployment  
in April 2005:

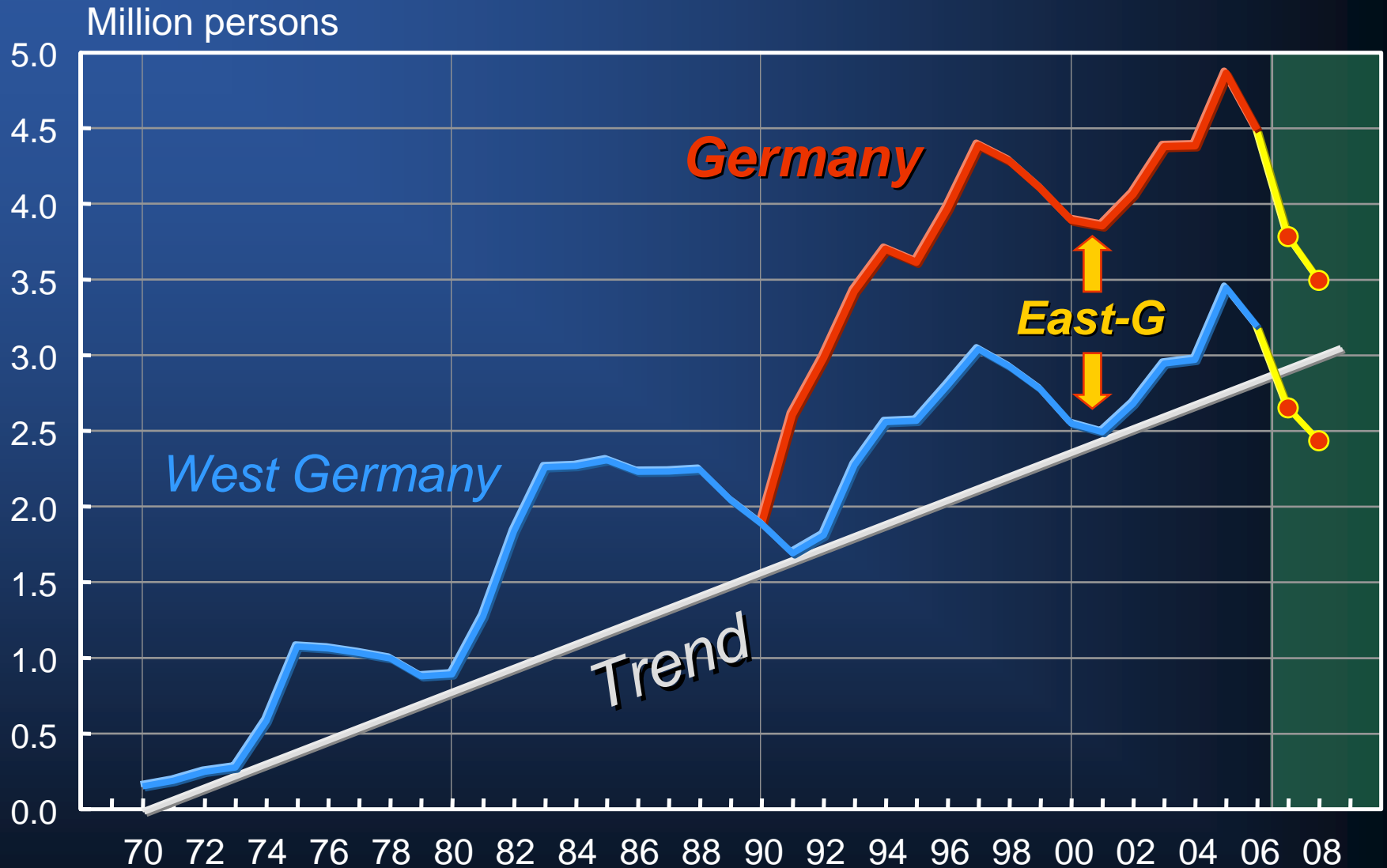
About 400 000 additional  
loan labour jobs

# Increase in Employment 2006

Average + 1.6 %

Above 50 years + 4.9 %

# Unemployment<sup>1)</sup> 1970–2008



1) West Germany incl. western Berlin, East Germany incl. eastern Berlin.

Sources: Bundesagentur für Arbeit; 2007 and 2008: forecast by the Ifo Institute (December 2007)

Regional distribution of Berlin: from 2001 Ifo estimates.

December 13, 2007

Germany at the

cross roads:

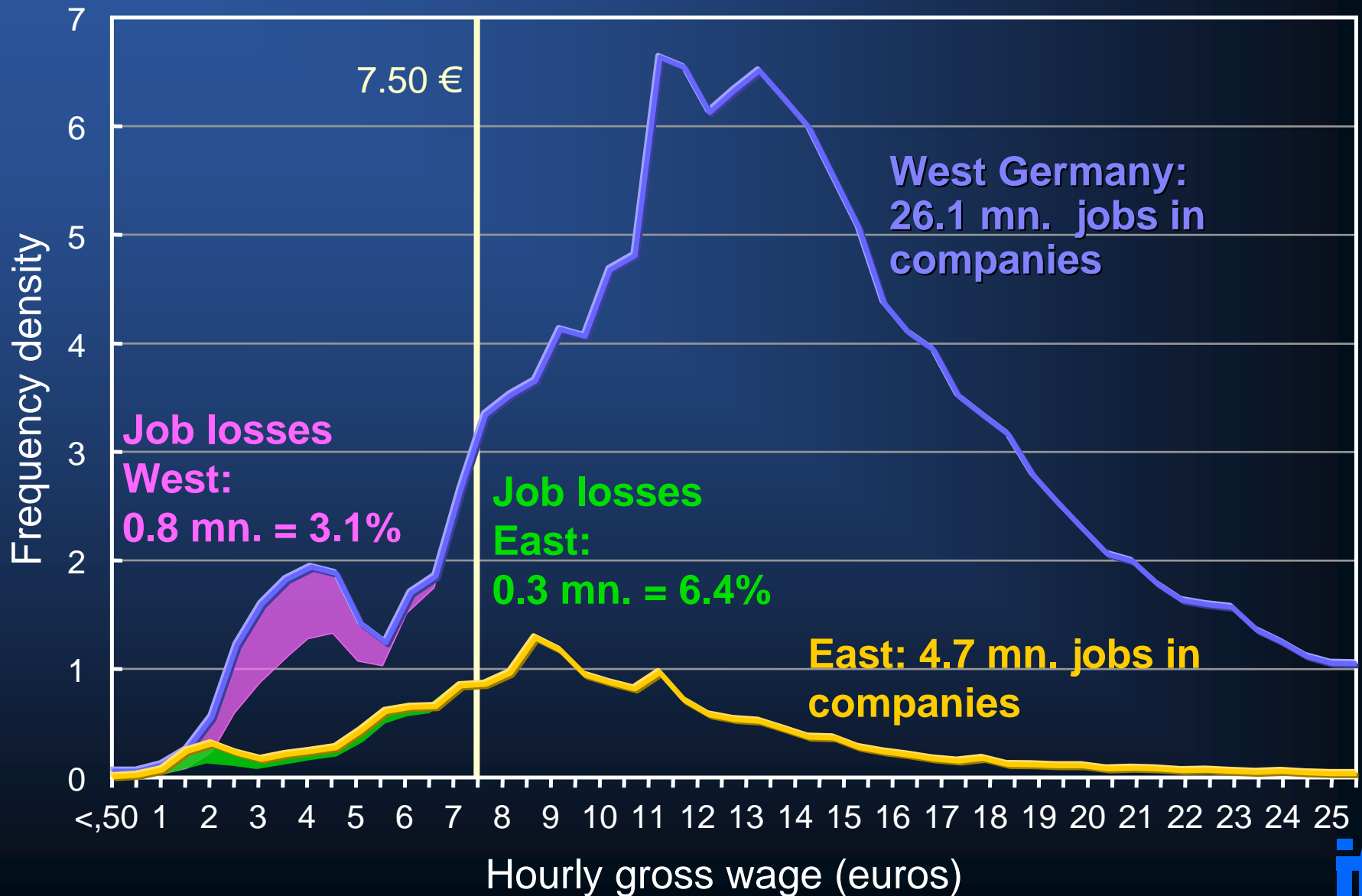
Minimum wage or  
minimum income?

# The four options



1. Education 

2. Replacement wages / minimum wages

# Employment losses because of minimum wage



# The four options

1. Education 
2. Replacement wages / minimum wages
3. Scandinavian course
4. Wage subsidies 

# The Ifo model of activating social assistance

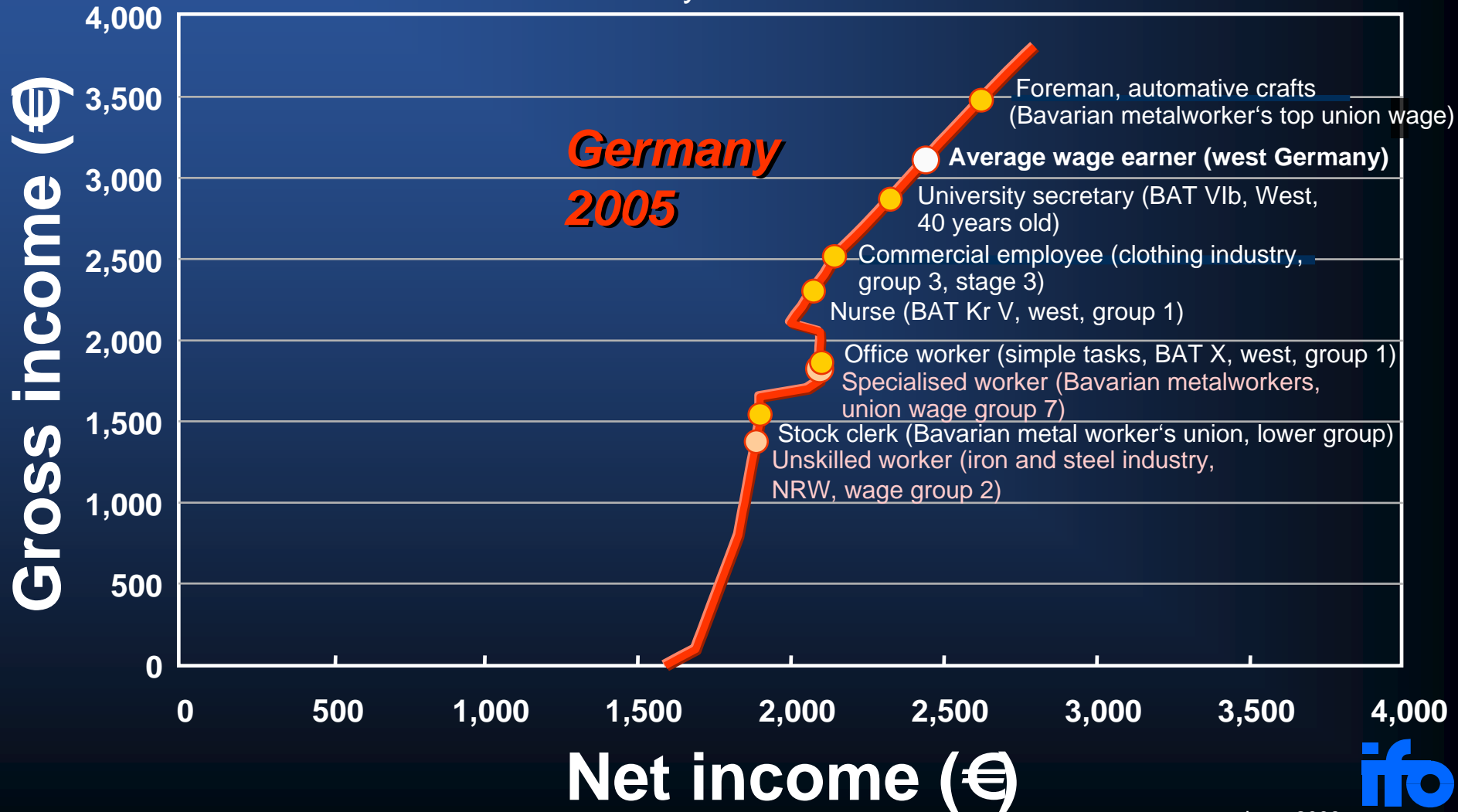
1. Additional earnings of up to €500 permitted
2. Lowering of unemployment compensation by one third
3. Former level of unemployment compensation for municipal contract labor



# The North Face of the Eiger:

## Disastrous effects of the wage replacement system

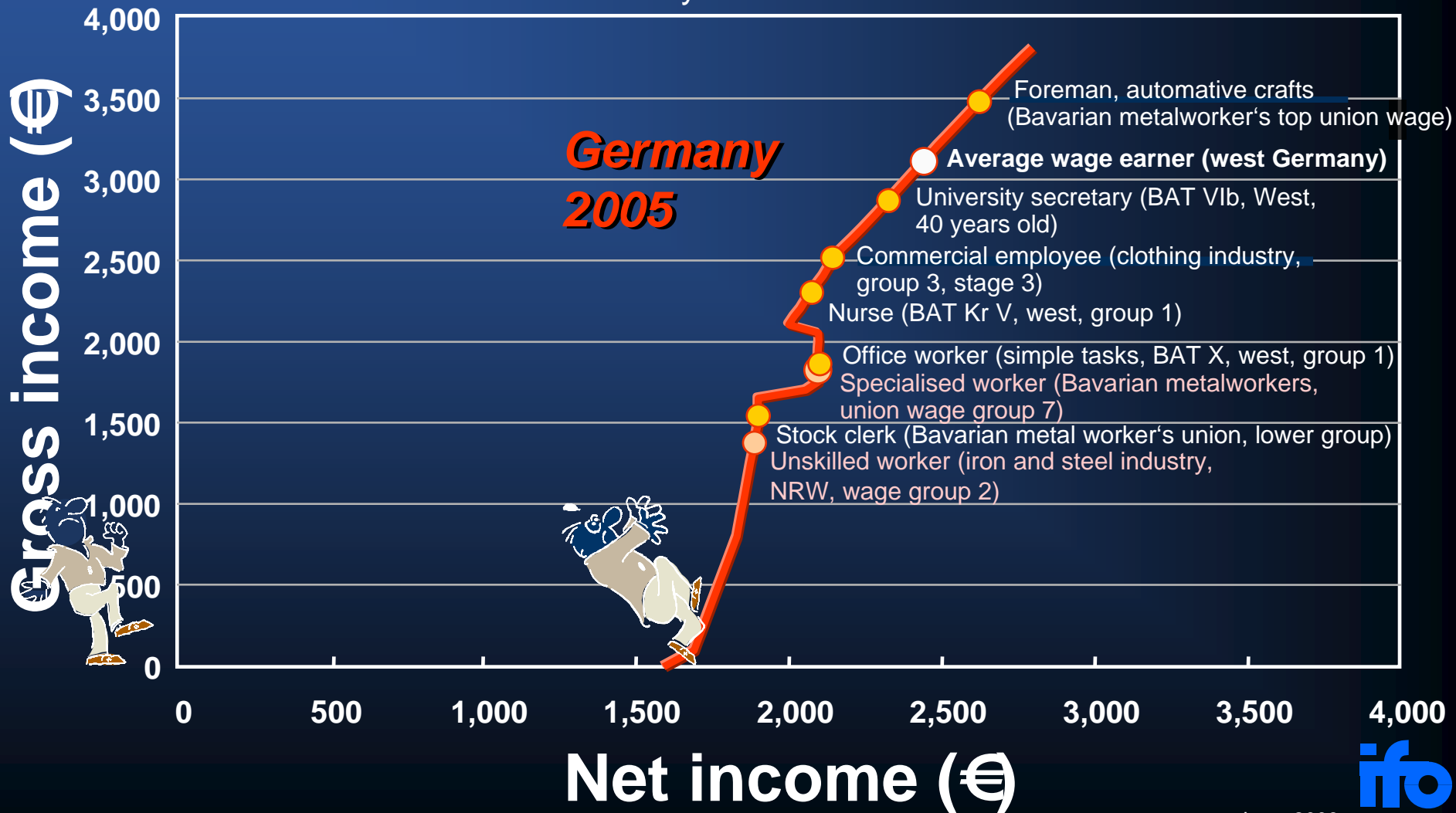
(Labor income per month, Unemployment Compensation II, child allowance, child bonus, wage taxes; employee's contribution to social security system; family with two children)



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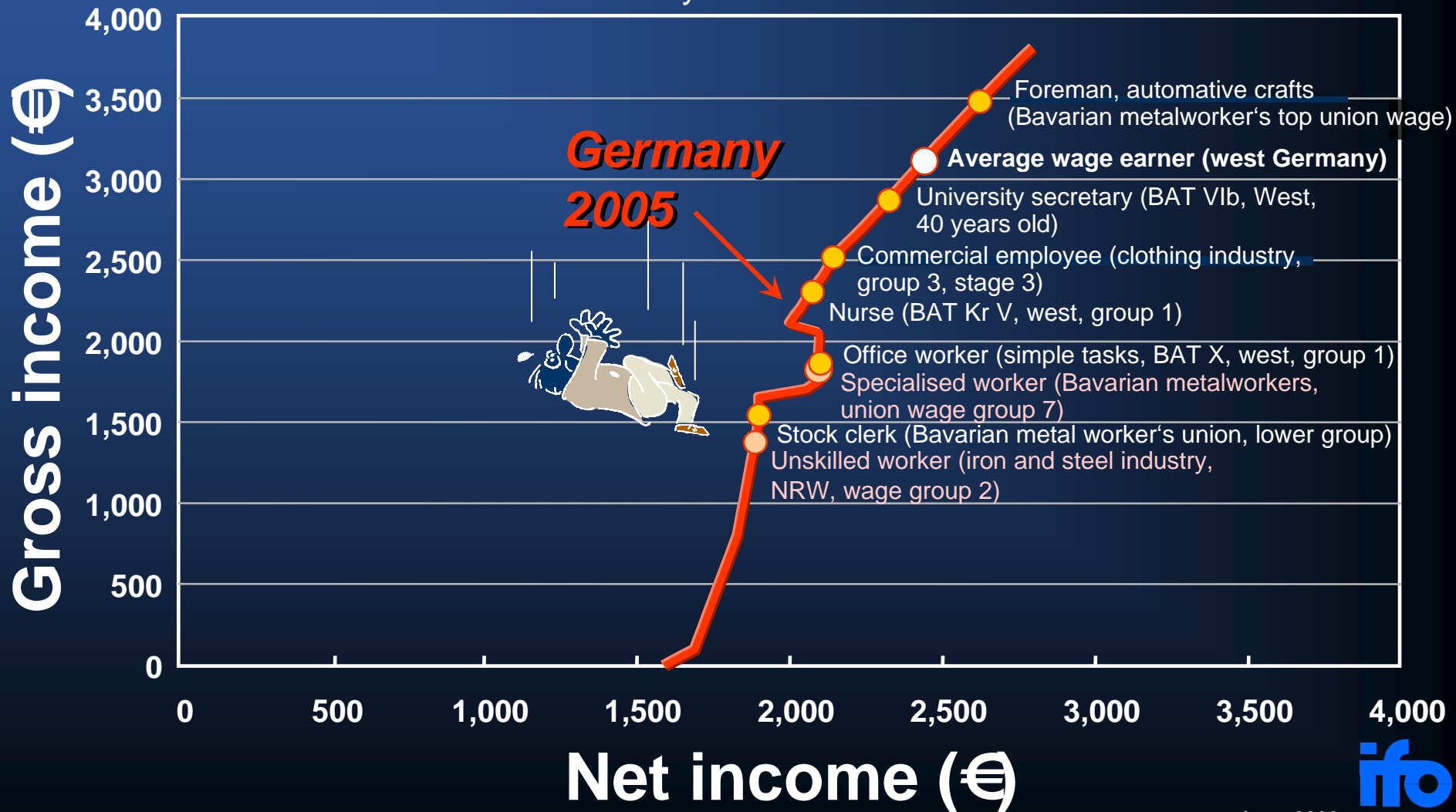
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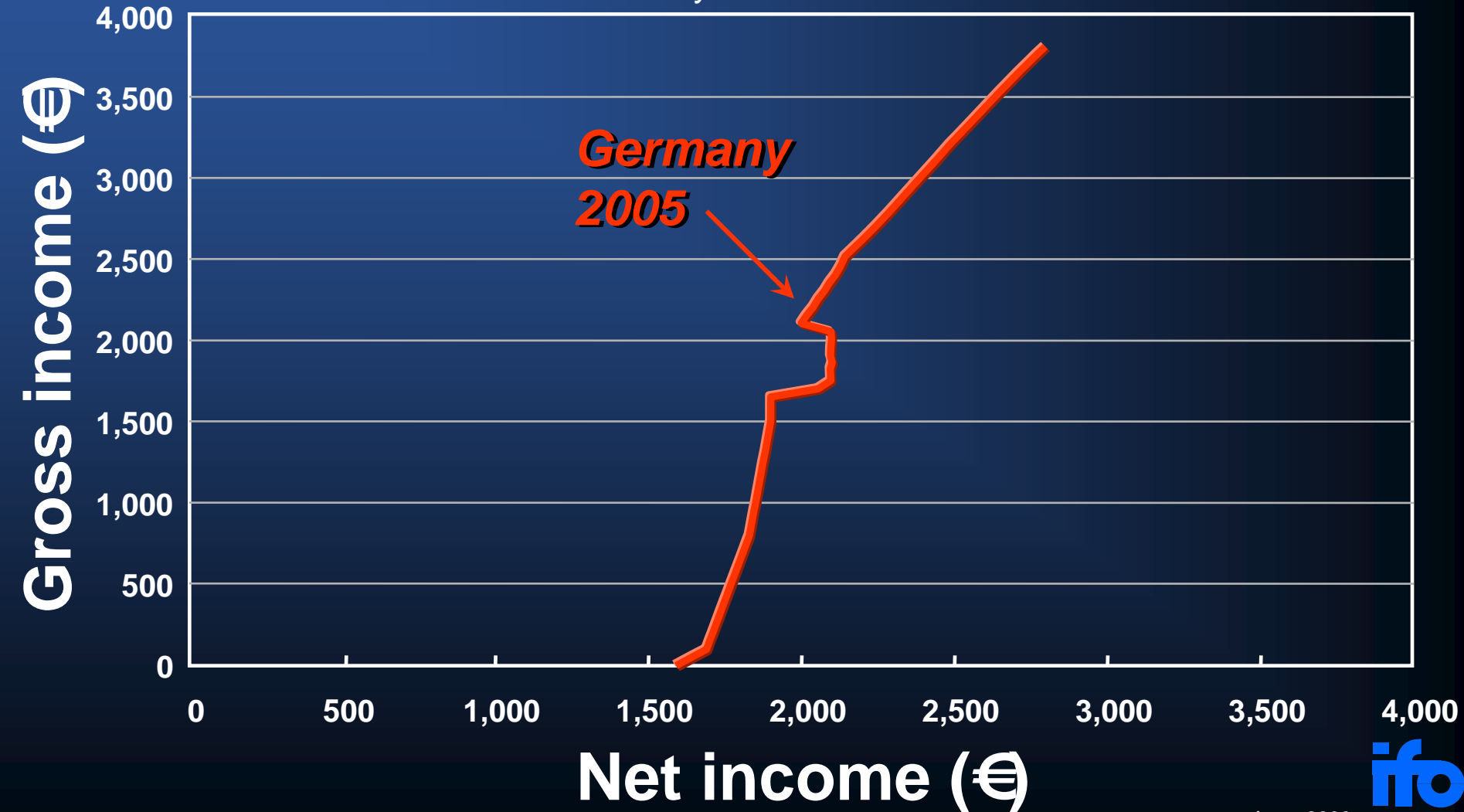
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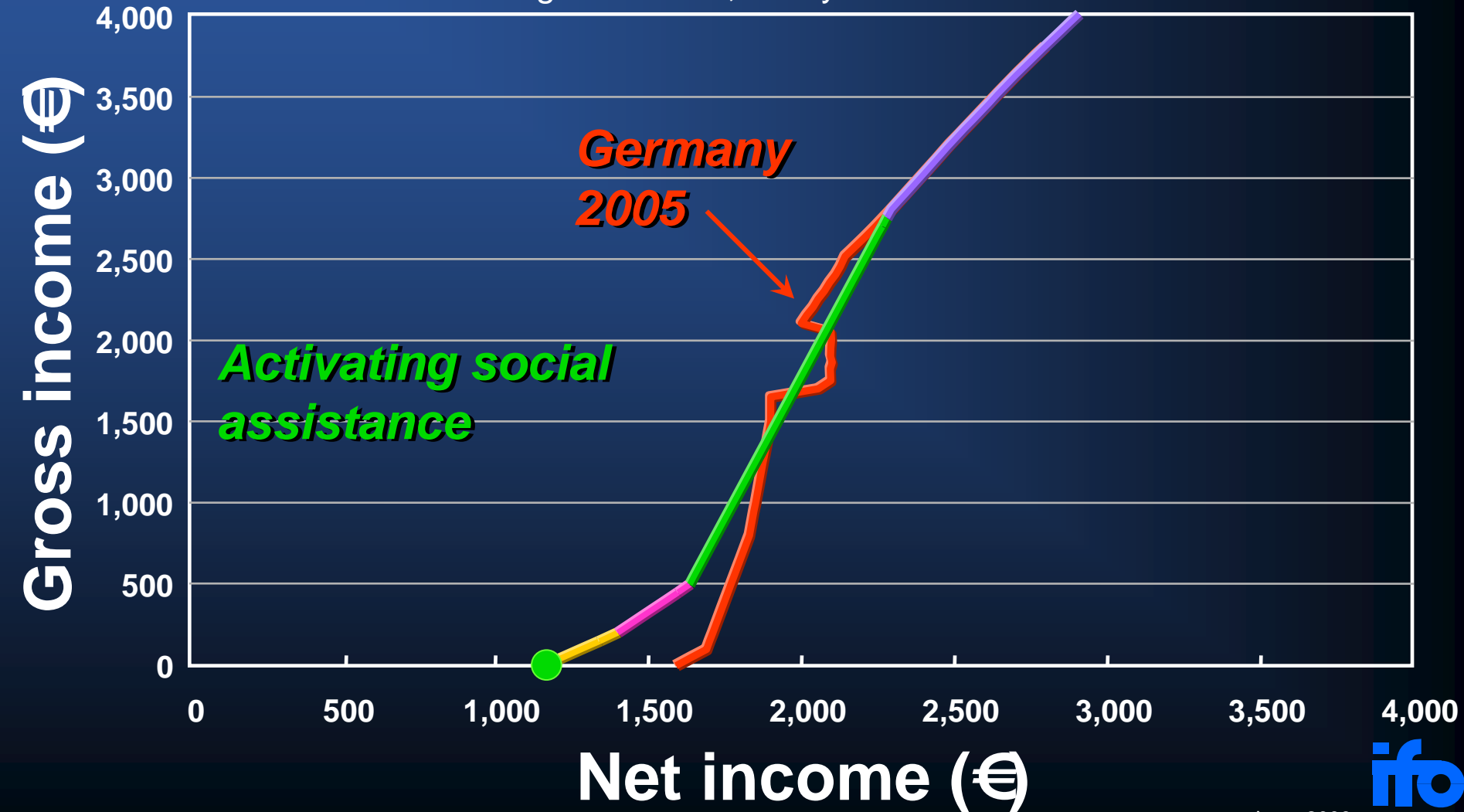
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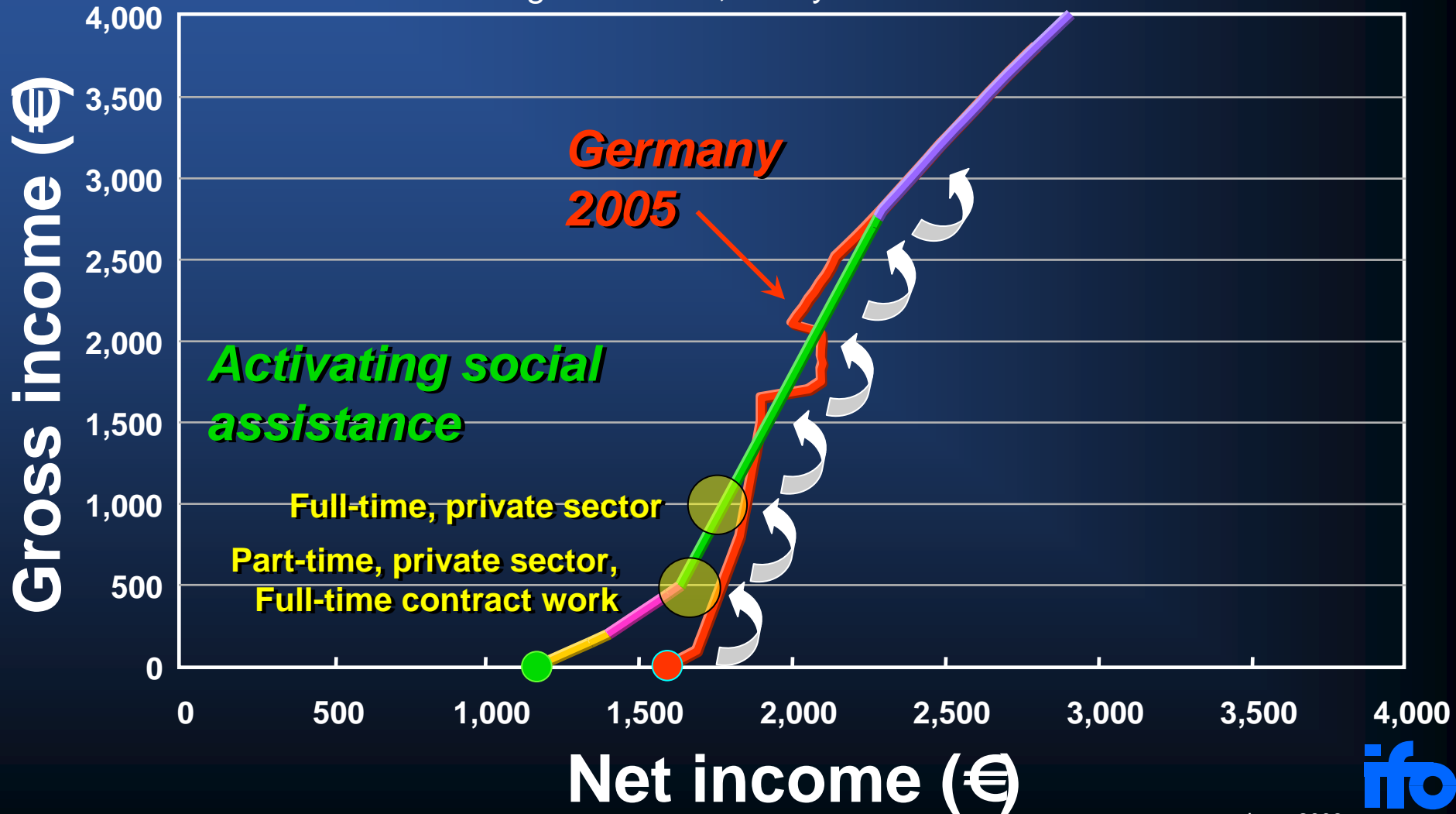
# Activating Social Assistance

(Labor income per month, Unemployment Compensation II, child allowance, child bonus, wage taxes; employee's contribution to social security system; wage tax credit; family with two children)



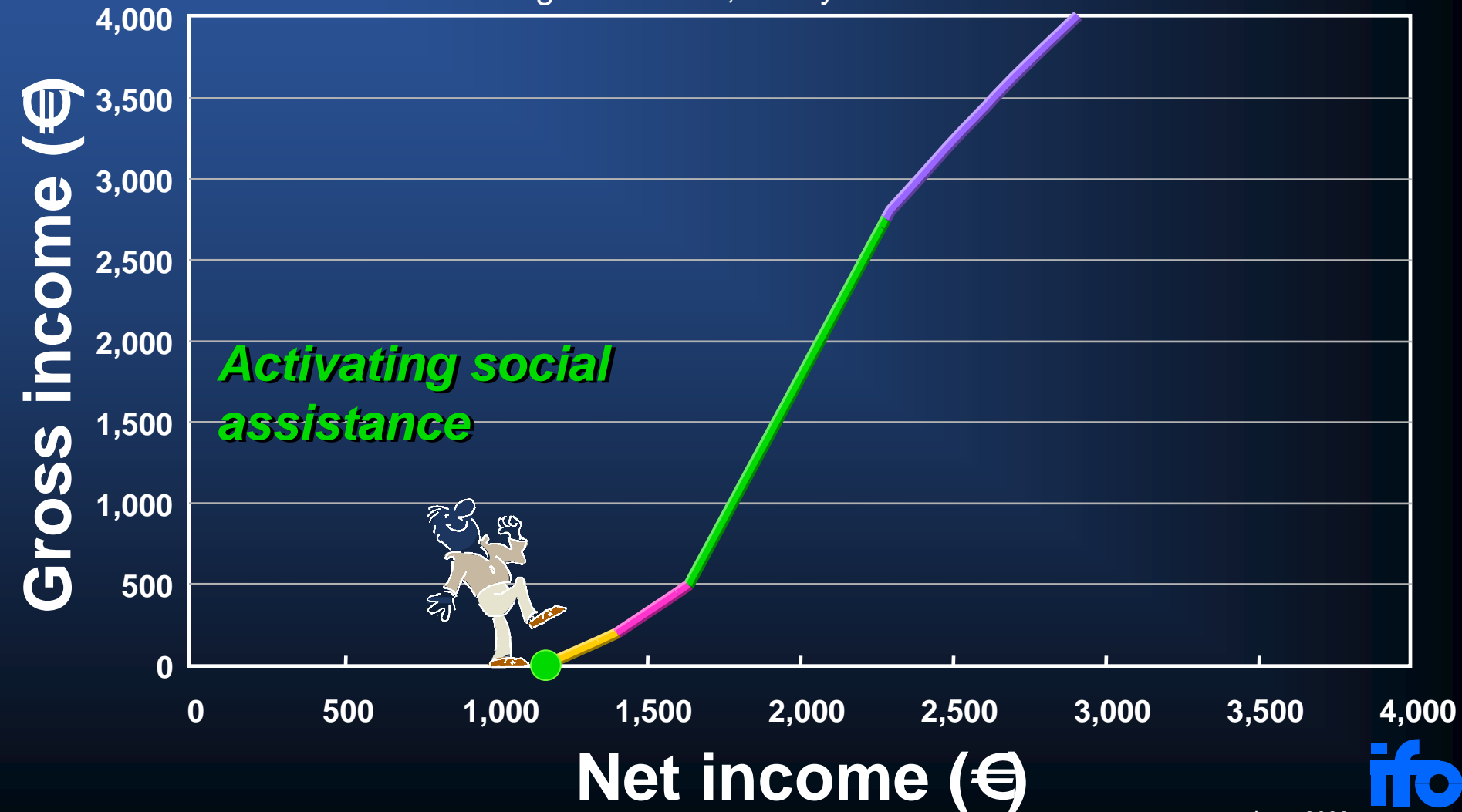
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# Advantages of activating social assistance

- Creates more than 3 million jobs
- Avoids immigration into unemployment
- Negative income tax: easy to administer
- Minimum income instead of minimum wage
- Increases economic growth
- Full social inclusion



# Conclusions

# Conclusions

- Germany invented the welfare state:  
it is the guinea pig of history
- Country is world champion in terms of  
unemployment of unskilled
- German unifications failed in economic  
terms
- Schröder´s reforms were successful
- Activating Social Assistance: Minimum  
income instead of minimum wage

**End**