

Distributional and Behavioural Effects of the German Labour Market Reform

On January 1st, 2005, the German labour market was fundamentally reformed. The main feature was the replacement of the earnings-related Unemployment Assistance (UA) by an income maintenance system, called “Unemployment Benefit II”, which is not related to former earnings, but uses stronger means testing.

Unemployment Benefit I, which is paid for a maximum of 32 months provided the requirements are met, was not affected by the reform. In addition, the former welfare programme, namely Social Assistance (SA) was also restructured and divided into two branches: (1) Social Assistance for individuals who are temporarily unable to work and (2) “Unemployment Benefit II” for people who are considered labour market participants.

The aim of our paper is twofold. First we are interested in the distributional effects of the reform for the total population and for several subgroups. Second, since the reform induces considerable changes in household behaviour, we also wish to capture these effects with our microeconomic labour supply model. These changes in labour supply will in turn change the distributional consequences of the reform. The redistributive effects may be mitigated or exacerbated by the labour supply reactions. We base our empirical analysis on the 2004 and 2005 waves of the German Socio-Economic Panel (GSOEP).

Our results are in accordance with the findings of other studies such as Becker and Hauser (2006), Blos and Rudolph (2005), and Schulte (2004) who focus only on former recipients of UA. Furthermore we identify reform winners in the subgroups of (1) former recipients of social assistance and (2) new recipients. The largest gains accrue to households with many children and to households which were not eligible for any benefits before. The new benefit system has a tendency to equalize the transfer payments at a level that is slightly higher than the old social assistance level. These results are also confirmed by the labour supply effects. Women with children tend to reduce their participation; this is observed for women in couple households and single mothers. In contrast, couples without children, single men and women without children increase their labour supply as a consequence of an income loss. These opposing labour effects of the different groups almost cancel each other out in the aggregate.