

**A Social Insurance State Withers Away. Welfare State Reforms in Germany – or:
Attempts to Turn Around in a Cul-de-sac**

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1. Introduction

Germany can be characterized as *the* “social insurance state” *par excellence*. In 2003, about 44 percent of the *general* government’s outlays ran through the various social insurance schemes, and they disbursed roughly two thirds of total social expenditure (according to national calculations). Social insurance spending amounted to more than one fifth of GDP what signifies the substantial impact of these social security institutions on the economy and people’s living conditions. The predominance of the institutionally segmented social insurance system stems from the still effective Bismarck legacy that made Germany the prototype of a comparatively large but transfer-heavy welfare state with earnings-related contributions paid by employers and employees providing the main source of funding and corporatist self-administration, albeit largely formal nowadays, as a correlative of this mode of financing.¹ Benefit eligibility depends on prior contribution payments and, until recently, levels of cash benefits secured true wage-replacement as long as the beneficiary met the criteria of *a standard employment-relationship*, i.e. had performed a continuous career as full-time worker in covered employment from finishing training for an occupation until reaching the statutory retirement age (or becoming disabled) with not more than short interruptions of gainful work. Based on the once realistic assumption that, ensured by collective agreements, former workers had always earned a *family wage*, social insurance schemes stabilized the *male breadwinner family* insofar as own and derived entitlements were high enough to also cover the needs of the dependants and, thus, not much attention had to be paid to social security of predominantly female workers in atypical or marginal employment.

After the sudden death of full employment at the mid1970s the wage earner-centered core of the social security system got under financial pressure and, largely (but not completely), the long phase of welfare state expansion came to a halt. It will be shown in this paper that the subsequent development can be divided into three periods, and institutional changes that were brought about over the last thirty years roughly coincide with Peter Hall’s (1993) heuristic differentiation in ascending order. During the first period, lasting from about the mid1970s until the mid1990s, mainly ‘first’ or ‘second order changes’ occurred when the shortfalls of the social insurance schemes were compensated by raising the total contribution rate (about six percentage points until 1990), thereby increasing or decreasing the rates valid

¹ In fact, Bismarck was a “Beveridgean”. For him workers’ social security was an element of an unfinished state-building process (*innere Reichsgründung*), and instead of functionally differentiated insurance schemes a unified agency (*Reichsversorgungsanstalt*) should hand out predominately tax-financed, flat-rate benefits to the “soldiers of work”. Albeit ultimately in vain, insisting on his concept delayed the legislation of the accident and disability/old-age insurance scheme (Henschel 1983: 11-29). Nevertheless, the (small) tax-funded basic amount added to every earnings-related pension was a remnant of Bismarck’s original plan and not abolished before the reform of 1957, while federal subsidies to the pension scheme’s revenues are still in place (and of increased importance nowadays).

for single schemes along varying dire straits (Trampusch 2003). Moreover, a ‘smooth consolidation’ of different schemes took place (Offe 1991). Mostly, such restrictions of benefit generosity were concluded in consensual manner and if not, resistance amounted to nothing more than “dutiful protests” by the respective political parties in opposition and the labor unions, always attempting to defend the status quo. In 1994 still, Marian Döhler interpreted the small downward adjustments that did not really eat into the core of the schemes’ benefits as an institutionalized survival strategy to secure the arrangement against far-reaching demands for dismantling (Döhler 1994: 160). At the time of unification in October 1990 and even until 1994 when the passing of the long-term care insurance scheme had obviously proven the social insurance technology not being exhausted, but rather, capable of becoming applied to new social risks, there was a broad-based confidence in the ability to modernize the single schemes and to maintain their financial viability in the long run (Nullmeier and Rüb 1994: 60-3). Indeed, the social insurance state appeared as a success story: it enjoyed a high degree of public support because it was ‘morally undemanding’ due to the perceivable link between contributions and benefits (Offe 1990), and these institutions had established a specific ‘culture of solidarity’ that made inherent redistribution over and above a simple life course balance acceptable (Hinrichs 1995; 2002). Moreover, by increasing coverage from blue-collar workers to almost all employees (and their families) and occupational fragmentation largely disappearing or becoming irrelevant, raising benefits to generous levels and extending protection against an ever wider range of social risks, this institutional arrangement had demonstrated to be no less modern and adaptable than welfare states that developed from Beveridge’s concept of universalism and basic security (Döhler 1994: 159-60; Leisering 2005). Indeed, the German *Sozialstaat* could compete with other nations when looking at replacement ratios or outcomes like poverty rates (Alber 1998; Korpi and Palme 1998).

While the first period was marked by bounded, largely path-dependent changes within the established social insurance paradigm, the second one during the latter half of the 1990s may be characterized as a *transitional period*, or: as a phase of gradual “defrosting” the German *Sozialstaat*. Not the least triggered by the fiscal costs of unification, the political discourse shifted from social insurance as a problem-solving technology to a perception of social insurance as a problem in itself and an impediment to a higher employment level that would actually relieve the schemes’ financial pressure. Thus, non-wage labor costs, globalization and generational equity emerged as catchwords for the ‘social construction of an imperative’ for reform (Cox 2001) and paved the way for an ideational change that materialized in substantial institutional changes during the third period. It started around the year 2000 and, still continuing, means a *transformation* of certain policy areas *within new paradigms*.

As a result, the German social insurance state has shown an *unprecedented* and, due to its assumed inertia following from numerous veto players, *unexpected* degree of adaptability. Despite these reforms Germany maintained the highest level of ‘*net* social expenditure’ of all OECD countries (Adema and Ladaïque 2005: 32) and, contrary to incumbent governments’ intentions, the total contribution rate has not been pushed back below the 40 per cent threshold. Moreover, in 2006 Germany is still confronted with deficits in the federal and state budgets that violate the EMU limits and constitutional requirements, and the decline in covered employment (of about 13 percent between 1991 and 2004) has not clearly come to a halt. Therefore, the main question raised in this paper is why is it so difficult to make the German welfare state more “employment-friendly” and, at the same time, retain a high level of social protection. It will be tackled in section 4. Before, in section 2., the most relevant institutional reforms that have happened in the different social insurance schemes are described and analyzed. Then it will be searched for reasons which have facilitated the various reforms since about 1995. Those explanations will make use of institutional approaches and predominantly relate to party competition within Germany’s specific political structures, providing ample incentives for blame generation and stalemate constellations, and the role of ideational change.

2. Reform Trends in Social Insurance Schemes

In this section I will focus on reforms that occurred in four of the five social insurance schemes² during the second half of the 1990s and thereafter because they meant more rigorous attempts to keep a further rise of the contribution rates in check. Previous changes pursued the same objective but were based on a widely shared belief that some increases were unavoidable as well as tolerable, and incremental changes would suffice to keep the well-established schemes viable. The most important earlier changes are briefly mentioned in the following before turning to the more recent reforms (see also *Table 1*).

The reform of the statutory *health care* scheme that was legislated in 1988 and went into effect one year later was a continuation of previous attempts to contain largely supply-side driven spending. To that end, it included numerous changes, however, the main emphasis was on introducing or increasing patients’ co-payments (for prescription drugs, dentures etc.) whereas numerous veto points the health care providers held within the institutional setting of this policy domain enabled them to successfully ward off ambitious reform proposals affecting their income or autonomy. The poor results of these cost-containment measures pure and simple triggered a political learning process that led to a

² The accident insurance where solely employers pay contributions according to risk classification will be left out. With regard to expenditure, it is by far the smallest scheme, and no significant changes have been concluded over the last decades. However, employers recurrently demanded to exclude accidents happening during travel to and from the place of work from coverage.

second stage of health care reform going into effect in 1993. Different from the 1988 reform, it came about as a negotiated compromise between the Christian-Liberal government and the Social Democrats whose majority of votes in the *Bundesrat* (since 1991) was crucial for pursuing a comprehensive reform approach. Beside increasing co-payments again, it included a temporal freeze of service providers' fees what meant an unprecedented intervention in the domains of corporatist self-government. However, what justified the term *structural* reform were two organizational changes. First, cross-subsidies between sickness funds were introduced so as to balance the differential risk profiles of their members (according to age and sex) and differences in their revenue structure (proportion of non-contributing family members and taxable wage-base). As a result of these risk-adjustment subsidies the hitherto broad range of contribution rates levied by the different sickness funds narrowed. That instrument was a prerequisite for the second change, namely to allow all members (and not only the white-collar workers as before) to choose from nearly all sickness funds which in themselves no longer have the right to reject applicants. The idea was that sickness funds should compete for members on the basis of efficiency and service quality, particularly when given more latitude to negotiate with service providers as part of a contemplated third reform stage. Immediate results of the 1993 reform, however, were that the sickness funds ran surpluses in 1993 and 1994 and a slightly lower average contribution rate in both years materialized.

In comparative perspective, the *pension reform* of 1989 (becoming effective in 1992) was an early response to imminent population aging and a highlight of corporatist incrementalism and a continuation of consensual pension politics including the social partners and the major political parties. It formally introduced the 'fixed relative position' principle, i.e. a net wage indexing of new and current pensions which had been more or less been applied by arbitrarily tinkering with the adjustment formula since the late 1970s. Moreover, in the long run workers taking out a first pension before reaching the standard retirement age (65) would have to face permanent deductions. Federal subsidies to the public pension scheme were increased to 20 per cent of the scheme's total spending. Finally, credits for child care that had been first recognized as an equivalent to waged work in 1986 were improved (three instead of one year for births given after 1991). The cumulative effect of the various reform elements was expected to facilitate a contribution rate of 26.9 per cent instead of 36.4 per cent in 2030 (Sozialbeirat 1998: 242). Among all relevant political actors the assessment prevailed that no substantial readjustments had to be considered much before the year 2010.

Already beginning in the mid-1970s, numerous changes of the *unemployment insurance* scheme (moderately) increased the pressure on unemployed people to accept job offers and "nibbled" on the eligibility criteria for unemployment benefits and impaired the entitlements in various way (changing the earnings base for calculating benefits, deducting variants of severance payments from benefit claims etc.). The reduction of the replacement

rate (lower for beneficiaries without minor children already since 1984) in 1994 is thus no reliable indicator of retrenchment efforts negatively affecting the transfer income of the unemployed.³ This scheme was first hit by the tremendous job decline after unification, and the additional revenues from raising the contribution rate to 6.8 per cent in April 1991 (from 4.3 per cent before) were used to often permanently leaving fallow large parts of the East German labor force. However, no true structural reform of this scheme happened before 2002.

The legislation of the *long-term care insurance* in 1994 was, for about ten years, the last manifestation of consensual reform policy carried out by the two political parties hitherto equally committed to the preservation of the social insurance state. In view of a social risk becoming ever more virulent in an aging society, the proponents within the CDU/CSU and SPD almost unanimously regarded the new scheme as the completion of the social insurance state. For long, the insufficient protection of elderly people against this social risk had been deplored, and a compromise on the contours of the benefit structure and levels (graded according to need classes with no full cost coverage) emerged quite early. However, what delayed a legislative solution for many years was the struggle on the organizational form and, directly related, how to finance a fundamental reform – concretely, whether to opt for a tax-transfer scheme, a mandatory private insurance, or an additional social insurance scheme. It was a principled conflict over either creating or warding off a precedent for future social policy development. Ultimately, the two *Volksparteien* (CDU/CSU and SPD) compromised on a variant that was most faithful to the traditional social insurance path, namely, a separate branch under the roof of the sickness funds. It avoided further burdening the federal budget, met the states' and municipalities' interests to immediately get relieved from risen social assistance spending on needy frail elderly, and it applied a principle most familiar and comprehensible to the public as contribution payments entitle to non-means-tested benefits in case of risk occurrence (Götting et al. 1994; Campbell and Morgan 2005). Nevertheless, the new scheme included two features unprecedented so far: *factually*, employers are not burdened with half of the contribution rate since one paid holiday was abolished,⁴ and the contribution rate (1.7 per cent) was fixed by law. Revenues determined that way hardly leave any scope for upgrading benefits in line with inflation when the number of beneficiaries increases as it actually does. In view of the dilemma to either depart from a stable contribution rate or to accept a further deterioration of the benefits' real value, several reform

³ The replacement rate of unemployment *insurance* benefits was lowered from 68 to 67 per cent for people with children (for childless: from 63 to 60 per cent); for unemployment *assistance* benefits the reduction was from 58 to 57 (with children) and 56 to 53 per cent (childless). For further details on the reforms after 1982 see Clasen 2005: 54-76.

⁴ This stipulation provided a justification for making pensioners liable for the full rate on April 1, 2004, and thus giving some financial relief to the public pension scheme which as their "quasi-employer" had paid half of the contributions before.

proposals have been put forward but until this parliamentary term no change has materialized.⁵

Although the long-term care insurance to a large extent replaced previous spending on means-tested care benefits, predominantly, it was an expansion of the German welfare state. When this institutional innovation went into full effect in July 1996 the direction of reforming the social insurance state had changed already and the policy process went less smoothly than before. All *health care* reforms from 1996 to 2003 were highly contested between the respective government and opposition. Due to the required consent of the *Bundesrat* the hospital sector, the largest spending component, was hardly tackled. Nonetheless, the all reform packages put a temporary brake on expenditure increases. The incoming Red-Green government never implemented some “privatization” measures legislated by its predecessor and partly revoked increased co-payments for patients which were no longer regarded as a “deterrent”, but rather, as a source of revenues to fuel the health care sector as one of Germany’s few “growth industries”. However, the new government was unable to carry through a comprehensive reform after the majority in the *Bundesrat* had shifted to its disadvantage in 1999. Its reform packages focused on the governance structure within the health care system for the sake of more efficient and qualitatively improved delivery of medical services. This approach was continued when the Red-Green government turned to the CDU/CSU⁵ to negotiate a compromise that was approved by the *Bundesrat* (Gerlinger 2003; Pilz 2004: 188-203). The reform package of 2003 also included tax revenues from an increased tobacco tax to be infused into the statutory health care scheme. They are meant to cover spending items “alien” to this scheme (like maternity benefits) and amount to about € 4.2 billion in 2006. Again, the 2003 reform further shifted the costs of health care to the patients (among others, they have to pay an “entrance fee” of € 10 per quarter when seeing a doctor in private practice) and to the insured. Since July 2005 the contribution rate is no longer equally shared between employer and employee, but rather, the latter has to pay 0.9 percentage points more than her employer who is relieved correspondingly.

[THIS PARAGRAPH HAS TO BE UPDATED AFTER A REFORM PACKAGE HAS BEEN AGREED UPON] The new “Grand Coalition” government plans to enact another health care reform during the 2005-2009 parliamentary term which will focus on the financing side of the scheme. Although the concepts of the CDU/CSU and the SPD differ fundamentally, both parties’ intention is to relieve the employers from non-wage labor costs, and both proposals imply a clear departure from a wage-centered social insurance scheme

⁵ One change is nonetheless worth mentioning: Since 2005 all childless members born after 1939 and older than 23 years have to pay a surcharge of 0.25 percentage points on top of the normal contribution rate. Immediate cause of this change was a ruling of the Constitutional Court that, in line with its previous opinion on the external effects of children and the indispensable role of the “next generation” for pay-as-you-go pension schemes, demanded to make parents better off than childless people. Those former decisions had compelled the legislature to improve the value of child-care credits in the pension scheme and were complied with in the reform of 1997.

which, indeed, has become somewhat awkward. Only employees with earnings up to an earnings threshold are liable to *earnings*-related contributions, but about 95 percent of the benefits granted to them and their non-working relatives are strictly related to *medical need* after initially predominant spending on earnings replacement (sickness benefits) has shrunk to a minor item. In order to attain a lower contribution rate, the Social Democrats propose a “citizens’ insurance”, i.e. to extend coverage to all gainfully employed and to also include income other than earnings (up to a ceiling) in the contributory base. In contrast, the CDU/CSU concept borrows from the Swiss model: whether employed or not, all adult members of the statutory sickness funds have to pay a flat-rate premium with tax-funded subsidies for those on low incomes. The employer contribution is abolished by adding the present payments to the workers’ gross earnings. Since the two concepts are difficult to reconcile no concrete agreement has been reached yet.

Until 2001 when a tacit consensus between the relevant political actors facilitated the legislation of a path-breaking reform, various changes in *public pensions* were no less controversial than health care reforms. In view of a steep rise of elderly unemployed claiming an early retirement pension (at age 60), the phasing-out of early retirement options without permanent deductions was accelerated in 1996, and various non-contributory entitlements, not based on individual contributions out of earnings, were further reduced and thus strengthened the link between contributions and benefits. The changes were a prelude for a more substantial reform legislated one year later and, once again, bitterly opposed by the Social Democrats and the labor unions. In particular, they resisted impairments for disability pensioners and the inclusion of a “demographic factor” in the benefit formula (that would have led to a gradually declining replacement rate), but not improving child care credits and higher federal subsidies (financed out of an increased VAT rate). After coming into office, the Red-Green government suspended both “social atrocities”, legislated a more moderate reform of disability pensions in 2000 instead. Moreover, it introduced (and subsequently raised) an energy tax (*Ökosteuern*) and funneled the revenues into the budget of the public pension scheme for the sake of a lower contribution rate. Finally, the Red-Green government executed a *paradigmatic change* when it legislated a reform package in 2001 of which three innovations are most important.

First, it replaced the principle of ‘fixed relative position’ with that of ‘fixed contribution rate’ (Myles 2002: 140-5) when it stipulated that the contribution rate must not exceed 20 per cent until 2020 and 22 per cent until 2030. In order to keep to these targets, “brake mechanisms” were included in the benefit formula, and the government was obliged to take further “appropriate” action if necessary. Thus, the benefit level became the dependent variable (and revenues from pre-defined maximum contribution rates the independent one), and its expected decline meant a clear departure from the dogma of status maintenance (after a complete full-time career) to be attained by public pensions alone. Second, the core of the

2001 reform was the institutionalization of the so called *Riester-Rente* that is meant to close the arising pension gap. The voluntary take-up of certified savings plans is encouraged by offering tax incentives or direct subsidies. Those incentives (which also apply if parts of earnings are converted into contributions to employer-sponsored occupational pension plans) are limited to savings of four per cent of earnings. This extension to *retirement income* policy has irrevocably put the German pension system on a multi-pillar track again after it had been tantamount to *public pension* policy and a one-pillar approach since 1957. Less attention has been paid to the third innovation: old-age (and disability) pensioners with insufficient resources are no longer referred to the general social assistance scheme, but rather, are entitled to benefits from a special basic security scheme which are still means-tested and not higher than before. However, the obligation of adult children to financially support their elderly parents is lifted. It is expected that this will increase the take-up rate, and the non-stigmatized access to benefits from the new scheme will make the combined effects of “new risks” in the labor market (fewer regular full-time employment careers) and of past and future pension retrenchments socially more bearable.

The 2001 reform gained a majority in the *Bundestag* after the labor unions and the “traditionalists” within the SPD were acquiesced by some (symbolic) concessions (Trampusch 2006), and a tacit inter-party consensus emerged after further concessions were granted to the CDU/CSU so that the party abstained from determined efforts to close the ranks in the *Bundesrat* and actually no unified bloc of states with the CDU in government obstructed the reform package. A similar pattern of conflict and, ultimately, of conflict resolution occurred in 2004. Based on recommendations of two reform commissions, the reform package included a shift in pension taxation (gradually, contributions will become tax-exempted and, correspondingly, benefits are taxed upon receipt) and again a change in the benefit formula. Calculations made prior to the 2001 reform had turned out to be overly optimistic, and for not to miss the contribution targets a so called “sustainability factor” was included in the benefit formula which will lead to a further decline of the replacement rate. If the change in taxation is also taken into account the *net* standard replacement rate is going to drop from about 69 percent at the beginning of this decade to about 52 per cent in 2030.

Since the aspired decline will only materialize if annual wage growth is large enough for employing all “brake mechanisms” in the benefit formula the year after, the new Black-Red government plans to introduce a “make up” factor that allows a prolonged non-indexing of benefits until the replacement rate attains the “correct” level. Furthermore, the government will take up another proposal by the reform commission (Kommission 2003), namely, to raise the standard retirement age by two years (to age 67) between 2012 and 2029.

This measure implies lower benefits for workers who, for whatever reason, (have to) claim their public pension at an earlier age.⁶

Since the major reform in 1969 it has been recurrently argued that active labor market policies are improperly financed out of contributions to the *unemployment insurance* scheme (Heinelt 1994; Reissert 1994). The funding method has hardly changed but two far-reaching reforms meant to modernize active labor market policy and to improve its effectiveness went into effect in 1997/98 and 2002. More drastic changes emanated from a reform commission's proposals (Kommission 2002). The so called "Hartz legislation" came in four parts. Among others, the first three included a modernization of the administration of the Federal Labor Agency, stricter "activation" of the unemployed and a curtailment of benefit eligibility for unemployed age 55 and older (maximum 18 instead of 32 months).

Most controversial was the "Hartz IV" act. It abolished the awkwardly constructed unemployment *assistance* scheme that was tax-financed and means-tested but, at the same time, earnings-related and meant to (infinitely) ensure status preservation at a lower level of provision than unemployment *insurance* benefits. Merging the unemployment and the social assistance schemes into a new institution was eased because the latter one had been emptied from two groups of beneficiaries: the asylum seekers were transferred to a special scheme in 1993, and pensioners with too low income are referred to the basic security scheme since 2003 (see above). Thus, only people of working age (and their children), entitled to work and, in most cases, obliged to seek employment, were left. The new benefit type *Arbeitslosengeld II*, in place since January 2005, is *means-tested* and *flat-rate*, and among the recipients there are "losers" (foremost single households) as well as "winners" (Blos and Rudolph 2005). It is financed out of a mix of sources: the federal government pays the largest share. The municipalities are financially involved and also gained competencies in the job placement of the long-term unemployed. Finally out of contribution revenues the Federal Labor Agency adds a "dowry" of € 10,000 for each (long-term) unemployed whose insurance benefit (*Arbeitslosengeld I*) has expired and who is transferred to the new scheme. The Federal Labor Agency is nevertheless relieved because it spends less on active labor market policy. Its present surpluses and, additionally, a share of revenues collected from an increased sales tax (VAT) will be utilized to lower the contribution rate to the unemployment insurance scheme in 2007 from 6.5 to 4.5 percent.

So far, the "Hartz IV" act did not come up to expectations of lower spending for means-tested benefits. On the contrary, in 2005 the federal government disbursed about € 12 billion more than had been calculated in advance (*Frankfurter Allgemeine Zeitung* 2006). It happened, because the number of people becoming entitled to *Arbeitslosengeld II* was clearly

⁶ It is planned to exempt those workers from permanent deductions who have produced a 45-years insurance record. This provision, however, will hardly benefit low-wage manual workers since those long careers are mainly attained by male employees who have earned at least an average wage (Bundesregierung/RV 2006: 57).

underestimated.⁷ Furthermore, the law was poorly crafted and provided various perverse incentives for (potential) beneficiaries to become and remain eligible. The reorganized administration at the local level encountered problems to effectively implement activation measures and to speed up the placement of the long-term unemployed (Bundesrechnungshof 2006). Finally, municipalities relieved themselves from previous expenditure at the expense of the federal budget. It still remains to be seen whether amendments to the reform legislation underway in 2006 will actually remove the ascertained deficiencies.

What are the trends that emerge from an inspection of the more recent reforms? *First*, the development clearly points to more basic security *viz.* a lower level of social protection and more frequent means-testing.⁸ This is clearly true for the enlarged number of unemployed, either receiving lowered insurance benefits or being on flat-rate *Arbeitslosengeld II*. Mainly due to the non-indexing of benefits from the long-term care insurance the number of frail elderly dependent on supplementary social assistance (*Hilfe zur Pflege*) is on the rise again. Without additional private savings efforts (not worthwhile if expecting a low public pension anyhow) status preservation in old age cannot be attained in future. Moreover, there will be more elderly receiving benefits from the means-tested basic security scheme as subsequent cohorts of retirees, having produced a less favorable insurance record, will be fully affected by the abolition of elements in the benefit formula that once ensured socially adequate pensions, and they will be hit by the general decline of the replacement rate.⁹ The payment of survivors' pensions will become tested against all income of the survivor above a threshold. Only in the health care scheme there have been no cuts into the *core* of benefits although some less vital medical treatments and pharmaceutical drugs have been removed from the catalogue and the level sickness benefits was slightly lowered. However, there is also one improvement in benefit access: family work – raising children or taking care of frail people – has been acknowledged as an equivalent to paid work and increases pension entitlements.

Second, in post-war Germany, employers and employees paying an equal share of social insurance contributions has been an “iron principle”.¹⁰ Recent reforms have dissolved

⁷ Unemployed people not receiving the former unemployment assistance benefit became eligible for *Arbeitslosengeld II* and, being designed as a basic security scheme, also the enlarged number of working poor may claim this benefit as a supplementary income source. Recent estimates show that about 4 million full-time workers (17.4 percent) and, if part-time workers are included, around 6 million (20.8 percent) employees earn an hourly wage below two thirds of the median (Rhein et al. 2005; Kalina and Weinkopf 2006). Not all of them are factually eligible, however, there should be a considerable non-take-up rate.

⁸ ‘The principle of *publicly* guaranteeing the achieved living standard is on the retreat, while the principle of publicly securing a minimum of existence is increasingly gaining importance’ (Bleses and Seeleib-Kaiser 2004: 92).

⁹ The *average* pension amount paid to *newly* retired *men* in *West* Germany has almost remained constant between 1990 (€ 793) and 2004 (€ 810). Such stagnation reflects the combined impact of labor market *viz.* employment career changes and pension reforms. It also implies that the average pension as a percentage of the “standard pension” has decreased from 94.5 per cent to 75.4 per cent (figures calculated from DRV 2005: 88 and 233).

¹⁰ Health care insurance has been an exception. Until 1949, workers paid two thirds of the respective rate.

this principle: employees pay more than half of the contributions to health care insurance since 2005; in long-term care insurance the employers were compensated for participating in financing; and employees who follow the recommendation to take out a contract for the *Riester-Rente* are burdened with additional contributions. Relieving employers from non-wage labor costs at the expense of workers' disposable income (also by higher out-of-pocket spending for medical benefits) hardly implies a cost increase through the backdoor when labor unions were pushing through compensatory wage demands. At present, most of them are too weak to even gain wage increases beyond the inflation rate or to successfully fend off attacks on once agreed achievements, like shorter working hours.

Third, there is a trend to depart from uniform contribution rates for all employees.¹¹ In long-term care insurance, childless insured persons pay a surcharge; employers pay no contributions to the unemployment insurance when hiring older workers; and for workers who have taken so called *Midi-Jobs* – i.e. earning a minimum of € 401 per month but less than € 800 – contribution rates are lower.

Fourth, the share of total social spending that is financed out of contributions has decreased from 65.6 per cent in 1991 to 59.9 per cent in 2003 (Sozialbericht 2005: 202). Largely, this is the result of more tax money infused into the social insurance schemes. To that end indirect taxes have been increased (VAT and tobacco tax) or introduced (eco tax). Those tax subsidies are granted to health care insurance, but the largest shift in the financing base happened in the public pension scheme. At present, payments out of the federal budget (including contributions for child-care credits, currently facilitating a lower the rate levied on earnings) cover about 33 per cent of the annual expenditure of this basically *contribution*-financed pension scheme, whereas in 1992 they delivered only 21 per cent. These subsidies amount to 42 per cent of the *federal* tax revenues in 2004 (Bundesrechnungshof 2004: 63-5). Tax expenditure on the *Riester-Rente* still come on top of these figures. Nevertheless, further refinancing of the German welfare state remains a core issue but is constrained by fiscal austerity (see section 4.).

Finally, what has not been shown so far are changes in the organizational structure of the social insurance schemes. The separation of public pension schemes by occupational status was finally abolished in October 2005 when they were merged into one, and due to voluntary mergers of sickness funds into larger units their number has been drastically reduced. Moreover, the traditional feature of corporatist self-administration has lost much of its relevance (except for the health care scheme) since ever more detailed legislation limited the scope for autonomous decision-making by the respective administrative bodies, and they themselves have been forced to adopt a more managerial structure of governance for the

¹¹ In case of newly hiring an employee aged 55 or older the employer is exempted from contributions to the unemployment insurance scheme.

day-to-day matters and, like joint stock companies, supervisory boards with representatives of employers and employees.

3. Institutional Reforms: Searching for Explanations

[THIS SECTION IS A VERY PRELIMINARY DRAFT AND HAS TO BE REWORKED]

During the first half of Chancellor Kohl's regency, Germany participated in the worldwide recovery of economic growth. Correspondingly, the employment level rose, the annual deficit in the federal budget dropped to less than one percent of GDP in 1989 and the social spending/GDP ratio went down from 31.2 percent in 1981 to 27.8 percent during the 1980s. This favorable situation nurtured false hopes to manage present and future challenges by incremental changes and to successfully master the social and economic consequences of unification. attain adjustments changed almost immediately after unification. Such self-confidence retarded political learning in Germany at a time when in Sweden and Finland (and in the Netherlands already in the early 1980s) an universally shared perception of an "acute crisis" helped to reframe social policy issues and to arrive at substantial welfare state reforms (Hinrichs 2002). In Germany, unification meant a "shock" but not immediately a "crisis", and all collective actors were anxious to avoid or limit repercussions on the established institutional structures that had been extended to East Germany. Thus, it was not before about 1995 when the discourse on social policy reforms changed. This is not to say that certain arguments had been absent so far but as new interpretative patterns of problem diagnosis came to the fore they condensed into irrefutable facts legitimizing more grave policy changes (Bleses and Seeleib-Kaiser 2004: 110-3).

With regard to the unemployment problem, the diagnosis moved further away from macroeconomic constellations as a prime cause. Instead, too little labor *market* due to excessive state intervention was identified as root cause (Bleses and Seeleib-Kaiser 2004: 121-3). Consequently, removing rigidities through deregulation was the recipe as well as extended recommodification, i.e. more incentives for unemployed to take up job offers and stricter sanctions if they refuse. A somewhat biased interpretation of "employment miracles" abroad (the Netherlands, Denmark), already applying stricter activation policies, were utilized to support the necessity of further changes.

Official estimates on demographic aging had hardly worsened since the early 1990s but were perceived as more dramatic than before. *Generational equity* that had been absent in the German discourse became an issue for the first time in 1997 when it appeared in the explanatory statement to the draft law of the pension reform that was legislated the same year. A declining replacement ratio for present and future pensioners was justified for not to overburden the younger generations. Interested actors, like the financial market industry, and policy entrepreneurs reinforced arguments about the non-sustainability of the PAYG pension

scheme and the exhaustion of the one-pillar approach to deliver appropriate retirement income and prepared the ground for the multi-pillar paradigm to become predominant.

About the same time *globalization* spread as a term in the political discourse and was immediately related to high *non-wage labor costs* as a threat to international competitiveness and job growth. Since then social insurance contributions are the central topic in almost any reform debate. One quotation from the spokeswoman of the Liberal Party, Gisela Babel, may suffice to show how the interpretative pattern had changed. When the 1997 pension reform act was read in the *Bundestag* she referred to the reform of 1989 and said: ‘At that time no discontent with a contribution rate to the pension scheme of 26 per cent or 28 per cent was discernible. That was flatly considered acceptable then. Today we do not consider it acceptable anymore’ (Deutscher Bundestag 1997: 16780-1).

These new interpretative patterns were foremost advanced by the government parties (and the employers and the economic advisory council anyway). The Social Democrats, the smaller opposition parties and the labor unions did not adopt them. Therefore, it were the Christian Democrats who departed from the commitment to a strong welfare state, they hitherto shared with the Social Democrats for electoral reasons and because of the strong stance of the labor wing within the party’s membership (with Norbert Blüm, Minister of Labor and Social Affairs for 16 years, as central guardian of the Bismarckian welfare state). Not the least driven by the Liberal party, the government turned to an unilateral approach, not actively seeking a compromise with the Social Democrats who then utilized the *Bundesrat* to block policy changes wherever it was possible, and in the run-up to the 1998 federal election they promised to undo the “social atrocities” the Christian-Liberal government had committed. In fact, the reform acts legislated in 1996 and thereafter contributed to the victory of the Social Democrats in the 1998 elections (Hinrichs 2005: 69, n. 5).

After coming into office and indeed revoking several pieces of previous reform acts it was not before spring 1999 that the “modernizers” with the Social Democratic party actually took over and the Red-Green government changed its course. Chancellor Schröder and the now dominating modernizers within his party clearly adopted the new interpretative patterns (the Greens as well) and placed *self-responsibility* and *efficiency* on equal footing with the traditional troika of principles: freedom (emancipation), solidarity and social justice. Moreover, there was a shift in the mode of policymaking that had already begun during the late years of the Christian-Liberal government: The government did no longer leave the initiative to reform and compromise-building to corporatist bodies (of which the pension reform of 1989 was a prime example but took the lead and partly ignored the interest organizations. To some extent, this was due to an elite change of “social politicians”. Whereas previously those with a (long-standing) career in the labor unions, charities or other associations dominated in the Ministry and the responsible committee of the *Bundestag*, they have been superseded by “party politicians” (Trampusch 2004). Another feature of social

policymaking after the year 2000 was ‘government by commission’ (Czada 2004) when the preparation of concrete reforms was delegated to commissions (largely staffed with “friendly experts”) for the sake of mobilizing consensus and relieving the government from the task of gaining legitimacy. However, since 1999 reform efforts of the Red-Green government were constrained by an adverse majority in the *Bundesrat* that, among others, foreclosed a more comprehensive health care reform in the year 2000. Thus, it was not before 2001 when a “tacit consensus” between the government and the Christian Democrats emerged on reforms that involved no principled dissent and of which the pension reform of 2001 was the prime example.

Therefore, it can be concluded that institutional innovations (like the long-term care insurance or the “Riester” reform of 2001) or structural reforms (like those in health care of 1993 and 2003, in pension of 1989 and 2004, the “Hartz” legislation) which were milestones in changing the social policy arrangement only came about when competition between the two large political parties was suspended and the respective party in opposition was prepared to negotiate on a compromise or a “tacit consensus” emerged. The pension reforms of 2001 and 2004 based on such a “tacit consensus” and meant not to utilize the veto potential of the *Bundesrat* but nevertheless to attain concessions from the government. In all these cases, key social actors (health care providers and labor unions) hardly had chance to significantly influence or even obstruct the legislation process or were fobbed off with symbolic concessions (like the labor unions at the end of the “Riester” reform in 2001 – see Hinrichs 2005). The results of the premature federal elections of 2005 left hardly any other option but to form an unloved “grand coalition” government. This constellation largely neutralizes all veto powers but shifts conflicts about social policy change into the government itself. Regarded as a temporary arrangement, party competition between the CDU/CSU and the SPD is not put to rest. Rather, the Social Democrats have already begun to again sharpen their profile as a *moderate left* “people’s party”.

4. Difficulties to Attain a Transformation

Objective challenges hardly translate directly into policy changes. However, an enduring or even aggravated “problem load” may limit the political space for reforms that exactly mitigates the pressure. There are several constraints which impede a transformation of the German social insurance state into an employment- and family- friendly welfare state patterned according to Scandinavian role models.

First, there are more beneficiaries to be supported now than there were in the first half of the 1990s. The number of old-age and disability *pensioners* went up from 13.7 million in

1993 to 18.3 million in 2004 (+ 33 percent; DRV 2005: 146).¹² In 2004, there were 31 percent more recipients of *unemployment insurance* benefits than in 1991 (1.85 million compared to 1,41 million), and the growth of long-term unemployed almost led to an explosion of people receiving *unemployment assistance* benefits: there were 0.42 million in 1991 but 2.20 million in 2004, the year before the “Hartz IV” act became effective (StTB 2005: Table 8.14). Since 1996 when the *long-term care insurance* became fully implemented the number of beneficiaries went up from 1.55 to 1.93 million in 2004 (+ 24 percent; StTB 2005, Table 8.18).

Second, while the number of beneficiaries increased there are now fewer workers contributing to the social insurance schemes although the number of gainfully employed people has hardly changed between 1991 (38.6 million) and 2004 (38.9 million). However, the number of employees liable to social insurance contributions has dropped by about 3.4 million. Additionally making things worse, among them there was a shift towards part-time workers (+ 1.6 million) who contribute less to the schemes’ revenues than do full-time employees (- 5.0 million). The declining share of compulsorily insured workers, down from 77.7 (1991) to 68.5 percent (2004), is partly due to structural shifts (towards service sector jobs) and cyclical reasons but also stems from policies to attain a more flexible labor market (Bach et al. 2005). The “Hartz II” act actively supports atypical jobs like marginal part-time work and self-employment. After it became effective in April 2003 the number of *Mini-Jobs* (monthly earnings \leq € 400¹³) increased by 1.8 million until June 2005 (Bundesregierung/AM 2006: 124-8). Repercussions of this development and slow wage growth are most clearly visible in health care insurance: not the least due to cost containment efforts, sickness funds’ spending grew by not more than 9.6 percent between 1996 and 2004 whereas GDP increased by 18.1 percent. Since the *wage base* for compulsory contributions to the statutory sickness funds moved up by only 8.5 percent the average contribution rate had to be raised (0.7 percentage points; StTB Gesundheit 2005, Tables 10.5A, 10.11, 10.13, 18.1; see Erbe 2005).

Continuing pressure on the spending side (more beneficiaries) and the worsened revenue base of the social insurance institutions have so far largely outweighed the savings effects of first and second order changes that have taken place since the early 1990s.¹⁴ Third order changes in labor market and pension policy which imply new goals for the respective policy area and the corresponding application of new instruments have not yet led to lower spending –quite the contrary, as could be ascertained with regard to the “Hartz” acts (section

¹² Recently, the annual inflow is declining (DRV 2005: 49) due to smaller cohorts approaching retirement age and more older workers no longer retiring as early as possible because of the permanent benefit deductions they face.

¹³ So far, only employers pay a 23 percent contribution rate on top of earnings. After June 2006 the rate will increase to 28 percent (13 percent to the health care and 15 percent to the pension scheme).

¹⁴ For example, the older part of the present pensioner generation receives benefits based on entitlements that were earned when employment careers had been more favorable (particularly in East Germany) and pension reforms had not yet cut into certain provisions (like granting education credits), but have to be paid out of contributions from a declining number of covered employees who, in addition, work part-time more often.

2.). Therefore, the total contribution rate to the social insurance schemes is still as high as 42 percent in 2006, and social expenditure attained a new peak in 2003 when it amounted to 34 percent (Sozialbericht 2005: 192; see also Schmidt 2005: 124).

A third reason for the enduring high level of social expenditure and difficulties to arrive at a more impressive shift away from contribution financing has to do with unification. The sluggish transformation of the German welfare state is not comprehensible without this singular event and its consequences. Still in 1990/91, it was regarded also as an economic blessing because it should trigger Germany's second "economic miracle" (Abelshauser 2004: 402-7). Such optimistic expectations did not materialize. Rather, after a short-term boom, unification enhanced the slowdown of economic growth. Due to the weak economic position of East German *Länder* and the high unemployment rate there, net interregional transfers out of public purses (federal, state and social insurance budgets) from West to East Germany are continuing. In 2003, they amounted to 3.2 percent of GDP what roughly matched the total public deficit in that year (Lehmann et al. 2005).

It is pointless to elaborate on the counterfactual question of how the reform process had looked like without the unification event. Notwithstanding, it is hard to deny that the EMU criteria on the public deficit and the level of public debt had meant such a severe constraint for reforms that imply more tax financing. Therefore, the irrefutable requirement to reduce the public deficit to less than three percent in 2007 at latest adds a fourth hindrance to modernizing the social insurance state because more insistent attempts to lower the contribution rates would imply higher taxation. That way out, however, is hampered by a combination of negative consequences, namely a setback in the tax competition among EU member states (after having lowered income tax rates in 2005), rising tax resistance among citizens and the threat of possibly stalling economic recovery. Thus, the last resort is to (further) shift the cost of social security to employees, either by making them liable to more than half of the respective contribution rate, imposing higher co-payments or encouraging them to take up supplementary private provision (for old age, for full-cost coverage in case of long-term care or for certain medical benefits). Indeed, those burden-shifting measures have been a main direction of reforms. They may possibly make the social security arrangement more employment-friendly but, at the same time, reduce the volume of redistribution and thus the level of *social* security. Combined with various level and instrument changes in the different schemes, implying less generous benefits and more restricted access to them, foremost the lower income strata become worse off.

The *raison d'être* of lower social insurance contributions is to enhance job growth and covered employment in particular for the sake of a relaxed financial state of the social insurance schemes and rising tax revenues. However, in order to get a virtuous cycle off the ground, non-wage labor costs would have to be lowered quite substantially. A reduction of the contribution rate by one percentage point (i.e. 0.5 percent for employers) relieves employers'

total wage costs by only 0.35 percent (Bäcker 2005). Most likely, such relief should be too small to trigger additional hiring at tangible numbers. The possibility to facilitate a larger relief is either limited by the public deficit or the counter-intentional consequence of raising the loss of contribution revenues elsewhere.

This obvious dilemma is exacerbated by a second challenge, namely to improve the “family-friendliness” of the German welfare state arrangement which, traditionally, has focused on the male wage earner. In that regard, Bleses and Seeleib-Kaiser (2004: 89-93) already observe a ‘dual transformation’, namely to shrink wage earner-centered social policies and to expand policy areas that help to reconcile paid work and family life. While retrenchments and an institutional reorientation of pension and labor market policies are undeniable, the asserted expansion of family-oriented policies seems somewhat exaggerated. Various *cash* transfers to families have indeed been introduced or increased (e.g. child allowances, pension credits for child and elderly care, parental leave benefits), and on that account Germany is spending more than most European countries (Abramovici 2003; Bundesregierung/FAM 2006: 38-40). Apart from federal subsidies (€ 4 billion altogether) to create facilities for full-day schooling, expenditure aimed at “de-familialization” policies has hardly increased. In particular, there have been only small improvements in the supply of affordable day care for children below the age of three which, as in Scandinavian countries, enables a higher employment rate of mothers that is going along with fertility rates considerably higher and child poverty rates clearly lower than in Germany. Again, such reorientation towards a “social investment state” is impeded by the lack of resources which states and municipalities can additionally allocate to that end. Moreover, on the federal level an unequivocal vision is missing since the coalition parties still differ as to whether family policy should facilitate a choice between a (temporary) “female homemaker family” and a “dual earner family” pattern (Christian Democrats) or to give clear priority to the latter concept (Social Democrats and all opposition parties).

Insofar, the large German welfare state resembles a truck having entered a cul-de-sac: the further it moves the more limited are the opportunities to turn around and to get a clear run again. Serving the income security needs of increasingly larger groups outside gainful employment consumes hardly leaves resources available for substantially lower social insurance contributions that could possibly increase the number of particularly low-productivity jobs (Scharpf 2002; Hinrichs 2002). Fiscal constraints also impede a decisive turn towards a family-friendly welfare state arrangement.

5. Conclusion

The analysis in the preceding sections has shown that the contribution- and transfer-heavy German welfare state is quite vulnerable to internal and external challenges. At the same time, it is less capable of flexible adjustment to those challenges, and the specific political structures

allow for determined reform steps only if an overt or tacit consensus between the two large political parties can be brought about. However, institutional reforms happened during the last ten years and, after 1999, at an accelerating speed and producing larger impacts for citizens financing the welfare state or receiving benefits. This development clearly contradicts the image of a ‘frozen welfare state’ (Esping-Andersen 1996) or of an ‘immovable object’, resilient to changes (Pierson 2001). If one looks at the more recent paradigmatic changes – the pension reforms of 2001 and 2004 or the “Hartz IV” legislation – then it becomes obvious that labor unions’ *ability* to defend the status quo has largely collapsed, or other “old politics” actors’ (notably Social Democrats) *willingness* to do so has faded.

Despite this ongoing institutional redirection of the German social insurance state that does not follow a coherent design for a “new welfare state”, the “welfare without work” problem has not been overcome yet. A less protracted departure from traditional Bismarckian traits is hindered by economic and fiscal constraints. Nevertheless, the directions of change are obvious: on the one hand, lower social insurance contributions, reduced levels of income security through wage earner schemes, accompanied by demands for self-responsibility, and stronger reliance on means-tested benefits what means a turn to a liberal welfare state; on the other hand, increasing tax financing and more spending on family-oriented benefits which signifies a move towards the Scandinavian approach. But having missed a window of opportunity for more substantial change when other countries did it under more favorable conditions of economic and employment growth and then becoming burdened with the costs of unification, social policy transformation in Germany comes down to a zero-sum situation at best: what families gain as parents they lose as wage earners or when out of waged work, i.e. being unemployed or of old age.

References

STILL MISSING!

Frankfurter Allgemeine Zeitung, No. 89, 15 April, 2006 (Hartz IV kostet bis zu vier Milliarden Euro mehr)

Table 1: Main Features and Developments of German Social Insurance Schemes

Scheme → Dimension ↓	Pensions	Unemployment	Health	Long-term care
Covered groups	All blue- + white-collar workers with earnings > € 400	All blue- white-collar workers with earnings > € 400 <i>All unemployed (+ family members) in need</i>	All employees with earnings > € 400 and upper ceiling plus voluntary members; family members included	All persons with public or private health insurance coverage
Structure and level of benefits	Earnings-related <i>Tighter link between contributions and benefits; replacement rate declining</i>	Earnings-related; duration dependent on length of contributions (and age) <i>UE assistance (earnings-related) merged with social assistance: UE benefit II = flat-rate</i>	Cash (sickness) benefit: 100 % of earnings; 70 % after 6 weeks in-kind benefits: according to medical need	Graded according to need but no full-cost compensation
Financing	Contributions plus tax subsidies <i>Contribution rate capped; increased tax subsidies; supplementary private savings to attain income maintenance</i>	Contributions plus tax subsidies (covering deficits); tax-financing of UE assistance expenditure <i>UE benefit II tax-financed</i>	Contributions and co-payments; cash benefits first 6 weeks: employer <i>Some tax subsidies; increased co-payments; contribution rate employees raised above parity</i>	Contributions plus co-payments/supplementary social assistance <i>Pensioners pay full contribution rate; higher rate for childless people</i>
Administration	(fictitious) self-administration <i>Organizational merger of blue- and white-collar schemes; new governance structure</i>	(limited) tripartite self-administration <i>Organizational reform with new governance structure</i>	(largely) self-administration <i>Organizational reform with new governance structure; fewer sickness funds due to mergers</i>	Like health care