Incentive Compatibility in Social Assistance: Reforms and Challenges in Germany

IZA/World Bank/OECD
Conference on Activation and Employment Support Policies

Ulrich Hörning
Head of Administrative Reform, City of Mannheim

Istanbul, 30-Apr 2012

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Germany’s federal political structure is a key framework for social safety net design and operation

<table>
<thead>
<tr>
<th>Federal Republic of Germany</th>
<th>Level</th>
<th>Key Figures</th>
<th>Responsible for …</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal (“Bund”)</td>
<td></td>
<td>82m population (79m by 2030)*</td>
<td>Labour market policy</td>
</tr>
<tr>
<td></td>
<td></td>
<td>€2,400bn Total GDP (2009)</td>
<td>Unemployment Benefit I (social insurance) and II (tax-financed base benefit)</td>
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<tr>
<td></td>
<td></td>
<td>€363bn total federal budget (2009) (15% GDP)</td>
<td>Public pensions and health</td>
</tr>
<tr>
<td>States (“Länder”)</td>
<td></td>
<td>16 states</td>
<td>Schools (teachers)</td>
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<tr>
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<td></td>
<td>€309bn total state budgets (2009) (13% GDP)</td>
<td>Child-care (w/ mun.)</td>
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<td>Police</td>
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<td>Culture</td>
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<td>…</td>
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<tr>
<td>Municipalities (“Städte, Kreise und Kommunen”)</td>
<td></td>
<td>11,300 Municipalities “Kommunen”, of which …</td>
<td>Unemployment Benefit II (housing cost)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>… 111 large cities “Kreisfreie Städte”</td>
<td>Social Assistance (SGB XII)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>… 1,951 cities (“Städte”)</td>
<td>Schools (buildings)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>301 Counties (“Kreise”) outside of “large cities”</td>
<td>Child care (w/ states)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>€186bn total municipal budgets (2009) (8% GDP)</td>
<td>…</td>
</tr>
</tbody>
</table>

Sources: Destatis, Wikipedia, SVR Wirtschaft, authors calculations (* Estimate by SVR Wirtschaft)
Note: All financial indicators as gross expenditure. Additionally, the Public Social Insurance Schemes (Pension, Health, Unemployment (Social Insurance) add €506bn (2009) (21% GDP) expenditure. Total gross public expenditure is 57% of GDP in 2009. Total public debt is 73% of GDP (2010 notification to EU).
Labour-market reforms in Germany (quick recap)

Segmenting the target group

Social assistance: three levels of incentives

  Work incentives

  Fiscal federalism incentives

  Case manager incentives

Current developments and summary
Germany implemented labour market reforms in 2003-2005 - activation increased but challenges remain

- Reform had three parallel thrusts:
  - **Redesign of Federal Labour Office**
  - **Benefit Reform** (single “Basic Income Support” scheme, 2% GDP)
  - **Deregulation** of Labour Market within “Coordinated Capitalism” model

- **Joint delivery structures** in majority of cities as cooperation between Federal Labour Agency and municipalities

- Central role of **case managers**: qualification and results-orientation

- **Evaluation and data systems** very important for ongoing system improvement

- But, challenges remain: (1) low-qualified groups still excluded and (2) shortage of skilled labour!
The package: Reorganization at Federal Labour Agency, merged benefits, more activation, labour market reform

<table>
<thead>
<tr>
<th>(1) Redesigning the Federal Labour Office</th>
<th>(2) Merging of Benefits and Focus on Activation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reorganization of public employment services <em>(Federal Labour Agency)</em></td>
<td>Reforming and merging benefits</td>
</tr>
<tr>
<td>Improved service standards</td>
<td>Linking benefits and sanctions to activation services</td>
</tr>
<tr>
<td>Improved targeting &amp; enlarged mandate</td>
<td>Requiring mutual responsibilities – proactive behavior of the unemployed</td>
</tr>
<tr>
<td>Comprehensive evaluation scheme (increasing relevance to policy makers)</td>
<td>Training and placement schemes</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>(3) Labour Market Reform / Self-Regulation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deregulation of the temporary work sector</td>
</tr>
<tr>
<td>Allow exemptions from restrictions on fixed-term contracts and dismissal protection</td>
</tr>
<tr>
<td>But: No fundamental switch away from German cooperative capitalism model, e.g. flexible handling of work hour accounts agreed within collective-bargaining system</td>
</tr>
</tbody>
</table>
Focus on benefits: tax-financed SA benefits were merged into „Basic Income Support / Unemployment Benefit II“ by 2005
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Hartz IV reform led to a step-change increase in the number of beneficiaries in 2005 and to subsequent fall in unemployment

- Basic Income Support covers 5.7% of population in Germany (including 1.4m in-work-beneficiaries)
- In addition: 2.6m recipients of “Sozialgeld” and “Sozialhilfe” not able and required to work (3.1% of population)**
- Political risk of very inclusive program (→ more beneficiaries)
- Initial negative name (“Hartz IV”) and image of program in Germany

* 90,000 cases of double-benefits UB I and UB II eliminated from summation
** Sozialgeld (SGB II transfer for dependents not able and required to work) 1.8m beneficiaries, Sozialhilfe (SGB XII transfer mainly for old-age income support) 0.8m beneficiaries (2008 data)

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- Labour hoarding by businesses during crisis (anticipation of qualified labour shortage)
- Short-shift scheme > €10bn in 2008-2010 from FLA (additional cost borne by businesses)
- Wide-spread use of work-hour accounts (available to 51% of German workers)

Source: SVR 2012
Despite all-time labour force participation high, long-term unemployment and low-paid jobs feed into income inequality

- Of a total population of 82m, 41m were participating in the labour force in Q2/2011. Highest post WWII absolute number. Amongst other factors …
  - Improved matching / activation via reforms
  - Improved Labour Force Participation of 55+ and women
  - 7.3m “Minijobs” (≤400€) in labour force*
- Increase of inequality and poverty
- Integration difficulties of long-term unemployed
- Of 1.17m labour market entrants from Unemployment assistance (UB II) benefit in 2008
  - > 50% entered jobs with in-work benefits
  - 13% returned to benefit within 6 months

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* IAB 2012: Monthly earnings below 400€, limited taxes and social insurance contributions paid, approx. 5m Minijob only, approx 2m combination of full employment with Minijob
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Segmenting the target group

Social assistance: three levels of incentives

Work incentives

Fiscal federalism incentives

Case manager incentives

Current developments and summary
### Segmenting the target group: Activating the work-able unemployed

<table>
<thead>
<tr>
<th># of persons</th>
<th>UnE Insurance UB I (SI)</th>
<th>Basic Income Support UB II (SA)</th>
<th>Other</th>
</tr>
</thead>
<tbody>
<tr>
<td>In-Work Benefit</td>
<td>Core Area of Activation Regime</td>
<td>1.4m</td>
<td></td>
</tr>
<tr>
<td>Unemployed (able (and required)* to work)</td>
<td>1.0m</td>
<td>2.0m</td>
<td></td>
</tr>
<tr>
<td>Inactive (able, but not required to work)</td>
<td></td>
<td>1.4m</td>
<td></td>
</tr>
<tr>
<td><strong>Totals UB I and UB II</strong></td>
<td>1.0m</td>
<td>4.8m</td>
<td>35bn€</td>
</tr>
<tr>
<td>“Social Money” (SGB II) (unable to work but living with UB II recipient)</td>
<td></td>
<td>1.8m</td>
<td>4.3bn€</td>
</tr>
<tr>
<td>“Social Assistance” (SGB XII) (unable to work or &gt;65years)</td>
<td></td>
<td>0.8m**</td>
<td>1.1bn€</td>
</tr>
<tr>
<td>Asylum benefits / war veterans</td>
<td></td>
<td>0.2m***</td>
<td>40.4bn€ ~1.7% GDP</td>
</tr>
<tr>
<td><strong>Total Basic Income Population</strong></td>
<td>7.6m (=9.3% of pop)</td>
<td>N.N. [6.4bn€ / 0.27% GDP]</td>
<td></td>
</tr>
</tbody>
</table>

* UB II only
** 85% of whom are >65years
*** 127k Asylum Seekers, 46k War Veterans and spouses
**** HzE-Benefit. No federal-level case numbers available, spending data only.
Sources: Destatis 2010, FLA 2008 and 2010

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**Indicative numbers 2010**
Segmenting the target group: A closer look to the activation target group

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<td>1.4m</td>
<td></td>
</tr>
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**Core Unemployed Basic Income Population**

- 41% Long-Term Unemployed (> 12 months)
- Male/Female-ratio 50:50
- 20% of households with children are in BIS / UB II (54% of which single-parents, mostly mothers)
- East / West Germany-ratio 35/65 (pop-ratio is 20/80)
- Of total BIS / UB II population (4.8m) …
  - 2.1m Entries (of which 50% returnees (in 12 month period))
  - 2.4m Exits

**“Aufstocker”**

- 55% earn <400€
- 93% employed
- #'s increased +43% 2005/2009

**“Not required to work”**

- e.g. mothers with children in first three years (→ hum-cap loss leads to dependency lock-in)
The number of in-work Basic Income Support recipients has increased – majority employed in low-wage “Minijob” scheme

- Numbers of in-work beneficiaries have increased in absolute and relative terms
- Majority in “Minijob”, not paying taxes and social insurance contributions
- Anecdotal evidence suggests combination of “Minijob” with undeclared income / grey-economy work and intention to avoid further activation measures
- Exit probability out of benefit increases with level of earnings (@ 24-months)
  - No-income: 75%
  - Minijob: 77%
  - >800€: 87%
Labour-market reforms in Germany (quick recap)

Segmenting the target group

Social assistance: three levels of incentives

- Work incentives
- Fiscal federalism incentives
- Case manager incentives

Current developments and summary
Three dimensions of incentives in social assistance: work/benefit, fiscal federalism, case-workers

1. Work-Incentives
   - Basic Benefit, in-work Benefit, disregards, etc.
   - In-work Benefit trap, marginal disincentives, etc.
   - Dilemmas between work-incentive, high fiscal cost, public job schemes, increased beneficiary numbers, etc.

2. Fiscal Federalism Incentives
   - Co-financing of benefits
   - Asymmetric phase-out of benefits
   - Joint operation of Basic Income Support delivery centers

3. Case Worker Incentives
   - Public management topic
   - Reporting and MIS to be in place
   - PES / municipality staff contract and collective bargaining issue
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Labour-market reforms in Germany (quick recap)

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Current developments and summary
Work incentives are mainly driven by income / benefit discussions – non-financial dimension important as well

1a Financial Incentives
- Incentive for Basic Income Support recipient to take up work or expand hours worked or increase salary earned
- Benefit / income schedule (disregards, earnings retention rates) and marginal effective rates (taxes, contributions, etc.) as main drivers of financial dimension
- Combination of legal in-work benefit income and undeclared “grey-market” income (no hard evidence available)
- “Interaction” between Basic Income Support and other benefits (additional child benefit, housing benefit, etc.) not in focus here

1b Non-Financial Incentives
- Social context, cultural norms and motivation are important
- “Barriers” to employment can counter financial incentives (health conditions, child-care needs, etc.)
- Activation regime: Attraction (support with job search) and penalties (reduction of benefits in case of non-compliance)
- Distaste for volatility → “complicated” prediction of monthly net income for in-work benefit recipients
**Basic Income Support** (2005-reform) improved take-home pay for in-work recipients

**Example:** couple with two children (one earner)

- **Child bonus + housing benefits**

**High complexity** because of different benefit eligibility and calculation methods

Source: BMAS 2009

Note: 2011 legislation increased retention rate of earnings between €800 and €1000.

SVR Wirtschaft (2010: 233) estimates minimal effects of 14k jobs p.a. at fiscal cost of €230m p.a.

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Basic Income Support for families with children can be 100+% of comparable work-income, providing little work-incentive

<table>
<thead>
<tr>
<th>General Initial Conditions</th>
<th>Beneficiary Household Set-up</th>
<th>Benefit-to-wage-differential I*</th>
<th>Change of Set-up</th>
<th>Benefit-to-wage-differential II</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Low qualifications</td>
<td>Single 30yrs</td>
<td>63% / 78%</td>
<td>Improve qualification to “high”</td>
<td>37% / 46%</td>
</tr>
<tr>
<td>2. Tertiary sector employment</td>
<td>Married 2 children one earner</td>
<td>95% / 104%</td>
<td>Add one earner</td>
<td>43% / 53%</td>
</tr>
<tr>
<td>3. West Germany</td>
<td>Single parent 2 children</td>
<td>100% / 111%</td>
<td>n/a</td>
<td>-- / --</td>
</tr>
</tbody>
</table>


* Second number denotes benefit-to-wage-differential with 400€ Minijob
Basic Income Support allows for in-work-benefits with a 100€ initial disregard and an initial 20% earnings retention range.
Reforms for incentive improvement have been proposed on the base disregard, earnings retention rate and benefit level.

**Base Earnings Disregard**
- 100€ → 200€

**Earnings Retention Rate**
- 20% → 40%

**Base Benefit**
- -10%**

Source: FLA Statistics, March 2010 "In-Work Beneficiaries of Basic Income Support" and SVR Wirtschaft 2010/2011
* in 100€ to 800€ range
** From 264€ to 328€
Reform proposals increase participation rate but come at relatively prohibitive fiscal or political costs

<table>
<thead>
<tr>
<th>Target Variable</th>
<th>A Increase Base Disregard</th>
<th>B Increase Earnings Retention Rate</th>
<th>C Decrease Base Benefit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Participation Rate (%)</td>
<td>+0.6%</td>
<td>+0.8%</td>
<td>+1.2%</td>
</tr>
<tr>
<td>Hours worked / week (h)</td>
<td>-0.8h</td>
<td>-0.9h</td>
<td>+0.2h</td>
</tr>
<tr>
<td>In-Work-Benefit Recipients (#)</td>
<td>+0.6m</td>
<td>1.0m</td>
<td>-0.2m</td>
</tr>
<tr>
<td>Net Fiscal Cost (-) / Savings (+) (bn€)</td>
<td>-2.8bn€</td>
<td>-4.8bn€</td>
<td>+6.3bn€</td>
</tr>
</tbody>
</table>

- Increasing the base disregard or increasing the earnings retention rate would yield small participation gains while (1) increasing number of in-work beneficiaries (→ negative political signal) at (2) great fiscal cost (→ reduced fiscal space)
- Decreasing the benefit politically not feasible (currently). Needs to be combined with public employment scheme to ensure ethical subsistence minimum (→ controversial)

Source: SVR-Wirtschaft 2010/2011, Microeconomic Simulation Model

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Survey data reveals differences between *Basic Income Support* beneficiaries and general working age population

<table>
<thead>
<tr>
<th>Category</th>
<th>General Working-Age Population</th>
<th>Basic Income Support Beneficiaries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Health Issues</td>
<td>22%</td>
<td>35% to 60%</td>
</tr>
<tr>
<td>Handicapped</td>
<td>9%</td>
<td>11%</td>
</tr>
<tr>
<td>Giving Care</td>
<td>7%</td>
<td>9%</td>
</tr>
<tr>
<td>Life Satisfaction (0-10)*</td>
<td>7,1</td>
<td>4,9</td>
</tr>
<tr>
<td>Willing to work, even if income is not needed</td>
<td>40%</td>
<td>49%</td>
</tr>
<tr>
<td>No professional training</td>
<td>19%</td>
<td>37%</td>
</tr>
</tbody>
</table>

Source: IAB, Survey-panel of 18k persons in 2006/2007
* Scale from “0” = not satisfied to “10” = fully satisfied

Reflection of the very inclusive “ability to work” rule (→ 3h/day)

Survey data suggests high motivation – to be tested in labour market behaviour
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Case manager incentives

Current developments and summary
Basic Income Support mainly delivered via cooperation of Federal Labour Agency (FLA) and municipalities

- Approx. 350 “ARGE/gE”* joint delivery units established between FLA and municipalities
  - Approx 100 “Option” municipalities deliver services by themselves (without FLA)
- ARGE/gE merges two logics:
  - Central: labour market, integration, training, standards, controlling, etc.
  - Local: social worker logic, focus on individual, neighbourhood work, etc.
- Central data and controlling systems required to ensure results-orientation of the organization
- Evaluation shows success factors:
  - intensive, activating and comprehensive case management
  - company-based training / activation measures
  - linkage to social services

* ARGE = Arbeitgemeinschaft (pre-2010 term), gE = gemeinsame Einrichtung (post 2010 term)
Despite two parallel local delivery setups, federal regulations ensure a minimum compatibility via joint base systems.

Municipalities and local job centers (FLA) work together on their own.

Municipalities fear too much central steering …

... while federal level fears too much deviation.

Municipalities / counties deliver all services and all placement services on their own.

... and continuing lack of transparency and accountability in “Option” municipalities.

Degree of Centralization

Benefit Calculation & Payment

Registers, IT-Systems (Verbis/A2LL) & Operating Standards

Data / Statistics Standards (X-Sozial)

Conceptual
Split payment responsibility between federal and local level can lead to load-shifting incentives

BIS recipient / not working but able to work

BIS recipient with in-work benefit

Payment Responsibility

(2) Municipality has incentive to maintain “able to work” status in order to prevent shifting to 100% municipally financed Social Assistance

Basic Income Support (364€ / month)*

Housing and Heating Allowance (depending on housing cost)

Basic Income Support (In-Work)

Housing and Heating Allowance (depending on housing cost)

100% Federal Government
(through Federal Labour Agency)

26%* Federal Government

74% Municipality

(1) Split payment can reduce incentive for FLA to move in-work benefit recipients to full employment …

(2) … but stronger activation regime in FLA-driven Joint Delivery Units overplays this effect on the macro level

** Note: 26% federal cost share in housing and heating allowance is average number, varies slightly by state.
Background information: High-level financing flows for Social Insurance and Social Assistance in Germany (€bn, 2010)

**Federal Government**

- ALMPs: -8,0
- "Compensation" for transition from SI to SA: -5,0
- Benefit: 19,5
- Housing Cost: 2,8
- ALMPs: 5,0
- Admin: 2,7

**Federal Labour Agency / Joint Delivery Units (ARGE/gE)**

- UB I (SI): Revenue SI: +37,0
  - Federal Support of ALMPs: +8,0
  - Payor Contributions: +23,0
  - Other: +6,0
  - ALMPs: -20,0
  - Unemployment Benefit I: -17,0
  - "Integration"-Payment: -5,0
  - Other: -3,0
- Spending SI: -45,0
  - Deficit SI: -8,0
  - "Compensation" for transition from SI to SA: +5,0

**Employees / Employers**

- Payroll Contributions: 0

**Municipalities**

- Joint Delivery Units ARGE/gE
  - Unemployment Benefit II: 19,5
  - Housing Cost*: 14,5
  - ALMPs**: 5,0
  - Admin-Cost: 3,8
  - Total Spending: 42,8

- Housing Cost*: Measure of total-system housing cost not consistent with local 26% federal / 74% municipal cost share owing to "Option/zkT" delivery model in some localities
- ALMPs**: of which: Public-Employment-Schemes 33%, Employer-Subsidies 20%, Training 16%, Job-Placement 12%

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3 Case manager incentives

Current developments and summary
Staff incentives and management: Asymmetric regulations between Federal Labour Agency staff and Municipal staff

<table>
<thead>
<tr>
<th>General Public Employment Contracts (Municipal Regime)</th>
<th>Federal Labour Agency Staff Contract (Federal Regime)</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Municipally employed tenured civil servants (“Beamte”) subject to respective state civil service law</td>
<td>- Framework agreement negotiated with unions applies to all federally employed civil servants and employees</td>
</tr>
<tr>
<td>- Public employees (“Angestellte”) subject to Germany-wide “TVöD” (collective public sector wage agreement)</td>
<td>- Comprehensive function and skill-based payment scheme</td>
</tr>
<tr>
<td>- In both municipal contracts, almost no scope for performance-based pay</td>
<td>- Staff can be moved between agencies</td>
</tr>
<tr>
<td></td>
<td>- Total pay: base pay + functional pay + incentive pay (up to 10% of base pay)</td>
</tr>
<tr>
<td></td>
<td>- Annual work-hour accounts allowed</td>
</tr>
</tbody>
</table>

“Old-school” public sector employment with no incentive pay and strong union-veto rights

Most modern staff employment contract in public sector in Germany

Simplified
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Current developments and summary
Incentive structure: Political economy makes fundamental change unlikely – but policy opportunities remain at margins

- **Work incentives** redesign requires either …
  - Lowering of benefit level (politically opposed because of “right to basic income” or requirement of massive public works provision)
  - Or, extension of the number of in-work beneficiaries at high fiscal cost (→ and rising number of “poor” BIS recipients → negative political signal!)

- But **work incentives** can be strengthened by limitation of “Minijobs” and increased activation / monitoring above the 400€ range

- **Fiscal federalism incentives**: Maintain “incentive balance” in fiscal federalism arrangements, especially by barring opportunities to “shift” and “reclassify” beneficiaries groups between federal and local level. Recognize that fiscal federalism might block “centralized” deal on benefit reform

- **Case manager incentives**: Public management reform matters

- Recent developments **challenge the “incentive” regime** in German SA:
  - “Education package” for children of BIS recipients breaks with lump-sum logic and again opts for monetization instead of “in-kind” provision of basic needs
  - “Betreuungsgeld” – payment to “honor” mothers who raise children at home. Incentive for low-income households to withdraw children from pre-school
Labor market / social safety net reforms in Germany: main axes of action and general lessons learned

- From status maintenance and long benefit durations to labor market integration (from “worker citizenship” → “social citizenship”)
- From segmented populations to one pool of beneficiaries and delivery channel
- From flexibility at the margins (pre-2005: mini-jobs) to flexibility at the core of the labour market (erosion of collective bargaining, deregulation of temp-labour)
- From old-school bureaucracy to applied New Public Management

- Allow for local variance via cooperation-model with municipalities while keeping central systems (data standards / reporting) strictly central without compromise
- Invest into case management and placement-oriented activation measures
- Invest into capability of the Public Employment Service (PES)
- Be prepared for a jump in recipients when including the inactive
- Allow for non-profit actors to support training but maintain competition among them
- Make evaluations a mandatory piece of policy and bank on long-term secondary effects (data availability, better ALMPs) even without immediate policy-advice impact
THANK YOU / VIELEN DANK!