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## **Farewell, Welfare State – Hello, Welfare Regions?** **Chances and constraints of welfare management in the German federal system**

### **Abstract**

*The German welfare state is in crisis. Alarming long-term demographic trends, the still not fully digested consequences of German unification and the current economic downturn in much of the Eurozone have combined to create an urgent need for welfare reform. Yet the constitutional arrangements which govern the German political system, and well-entrenched political practice let any such reform process become a daunting challenge. Thus, the welfare crisis is also a crisis of German-style co-operative federalism. Current empirical evidence makes for uncomfortable reading, and triggers a debate on the nature of the German federation: have the two constitutional principles of federalism and establishing equal living conditions throughout the federation become mutually exclusive? However, as much of the welfare state is centred on the best utilization of scarce financial resources, it is debatable to what extent alterations in the functional distribution of welfare responsibilities among the territorial levels of government can be regarded as a solution for the current problems. The article concludes that in the search for long-term sustainability of the welfare state the territorial dimension is likely to remain a secondary issue.*

### **Keywords**

Germany – federalism – welfare state – welfare reform

## Introduction

Social welfare has been a core issue in the German political and economic system for several decades. Its first stirrings go back to the Bismarck era, when compulsory sickness insurance was introduced and workers in certain branches of industry, e.g., miners, started to organise mutual social support schemes. The Weimar Republic, in its early, optimistic days after the revolution of 1918, strengthened this approach and developed a series of socially orientated organising principles for the economy, ranging from postulating social rights to formalising and systematising welfare measures throughout the country (Art. 151-165 WRV<sup>1</sup>). Noteworthy here, though, is that huge ambitions, such as the “right and the duty to work” (Art. 163 WRV) are counterbalanced by much less concrete descriptions of welfare rights (e.g., Art. 161 WRV), which effectively amounted to little more than declarations of intent (Boldt, 1987:57-58). Nevertheless, the resulting legislation, the *Reichsversicherungsordnung* (RVO), in its 1924 version<sup>2</sup>, was a significant step forward in the development of a coherent social security system in Germany. Indeed, it was so advanced that certain sections of it are still in force.<sup>3</sup> However, the end of the Weimar era, with its breakdown of the welfare system, and the resulting massive social unrest which contributed so significantly to Hitler’s rise to power, served as a clear indicator to the founding fathers of the Federal Republic of Germany (FRG) that one ignores or mishandles the social welfare issue at one’s peril.

Consequently, the welfare issue was a key constituent element of the post-war reconstruction. Even before the founding of the state in 1949, the debate on the future shape of the German economy was dominated by concepts such as *Moralökonomie* (moral economy), *Wohlfahrtskultur* (culture of welfare) and *soziale Arbeit* (social principles in the workplace) as key characteristics of the new market economy to be established (Pankoke, 1990:88). Seen as a socially acceptable capitalist alternative to the socialist command economies emerging in Eastern Europe and the Soviet Zone in Eastern

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<sup>1</sup> *Weimarer Reichsverfassung*, the Constitution of the Weimar Republic, which came into force on 14 August 1919.

<sup>2</sup> The first version came into force on 19 July 1911.

<sup>3</sup> §§ 179, 195-200 (entitlements resulting from pregnancy and motherhood), 349-358, 360 (social security provisions for civil servants), 407, 409, 411-413, 414b (Association of Insurance Funds running state sickness insurance schemes).

Germany (later to become the GDR), the resulting solution for the emerging FRG became known as the concept of *Soziale Marktwirtschaft* (social market economy). This solution was regarded by many as more than just a compromise, as it contained elements of interest for a number of groups. The owners of the means of production would be happy to start investing as property ownership was regarded as sacrosanct, albeit regulated. The Social Democrats got the welfare principle established as a permanent role and responsibility of the state, and in this found much common ground with the proponents of moral justice, notably on the left fringe of the Catholic Church<sup>4</sup> (see also Nell-Breuning, 1975:13-16; Gauly, 1992:153-157). And for the masses there was Ludwig Erhard's classic promise of *Wohlstand für alle*, i.e. high standards of living for all, resulting from hard work and hence society's ability to afford a well-developed welfare system for the very few needy who would be unable to participate in the new "economic miracle". A number of features were incorporated into the welfare system which to this day seem to remain beyond questioning, such as the huge scope of coverage, both territorially and in terms of types of need: the mixture of elements funded by contributions and elements funded by taxation, the co-funding of part of the welfare system by both employers and employees (often in equal measure or slightly tilted towards higher contributions by employers), the "generation contract" where the current workforce pays for today's pensions supposedly secure in the knowledge that their pensions would be paid by future generations of workers, and the close co-operation between the public administrations concerned with welfare and private and voluntary providers of insurance schemes and services.

All is well, then? The end of the economic miracle, the quantitative improvements of the welfare system in the 1970s, the challenges to the system caused by the 1980s economic slumps, the ever-increasing service costs, and not least German unification in 1990 with millions of new entitlement holders who previously had not contributed to West German schemes have put increasing pressures on the German welfare system,

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<sup>4</sup> Its leading representative, Oswald von Nell-Breuning SJ, already established as the foremost thinker on Catholic social teaching, was more than willing to co-operate with the Social Democrats and the trade union movement, whereas the official church establishment favoured Adenauer's new centre-right Christian Democrats.

resulting in new forms of poverty and marginalization.<sup>5</sup> Structural reform has been discussed more or less permanently since the 1970s, with little result, due to the lack of sufficient political will to question openly the fundamental principles established in the late 1940s and early 1950s. Both enhancements and cuts have tended to be incremental when introduced, and the growing funding crisis was, for some time, addressed by ever-increasing taxes and contribution levels, by both employers and employees. Over the last two decades, both groups have grown increasingly restless with this spiral.

The current critical economic climate has brought the debate to the fore and threatens Schröder's hold on the political power every bit as much as it contributed to the ousting of Kohl in 1998. But a closer look at the German welfare system reveals that there are considerable limits to the Federal government's ability to act. It is therefore worthwhile to investigate the territorial element of welfare provision. Part 1 of this paper briefly examines current theoretical approaches to the welfare role of the state in federal systems and discusses their applicability to the German case. Part 2 surveys the territorial and functional elements of the welfare system in Germany. Part 3 takes a close look at the practical implementation of the system in the Eastern part of the country, where the issues are most pressing due to what, at least by German standards, can be regarded as widespread deprivation. Finally, some conclusions are drawn with regard to the concept of territorial welfare management in Germany.

## **1. Federation and welfare state: compatible concepts?**

The German federal system at present shows a number of organisational peculiarities in the distribution of functions and responsibilities for welfare issues which result from the construction of the German federal system. The key principles are briefly outlined in the federal constitution, the Basic Law (*Grundgesetz*, GG).

Article 20(1) GG manages to press three of these key principles into a single sentence: "The Federal Republic of Germany is a democratic and social federal state."<sup>6</sup> However, the GG is remarkably sparse in explaining what 'social' might mean in

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<sup>5</sup> For a detailed analysis of this phenomenon see Geißler, 1996:182-203.

<sup>6</sup> Throughout the text, English language quotes from the GG follow the translation by Axel Tschentscher (Tschentschner, 2002).

practice. Contrary to the wish list contained in the WRV, the authors of the GG have confined their ambitions in establishing social rights to some rather vague notions of protecting the family, mothers and children (Art. 6 GG). Beyond that, according to Art. 74(1)7 GG, the *öffentliche Fürsorge* (public welfare)<sup>7</sup> is a matter of *konkurrierende Gesetzgebung*, i.e. the *Länder* are free to act as they see fit unless the federal level produces either specific or framework legislation on certain matters in that field. Art. 72(2) GG limits the federal level's right to do so: the federation may legislate in the field "if and insofar as the establishment of equal living conditions in the federal territory or the preservation of legal and economic unity necessitates, in the interest of the state at large, a federal regulation".<sup>8</sup> This clause was changed by the 42<sup>nd</sup> Amendment, of 27/10/1994. The previous version allowed the federation a greater freedom to act if the federal level deemed doing this useful – even if not strictly necessary. This apparent weakening of the federal level's right to act can be regarded as part of a new trend aimed at making the German political system more flexible to meet the post-1990 challenges: "Only in the last decade or so has there been (as a legacy of the need to digest the former communist East) pressure to reverse the tendency to national policy standardisation and allow greater territorial policy variation." (Jeffrey, 2002:180)

National policy standardisation, however, was – and to a very large extent still is – very much the order of the day in German welfare policy-making, as in a great number of other policy areas. Indeed, the right to establish national policy standardisation has for decades been seen as the main means by which the federal level is supposed to achieve the key idea behind Art. 72(2): the "establishment of equal living conditions" throughout the federation, which was more or less automatically regarded as being "in the interest of the state at large" – and hence all citizens, encompassed as they would be in the universal coverage thus established.

Where does this leave the federal principle, though? The remarkable success in establishing quite equal living conditions in the pre-1990 FRG, along with the strong leadership displayed by the federal government led by Chancellor Helmut Kohl in the process of unification, prompted serious questions about the nature of the German state.

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<sup>7</sup> In the same Article, Art. 74(1)19, a joint responsibility for the funding of hospitals is also mentioned.

Has it indeed become a unitary state camouflaged as a federation, as Abromeit (1992) suspected? Or has it retained its recognizable shape as a *Bund*, a union in the traditional sense of *foedus*, as Grasse (2001) argues? In the current debate on the nature of German federalism there is at least some consensus insofar as it is now widely acknowledged that the problem of *Politikverflechtung*, with its associated ‘joint-decision trap’, first identified by Fritz W. Scharpf (Scharpf, 1985; Benz *et al.*, 1992; Scharpf, 1994), has limited both the federal and *Land* level’s ability to act, with the result that reform projects in many policy areas have taken a long time in the legislative process and took on so much of a compromise character that they were no longer capable of fulfilling their original aim. Various health reforms throughout the 1980s and 1990s may serve as an example.

Lessons from other federations, notably the USA as the apparently archetypal federal model, may provide some pointers for the German debate. Based on earlier investigations into the growing social deprivations of the United States’ inner cities as local public welfare managers found it increasingly difficult to cope with exploding welfare demand in the era of Reaganomics (Peterson, 1985), Peterson (1995) presents two theories of federalism, the functional and the legislative theory, respectively, designed to shed light on the domestic policy-making processes by which public policy, including welfare policy, is shaped.

Functional theory identifies the two main economic purposes of domestic government as developmental and redistributive. Developmental programs provide the physical and social infrastructure necessary to facilitate a country’s economic growth. ... Unless these and other basic social services are provided, modern industrial societies are unlikely to develop. Redistributive programs reallocate societal resources from the “haves” to the “have-nots”. They transfer economic resources from those who have gained the most from economic development to those who have gained the least: the elderly, the disabled, the unemployed, the sick, the poor, families headed by single parents, and others lacking in material resources. Some analysts believe that these redistributive programs indirectly contribute to economic development in the long run; others think they retard economic development by reducing incentives to work and save. Most people regard at least a minimal level of redistribution as justifiable regardless of the developmental consequences.

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<sup>8</sup> Where federal legislation is in place, however, it supersedes any *Land* legislation (Art. 31 GG), and the federation may act to enforce this (Art. 37 GG).

Most people also think that the higher the level of economic development, the more a society should redistribute some resources to the poor and the needy. (Peterson, 1995:17)

In this rather benign scenario, holders of political responsibility – notably the executive – display strong leadership and provide as much public service (both developmental and redistributive) as public opinion would tolerate. The allocation of funds and other resources, along with practical tasks and responsibilities, is distributed among the levels of government by means of functional logic – each level or institution doing what it can do best, and depending on the other levels and institutions to do their job as best they can and create optimum conditions for the other elements in the system. The Federal level’s role is to set and collect taxes federally (and thus uniformly) throughout the nation, and secondly to instigate redistributive programmes, either in the form of general social security programmes which are available nation-wide but with varying take-up rates from region to region, or in the form of targeted grants to regions in need (either as block grants to state governments or, with significant regulatory strings attached, as specific grants or co-funding measures to public and/or private service providers). All these forms of redistributive measures are not uncommon in Germany either, but in the US system we do not see an intergovernmentally negotiated mechanism for direct horizontal redistribution such as the equalization payments between the German *Länder* (*Länderfinanzausgleich*). It is noteworthy that in the context of federal grants and fiscal relief provisions Peterson also uses the term ‘co-operative federalism’ (Peterson, 1995:60). However, in this American sense the scope of this concept is limited to denoting steps and procedures of practical co-operation among the levels of government in conducting the financial redistribution function. As we shall see, the German concept of co-operative federalism goes far beyond mere practical co-operation between levels, to the point that political actors on the different levels become identical on some occasions – most prominent in the shape of the *Bundesrat*, where representatives of *Land* governments sit in a chamber of the federal Parliament.

By contrast, Peterson’s legislative model is characterized less by co-operation and more by competition among territories, with legislators trying to maximize positive policy outcomes for their territory – which in terms of welfare policies is likely to

comprise different policy contents for different territories, depending on the social structure of the constituencies concerned.

A second theory of federalism, best characterized as legislative theory, is much less optimistic. It thinks that the political incentives that shape the decisions of policymakers induce them to make the wrong choices. The national government takes on responsibilities it should best avoid. It imposes unaffordable tasks on lower levels of the system. The theory bears the legislative label because it assumes that policies are shaped by the political needs of those who write the country's laws. It also gives a less important policy role for presidents than does functional theory. It assumes that, in general, the preferences of presidents (and governors) have much less effect on domestic public policy than do preferences of the members of Congress (and state legislatures). ... Legislators' opinions about redistribution are, according to legislative theory, strongly influenced by constituency pressures. A legislator who represents a low-income, needy population or a liberal constituency is likely to favor the expansion of redistributive programs. Those who represent middle-income constituents less likely to need government aid are more likely to resist redistribution. Political support for redistribution is expected to be greater in cities and states with higher poverty rates. Geographical politics are likely to affect redistributive decisions less than developmental ones. Both the costs and benefits are geographically diffuse. In addition, legislators apparently do not gain votes from securing more redistributive dollars for their district. Legislators need to balance the demands of those anticipating geographically diffuse benefits against those anticipating the equally diffuse tax burdens necessary to finance them. Legislators find themselves caught between intense demands for redistribution and equally intense opposition to tax increases. Whether they choose to raise taxes or to cut benefits, they are likely to be criticized. (Peterson, 1995:39-44)

At a first glance, this model with its strong emphasis on the role of legislators seems to be more in line with the German system, as in Germany no executive even exists without the express support of the legislative branch of government. And indeed the production of federal regulations while pushing the less glamorous implementation and funding tasks to the lower levels, routinely done in Germany, would be a dream come true for US legislators. However, there are key differences between the US and German models. First, the legislators' constituency links are far less pronounced. Even in the first chamber of the German Parliament, the *Bundestag*, only half the members represent a constituency, while the other half are effectively party representatives elected on regional quota. Party discipline is very strict for both types of members. A similar situation exists



in the single-chamber *Land* legislatures, the *Landtage*.<sup>9</sup> The *Bundesrat*, the second chamber of the federal *legislature*, consists entirely of delegates from regional *executives*. Secondly, and this is probably the more important of the two key distinctions as well as the biggest problem, neither the federal nor the *Land* legislatures are constitutionally empowered to act unilaterally in a wide range of policy areas, with the constitutional co-operation requirements augmented by a series of formal agreements and informal links from which the dense grid of *Politikverflechtung* is woven. So, with regard to the applicability of Peterson's models to the German case there are strict limits. The functional and legislative theories are essentially a variation on the age-old theme of operating modes of the *American* federal system: the perpetual struggle between legislative and executive branch for predominance over domestic affairs, in Peterson's version with a special focus on how this struggle between the two sides involves the federal states and large-scale urban local government, and its impact on relations between the levels.

Finally, Peterson acknowledges that regarding the welfare question not even the American system seems to work perfectly in line with the two models:

I reported that states with higher poverty rates spent about the same on redistributive programs as did states with lower poverty rates. This finding is contrary to functional theory, which hypothesizes that states with higher levels of poverty will spend less on redistributive programs in order to avoid becoming a welfare magnet. It also is inconsistent with legislative theory, which says that mandates imposed by the national government force states with larger poor populations to spend more money on redistribution. To comply with federal mandates, states with more poor people are compelled to spend more, despite their fears of becoming a welfare magnet. (Peterson, 1995:108)

So, does the US system achieve by the back door what the Germans do openly in pursuit of their constitutional aim of equal living conditions: national policy standardisation to avoid welfare tourism without resorting to a spiral of lowering welfare provisions by state legislatures, which Peterson (1995:108) calls a "race to the bottom"? Peterson subsequently (1995:111-128) argues that in a difficult economic climate an increasingly conservative population becomes more interested in 'reducing the price of federalism',

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<sup>9</sup> Berlin: *Abgeordnetenhaus*, Hamburg and Bremen: *Bürgerschaft*.

and that state legislatures started to act on these demands by indeed beginning a ‘race to the bottom’, but that co-operation between the legislative and executive branches of federal government have more or less successfully prevented the worst outcomes by providing alternative resources in the form of federal programmes.

However, the German system is not designed to encourage either the members of the federation or the federal institutions of government to compete with each other in terms of domestic redistribution, or to take over each others’ functions. Moreover, co-operation and co-ordination are the key virtues to be promoted by both the federal legislature (and the federal executive which depends on it) and the *Land* institutions of government (again, both legislature and executive) – while still retaining reasonably strong regional political actors to give voice to distinct regional interests and desires, in the regions themselves as well as on the federal level, through the *Bundesrat*. The initial intention behind the close links between the federal and *Land* levels may seem quite sound:

Germany ... is unusual as a federal system in that it was re-established after World War II not to reflect distinctive regional preferences, but rather to strengthen checks and balances on political power after the Third Reich. Its guiding constitutional rationale – crafted against the background of extreme social and economic dislocation caused by war and national division – was to attain and maintain a ‘uniformity of living conditions’, not to promote territorial diversity. To that end the main role of the regions – the *Länder* – is to participate in the formulation of national legislative standards through Germany’s territorial second chamber and then to apply those standards on the ground. The *Länder* do possess a range of their own legislative powers, but these have typically been absorbed into joint federal-*Länder* decision-making ... or subjected to a voluntary co-ordination of standards across the *Länder*... The dense co-ordination of federation and *Länder* in generating common nation-wide standards of public policy has aptly been termed ‘co-operative’ federalism. (Jeffery, 2002:180)

This gives the *Länder* an almost unique scope of access to decision-making on the federal level, which often is the envy of many regions and stateless nations within the EU. Yet the constitutional requirement to exercise these rights jointly rather than individually and to co-ordinate policies has severe consequences for policy-formulation by the *Länder*. The regional debates are often dominated by what can be achieved on the federal level.

Federal party politics also has a strong influence on these considerations, in particular since for much of its existence the *Bundesrat* has seen majorities which were different from the majorities in the first chamber of the federal Parliament, the *Bundestag*, whose majority determines the composition of the federal government. For this reason in particular, the co-operation on which the German ‘co-operative federalism’ so clearly depends has often been in short supply after the end of the Grand Coalition in 1969. The second half of Helmut Schmidt’s chancellorship (1974-1982) can probably be regarded as the worst period of co-operative federalism breaking down.

This is not to say that co-operative federalism does not work at all. If the challenges and external pressures are severe enough, such as with several reforms of regional development policy-coordination both before and after the introduction of a distinct EC/EU regional policy, and with the economic reconstruction tasks derived from German unifications since 1990, a close working relationship between the federal and *Land* levels can produce enormous benefits. This close working relationship, however, entirely depends on the political will of the various governments to commit themselves (and their resources) to it – and this political will is in turn shaped by regional interests, pressures and desires. With sufficient political will lacking, and the constitutionally proscribed inability of the governments (both federal and *Land*) to act unilaterally, very little can be achieved – the ‘joint decision trap’ snaps shut. The outcome of this situation is commonly referred to as *Reformstau*, a backlog of necessary reforms which lack political support to get enacted – with perhaps only a lowest-common-denominator solution or an incremental (rather than substantial) alteration to the status quo being established instead.

A key element of the welfare state reform debates in Germany – as elsewhere – focuses on the issue of funding. A comprehensive welfare system is expensive, and, sadly, becomes less affordable in times when society’s need for it increases, i.e. in times of economic crisis. Both the immediate post-unification period and the current economic crisis have demonstrated this to the Germans only too clearly. Years of *Reformstau*, followed by a significant economic downturn at present have led to a situation where two seemingly contradictory phenomena, both driven by popular and interest group demand, have appeared on the German political landscape. On the one hand, political actors have

recognised that to continue current practices is likely to become completely unaffordable in the not too distant future. So, in principle, the preparedness to muster the political will for substantial reform is rising – not only on the part of the federal government, but also in the *Länder*. On the other hand, however, there is a distinct tendency among interest groups to prevent uncomfortable reforms in their particular area of interest – the key word here is *Bestandsschutz* – reforms, yes please, but not in our backyard, or only on our terms. With regard to the territorial dimension, some Land governments – notably the Bavarian and Saxon governments – have started to display a similar attitude. Reforms, though necessary, should be differentiated and enacted on a smaller (i.e. *Land*) territorial scale, to allow a more precise addressing of specific needs, and within the territory’s own resource structure. Such strong tendencies to say farewell to the constitutional principle of establishing equal living conditions throughout the federation, and towards de-solidarization within the German society have not been seen since the 1960s, before the establishment of the regional development joint task (*Gemeinschaftsaufgabe Verbesserung der regionalen Wirtschaftsstruktur*).<sup>10</sup> The political will to enact federal reforms decreases, at least on the part of the *Länder*, on whose co-operation any federal reforms legally depend. By the same token, the *Länder* are very limited in their own freedom of manoeuvre unless they get the permission – or at least acquiescence – for their own reform ideas from the federal level. It is this context in which the current welfare reform debate in Germany takes place.

## **2. Territorial and functional elements of the welfare state in the German federal system**

The organisation of the welfare state in Germany has been a very typical example of joint-decision making, or ‘co-operative federalism’, if one prefers. The federal level has consistently taken up its right to act directly and specifically (Art. 72 (2) GG) in only two

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<sup>10</sup> At that time, the *Länder* – then only the Western ones, of course – were engaging in an increasingly cut-throat competition to attract inward investment. As it became clear that overall society’s costs for this competition started to outweigh the benefits for individual regions, the *Gemeinschaftsaufgabe* was put in place to stop this trend.

major welfare-related matters. One is employment management, in particular the administration of unemployment-related benefits and the promotion of job creation schemes (Gagel, 2002:X). The second area is the management of state pensions. In all other welfare matters the federal level has been limiting itself to either providing the specific regulations but leaving the implementation to *Land* or local authorities, or to just setting general framework regulations which the *Länder* are obliged to fill – but with a considerable room for manoeuvre.

This is not to say that the federation was not active in ensuring that the federal regulations provide comprehensive coverage of a wide range of social needs. The so far ten volumes of the *Sozialgesetzbuch* (SGB), a collection of various social security provisions<sup>11</sup>, plus associated acts cover an enormous range of specific entitlements in four key categories: (i) insurance-based entitlements (sickness, accidents at work, unemployment, pensions and care for the elderly); (ii) state compensations for victims of difficult or dangerous circumstances beyond their control (wars, losses incurred while serving in armed forces, political injustices by the former GDR regime, crime and terrorism), (iii) state promotion of social development (student loan/grants, funding for participation in adult education schemes, housing benefits, childcare benefits, disability allowances, etc.), and (iv) state social security for anyone having needs not covered by any other scheme and being unable to cope with these needs on his or her own, in particular one-off help in specific difficult situations (e.g. bereavement), and longer-term help with on-going living expenses.<sup>12</sup>

Overall, Germany usually spends just under one third of its Gross Domestic Product on welfare matters.<sup>13</sup> The 2000 figures may serve as an example (Table 1).

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<sup>11</sup> Contents (latest full-text versions; most parts have seen minor amendments recently): SGB I General Provisions (1975), [no SGB II], SGB III Promotion of Employment (1997), SGB IV Joint Regulations (for all SGB parts; 1976), SGB V Sickness (1988), SGB VI Pensions (2002), SGB VII Accidents at Work (1996), SGB VIII Children and Juveniles (1998), SGB IX Disability (2001), SGB X Administrative procedures and data protection (2001), SGB XI Care for the Elderly (1994).

<sup>12</sup> A more detailed listing of types of support can be found in Schulin, 2002:XVI-XIX.

<sup>13</sup> This puts Germany close to the EU average of 29%; within the EU the percentage varies between 21% in Ireland and 37% in Sweden (Hanesch, 1998:18).

**Table 1. German Welfare Expenditure 2000, by type**

Type of Expenditure	Amount (bn DM)
State Pensions (contribution-based)	425
Sickness Benefits (insurance-based)*	258
Accidents at Work Benefits (insurance-based)*	21
Care for the Elderly (insurance-based)*	33
Unemployment-related Support (approx. one third insurance-based)**	127
Childcare Benefit (taxation-funded)	7
Top-up Pensions for Farmers (partially contribution-based)	6
Compensations for Victims (taxation-funded)*	10
Support for Juveniles (excluding education; taxation-funded)	33
People in Higher/Further Education (half taxation-funded, half loan)	2
Housing Benefit (taxation-funded)	8
Social Security Benefits (taxation-funded)*	50
Other Social Security Measures (taxation-funded)*	350
<b>Total</b>	<b>1,330</b>

\* Disability Allowances may be paid out of any of these sources (or a combination thereof), depending on the nature of the disability, and on the reason why it came about.

\*\* *Arbeitslosengeld* (unemployment benefit) is insurance-based, *Arbeitslosenhilfe* (lower-level unemployment benefit for those whose insurance entitlements have run out)<sup>14</sup> and special funding for job-seeking activities and participation in re-training measures are taxation-funded.

Source of figures: Schulin, 2002:XIX.

The principle of allowing territorial variations in social security provisions is particularly relevant concerning the legislation for the worst cases of hardship, i.e. persons entitled to receive support under the *Bundessozialhilfegesetz* (Federal Social Security Benefits Act, BSHG).<sup>15</sup> This act is the archetypal example of framework legislation, setting absolute minimum standards, but devolving all specific responsibilities, including funding, to *Land* and local authorities, with some encouragement for them to lay on additional provisions to the best of their ability. Therefore, most *Länder* have used §§ 96-101 BSHG to devolve welfare matters – and the financial obligations that go with it – further, to the sub-regional and local levels (*Überörtlicher Träger* and *Örtlicher Träger der Sozialhilfe*, respectively). The basic idea of bringing social security matters as close to the citizens as possible sounds applaudable, and indeed, with the exception of Berlin, all *Land* regulations define the local authorities as principal holders of responsibility for the people residing in their area.

<sup>14</sup> In the current reform debate, it is envisaged to merge *Arbeitslosenhilfe* with the standard Social Security Benefit, *Hilfe zum Lebensunterhalt*, at a level slightly above the old *Hilfe zum Lebensunterhalt*.

<sup>15</sup> The BSHG is not (yet) part of the SGB, so that it can be more flexible in defining entitlements and actual local or regional implementation than the generally stricter provisions of the SGB canon, although the general principle of social security in hardship cases is outlined in § 9 SGB I.

However, the *Länder* show different ambitions in determining the engagement of the *Land* in the process, often arising out of welfare-related clauses in the *Land* constitutions and resulting in different administrative practices with regard to the organisation and funding of welfare. Pestalozza (1999:XLIV) argues that the new (ex-GDR) *Länder*, shaping their constitutions in the 1990s, have been more cautious and hence more realistic in defining their welfare engagement. Indeed, the post-war climate of a new beginning has led West German *Land* constitution-framers straight into the WRV trap of defining a number of social rights, such as the right to work<sup>16</sup>, which might have sounded appropriate at the time. With hindsight, one can now argue that these ambitions were unlikely to be sustainable in the longer term – but it is not surprising that so far nobody has yet summoned the political will to change these provisions. Nevertheless, the Eastern *Länder* benefited from this experience and thus limited their approach to the definition of state aims, general political declarations of intent, encouraging – but not legally forcing – any *Land* government to do as much as they can to achieve these aims.<sup>17</sup>

The different ambitions and intentions also filter down into the administrative practice insofar as the *Länder* may be more or less willing to supplement the welfare expenditures by local authorities. Normally, social security benefits are paid by the local authorities in whose territory the recipient resides. This expenditure is supposed to be funded by locally raised business rates (*Gewerbesteuer*) and the local authorities' share of income tax revenue. The *Länder* therefore need to consider local authorities' ability to pay when defining, by annual review, the *Land* minimum standard rates (*Regelsätze*), and the household threshold incomes which, if not reached, trigger entitlement.<sup>18</sup> For the 1999-2000 calculation period (1 July – 30 June), the *Regelsätze* for the first adult per household<sup>19</sup> per month varied by DM 26, from DM 522 in Mecklenburg-Vorpommern, Saxony and Thuringia to DM 548 in Baden-Württemberg and Hesse. The highest-paying

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<sup>16</sup> See, for instance, Art. 166(2) of the Bavarian Constitution, and Art. 28(2) of the Hessian Constitution.

<sup>17</sup> See, for instance, Art. 45(1) of the Brandenburg Constitution, and Art. 7 of the Saxon Constitution.

<sup>18</sup> In 1997, the eligibility rates for this direct income support were 3.6 persons per 1000 residents in the Western *Länder* and 3.3 persons per 1,000 residents in the Eastern *Länder* (Maretzke and Irmen, 1998:5). The eligibility rates in the Western *Länder* is somewhat higher as the household threshold incomes are on average 15% higher than in the Eastern *Länder* – roughly in line with the still prevailing differences in wage incomes (but not living expenses, which are now almost equal in both parts of the country).

<sup>19</sup> Further adults and minors receive a fixed percentage of this standard minimum.

East German *Land* was Saxony-Anhalt (DM 527), the lowest-paying West German *Land* was Bavaria (DM 530) (BSHG, 2000:70). However, § 22(1)2 BSHG specifies that deviations from the standard provisions may be applicable according to a person's circumstances.

As much of the welfare bill – with the exception of insurance-based schemes and certain federally administered employment promotion schemes – is paid out of local taxation, the scope and quality of available services varies more widely than the differences in direct payments to claimants suggests. As welfare-related expenditure is usually one of the largest expenditure types in local government, communities with a high numbers of residents are put under the most strain, even when locally generated revenues are relatively high, e.g. in the larger West German urban areas such as the Ruhr area. Financial *Land* support for the locally incurred expenditures is therefore crucial, but administrative practice in this matter varies considerably. A common feature of *Land* support is compensation payments to local authorities for the funding of institutions and specialist services (rehabilitation clinics, youth centres etc.) used by residents of other local authority areas, in whose territory such institutions and services are not available. In other fields, though, the funding practice varies considerably (see Table 2). In most *Länder*, a system of mixed funding has been established. Local tasks are funded predominantly locally, with more or less additional input from the *Land*. Brandenburg and Saxony, for instance, take on the additional burden of fully funding local support institutions. Bavaria, by contrast, leaves it to the upper tier of local government to fulfil even the regional requirements. Schleswig-Holstein even demands a 61% contribution by the local authorities for regional tasks. However, there is no direct correlation between a *Land's* overall wealth and its social engagement. The relatively poor Brandenburg, Saxony, and The Saar are happy to take on considerable responsibilities, while the relatively rich Baden-Württemberg and Bavaria limit their involvement as much as they can – as do the relatively poor Mecklenburg-Vorpommern, Saxony-Anhalt and Bremen. Berlin remains a special case as it is the only *Land* to keep responsibility for the entire welfare bill with the *Land* government – normally not a problem, but with the current self-inflicted funding crisis (general financial mismanagement by the previous government), the current government has already had to embark on a series of cut-backs



across the entire city. So far these cuts have mostly focussed on the funding of non-governmental welfare service providers (*freie Träger*), which are now in principle funded on a case-by-case basis as each welfare recipient has to apply to the competent district authority of his or her place of residence for the funding of each individual service to be provided. This differs considerably from the previous practice of funding the *freie Träger* by block grants (*Zuwendungsfinanzierung*). Administrative practices in the implementation of the new Berlin-wide regulations and the speed of processing applications and payments now vary even more widely from district to district. This also applies to support schemes for non-German residents, e.g. asylum seekers. Some districts hand out cash, while others operate “entitlement card” or voucher schemes.

**Table 2. Land Involvement in Local Welfare Services Funding, by Land\***

Land (Year of legislation**)	Living Expenses	Advice and Coun- selling	Special Needs	Funding for instituti- ons	Regional responsi- bilities	Regional responsi- bilities devolved ?
<b>BSHG §§ (1994)</b>	<b>11, 12, 21, 22</b>	<b>17</b>	<b>13-15b, 27, 36-41, 68-69c</b>	<b>93-95</b>	<b>39(1), 67, 72, 100-101</b>	<b>96(2), 151(2)***</b>
Baden-W. (1963)	no	no	no	no	part	LWV
Bavaria (1993)	no	no	no	no	no	LG
Berlin (1962)	full	full	full	full	full	no
Brandenburg (1996)	no	part	no	full	full	no
Bremen (1962)	no	no	no	part	full	no
Hamburg (1971)	part	part	part	part	full	LG
Hesse (1970)	part	part	part	part	part	LWV
Lower Saxony (1999)	part	part	part	part	full	no
Mecklenburg-V. (1992)	no	no	no	no	full	no
North Rhine-W. (1999)	part	part	part	part	part	LWV
Rhine Land-P. (1963)	part	no	part	no	full	no
Saxony (1991)	no	no	part	full	part	LWV
Saxony-A. (1991)	no	no	no	no	full	no
Schleswig-H. (1985)	no	no	no	no	part	no
The Saar (1995)	part	no	part	part	full	no
Thuringia (1993)	part	part	part	part	full	no

LG = Local Government (Bavaria: upper tier, *Bezirke*; Hamburg: see below).

LWV = *Landeswohlfahrtsverbände* (North Rhine-Westphalia: *Landschaftsverbände*), consortia of public, private and voluntary sector service providers. They are only partially funded by the state, the amounts they receive from public sources depends partially on service costs and partially on political decisions on how worthy their cause is judged by the *Land* and local authorities – and the funds situation of these authorities.

\* based on a comparison of the applicable *Land* legislation, i.e. the 16 BSHG Implementation Acts.

\*\* year in which the full text of the current version of each Act was introduced or significantly changed. Most of these acts have seen minor amendments since.

\*\*\* § 96(2) BSHG leaves it to the *Länder* whom to charge with regional responsibilities. As is usual in most German federal framework legislation, § 151(2) BSHG allows the three city-states to deviate from the standard divisions of local and regional responsibilities (§§ 99-101 BSHG). Berlin decided to keep all financial responsibilities at the *Land* level. Bremen defined the two *Land* parts City of Bremen and City of Bremerhaven as the holders of local responsibility while the *Land* kept the regional responsibilities. Hamburg defined the City District Authorities (*Bezirksämter*) as the holders of local responsibility, and divided the regional responsibilities functionally among designated District Authorities, with full financial compensation to these designated authorities by the *Land*.

The problem of welfare management is further complicated by the fact that most items of federal and regional welfare regulations are littered with optional clauses, i.e. a support measure *may* be provided but the applicant has no absolute legal entitlement to receive the support claimed. Indeed, the applicable regulations usually leave it to the individual civil servant to assess an applicant's specific needs. This goes in particular for the provision of additional funds to cover larger one-off expenses such as clothing, heating materials, repairs and renovations of flats and their contents, purchases of household equipment and special occasions. In theory, there are few limits to what can be claimed under these regulations (§§ 15, 15a, 21(1a) and 72 BSHG), ranging from an extra pair of woollen Winter socks to structural repairs to residential buildings costing hundreds of thousands of Euro.

Each *Land* has semi-official lists of provisions that are normally granted more or less automatically on application, while claiming provisions not covered there either leads to immediate rejection or triggers an extensive process of checking the actual need. *Land* regulations usually also specify the frequency of entitlements for recurring provisions. These regulations are reviewed annually, investigating take-up rates as well as the *Land's* and the local authorities' ability to pay. However, often extensive yet not publicly available internal guidelines for needs assessors have a strong influence on the individual applicant's personal experience with the system. Means tests are strict in all cases, and often family members or persons with whom the applicant shares a residence (even unrelated co-habitants) are required to pay all or part of the applicant's living expenses before the state gets involved. But once the applicant has passed these tests, and if the need is established, there are still no absolute guarantees concerning the speed and scope of provisions. In effect, the individual welfare bureaucrat rules whether in a particular individual case the applicant is worthy of receiving certain sums, goods or services at the public's expense. There are administrative and legal appeals procedures, but there is much scope for abuse by claimants on the one hand, and for bullying by bureaucrats, on the other hand. Sadly, both phenomena are rather commonplace.

As a result, some districts provide a better service, while other localities provide only the minimum standards allowed by the framework regulations – and still may end up

heavily in debt because of this. Therefore, the German system is extremely fragmented and applicants often do not receive a fair or equal deal, even within the same region. In 1999, the federal level has recognised this problem and was prepared to use federal legislation to make amends, without undermining the principle of regional and local self-determination. The federal legislation, § 101a BSHG, therefore contained a time-limited<sup>20</sup> invitation to *Land* governments to experiment with models of harmonisation and the use of standard provisions (*Pauschalisierte Leistungserbringung*). The results of these experiments will be discussed between the *Land* governments and the federal government before possibly further federal regulations or recommendations are going to be put in place.

### **3. East Germany: new role-model welfare system or bottomless pit?**

The East German *Länder* face a number of specific welfare-related problems arising out of a trap created by the mixture of federal regulation and regional/local implementation. The federal constitutional concept of striving for equal living conditions (*Gleichheit der Lebensverhältnisse*) demands that standards of social security are to be applied in – more or less – the same scope and quantity throughout the federation, including the Eastern *Länder*. Over the 40 years of separate development, the West German social security system has developed into a network of very comprehensive coverage, as intended by the founding fathers, and has been kept going even through periods of relative economic decline and rising unemployment. As Bulmahn (1998:11) argues, these adverse conditions put a notable strain on the West German economy over time, but by gradually increasing contributions to insurance-based welfare schemes and by gradually eroding the levels of entitlements and services as and when required, the system as a whole has been preserved.

In recent years, however, these two incremental strategies have become less and less effective, giving rise to a debate about radical systematic reform involving new concepts of social security. These new concepts included introducing elements of

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<sup>20</sup> 25/06/1999 – 31/12/2004

privatisation and individualisation, e.g. deregulation in the sickness insurance schemes which are managed by the private sector anyway, and also a strengthening of individuals' personal responsibilities, in particular with regard to pensions. Furthermore, there have been several attempts to lighten the load on taxation-funded state schemes, but so far less in expenditure types affecting individual personal entitlements and more concerning institutional and infrastructural expenditure, e.g. funding for job creation schemes or funding for voluntary sector organisations supporting welfare recipients. The idea was more targeted funding for specific needs, and having longer-term effects in reducing the welfare bill by eroding provisions seen as contributing to a prolongation of dependency. While not exactly a 'race to the bottom', these considerations were nevertheless the product of increasingly conservative thinking in times of a difficult economic climate – without publicly admitting any attack on the established welfare state. The Kohl government had already set this trend with various schemes in the 1990s, such as the *Kanzlerrunde*, aimed at reducing unemployment.<sup>21</sup> In 1998, the incoming Schröder government saw the reform of the social security system as one of its key tasks. Indeed, at that time Schröder (Bundesregierung, 1998:25) went as far as to compare the envisaged social security network to a “trampoline”: anyone falling into it would not only not slip through the net but, moreover, should be able to bounce right back into non-dependency. To this end, he announced a series of federal support measures, mainly in order to jump-start the employment market (*Bündnis für Arbeit*), in co-operation with employers, the unions, the education sector and the voluntary sector.

During the last few years, and in particular since the federal elections of September 2002 which saw the current government comprising Social Democrats and Greens hold on to power by the thinnest of margins in the *Bundestag*, the German welfare reform debate has gained momentum. In March 2003, Schröder instigated a comprehensive review of all work- and welfare-related matters, including a complete review of administrative practices, known as *Agenda 2010* (Bundesregierung, 2003). What is unusual in this context is that most details of the reform agenda were to be developed not by the political parties or the civil service, but by two independent expert

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<sup>21</sup> One of Kohl's catchphrases was *Arbeit muss sich wieder lohnen*, i.e. “to work must again become worthwhile”, used to justify a driving-down of social security entitlements to increase the gap between

commissions, with the government committing itself to taking their advice. The first commission's brief comprised all employment market matters, while the second commission was put in charge of finding long-term financially sustainable solutions for all welfare matters.<sup>22</sup> Their proceedings have sparked a substantial public debate, and a series of reform steps has since been started, after considerable debate in both chambers of the parliament, with the Christian Democrats torn between their agreement on most of the reform contents – with many measures appearing to be quite hard on citizens' private purses – and their party-political instinct not to support a politically vulnerable and increasingly unpopular Social Democrat Chancellor.

For some interest organisations, notably the Federation of German Industry (*Bundesverband der Deutschen Industrie*, BDI), the reforms currently in progress do not go far enough. Couched in terms of keeping the German industry's competitiveness up to the requirements of not only today but also tomorrow, the BDI has essentially argued<sup>23</sup> that something akin to a 'race to the bottom' would probably not be a bad idea: constitutional changes would be in order to facilitate a transformation of German Federalism towards a federalism of competition (*Wettbewerbsföderalismus*). Moreover, a greater regional differentiation, so far not part of the Agenda 2010, would also be welcome: There would be no reason why welfare services, and indeed wages, should be uniform in all Länder – a point also made by some of the *Länder* (see above).

It would certainly be quite inaccurate to blame all the current economic and social difficulties in the German federal system on the German unification and its aftermath. However, the German unification must be regarded as a massive systemic shock to the entire German concept of social security coverage. In accordance with the concept of equality of living conditions, West German social security regulations became applicable in East Germany virtually overnight on 03/10/1990.<sup>24</sup> The decision to make the West

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social security payouts and low-wage job incomes.

<sup>22</sup> The commissions were called *Moderne Dienstleistungen am Arbeitsmarkt* and *Kommission für die Nachhaltigkeit in der Finanzierung der sozialen Sicherungssysteme*, but popularly became better known as the *Hartz-Kommission* and the *Rürup-Kommission*, based on the names of their chairmen, Dr. Peter Hartz and Professor Bert Rürup.

<sup>23</sup> See their key position paper for the current 15<sup>th</sup> legislative period, *Für ein innovationsorientiertes Deutschland* (BDI, 2003).

<sup>24</sup> With the exceptions outlined in Art. 17-25 of the Treaty on Creating a Monetary, Economic and Social Union [WWSV; 01/07/1990], and Art. 7 and 30-33 of the Treaty on German Unification [EV; 03/10/1990].

German social security legislation applicable in the East immediately was probably a political necessity to prepare the ground for the political union. After all, the greatest fear among the East Germans, and the only serious source of political resistance against unification, was the fear of social insecurity. A population which was accustomed to a perfectly organised welfare state with virtually no unemployment, subsidised living expenses, including housing and public transport, generous support schemes for families and children, and access to free healthcare on demand, and also, thanks to West German television, well-informed of the social shortcomings of the West German system, needed a lot of convincing, despite the allure of a potentially far higher material standard of living associated with having the DM in one's pocket.

However, the months and years immediately after the unification saw the complete overhaul of the East German economy, creating almost instant mass unemployment (3.4m jobs lost, over a third of all jobs that existed on unification day – see Marezke and Irmen, 1999:4), an enormous amount of re-training needs, and millions of new welfare entitlement holders.

Three factors, to some extent intertwined, can be distinguished which created very difficult conditions for the establishment of the Western-type welfare state in the Eastern *Länder*: (i) a lack of previous contribution payments, (ii) significant demographic shifts in patterns of residency and employment, and (iii) a severely limited ability of local authorities to raise revenues on the local level.

With regard to the lack of previous contributions, it has to be noted that only the smaller part of the East German welfare expenses were paid out of the *Sozialversicherungskasse* (SVK), a blanket state-run national insurance system which in effect was little more than a general fund to supplement state expenditures on politically defined needs and social engineering intentions. One's entitlement usually did not depend on the amount of contributions paid in, but on actual need (e.g., sickness), or on personal social circumstances which attracted special attention and support by the state (e.g., families with three or more children). The only notable exception to this rule was pensions, where the sums received by pensioners did depend on contributions previously paid in by the individual. However, workers usually had a lump sum deducted from pay packets for all other social service entitlements. These deductions normally amounted to

less than a quarter of the gross wages, and the sums thus raised came nowhere near the sums spent by the state on welfare matters. The difference was paid from profits of the state-run industries, which were not “taxed” in the Western sense or forced to co-contribute (along with the employee) to individual insurance schemes, as was the West German practice. Instead, the East German companies received budget allocations covering their running expenses, and any revenue – above the following year’s allocation – resulting from the company’s business activities had to be handed over to the state (*Gewinnabführung*). The privatisation or closure of these companies following unification cut off this source of revenue for the state, and usually there were no alternative schemes in place. With regard to unemployment, for instance, the full employment in East Germany meant that the GDR government had seen no need to run an unemployment insurance scheme. Only in the process of German unification, in particular the monetary, economic and social union which started on 1 July 1990, were such schemes introduced in the GDR. Therefore, neither the federal government nor the new, Western-style regional and local authorities had any former GDR funds available to cover those welfare expenses which in the West were insurance-based. The shortfall had to be paid out of the newly raised contributions, and federal tax revenue, not least the new *Solidaritätszuschlag*, a 7.5% surcharge on income tax to be paid on all incomes, in both East and West.<sup>25</sup>

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<sup>25</sup> Initially, the *Solidaritätszuschlag* was sold politically by the Kohl government as a time-limited payment to jump-start the East German economy, mainly by modernising the physical infrastructure (*Gemeinschaftsaufgabe ‘Aufschwung Ost’*), i.e. a developmental task, but in the event the welfare bill, i.e. a redistributive task, proved to be the greater headache compared to the one-off infrastructure-related projects. The latter are now mostly complete, but the on-going welfare costs have made it unlikely that the *Zuschlag* is going to be abolished any time soon. However, it has recently been lowered to 5.5%.



**Table 3. Federal Start-up funding for East German Welfare Schemes, 1990-1991**

<b>Scheme</b>	<b>Period</b>	<b>Start-up funds (m DM)</b>
State Pensions	1990 (July-Dec.)	750
Unemployment Benefits	1990 (July-Dec.)	2,000
Unemployment Benefits	1991 (Jan.-Dec.)	3,000

Source: Art. 28 WWSV.

According to Art. 17-25 WWSV, further funding for other welfare schemes was available on application by the GDR government. The applications had to be made by 02/10/1990, including those for the 1991 financial year.<sup>26</sup> There was a request to specify the detailed financial need, which would be met out of a general grant to balance the GDR budget (*Finanzzuweisung zum Haushaltsausgleich*) by the FRG Government, which was not limited to welfare matters. The general grant limits were DM 22bn for the second half of 1990 and DM 35bn for the whole of 1991 (Art. 28(1) WWSV).

The key issue in getting the East German welfare system up and running under the new structures, however, was the double strain of reduced tax and contributions income, and the triggering of new entitlements associated with a person becoming unemployed. In terms of unemployment, the East-West divide could not be more obvious. By 1998, regional disparities had emerged which have become relatively stable since. All East German local government districts apart from the Eichsfeld, a small strip of Thuringia along the borders to Bavaria and Hesse, showed unemployment rates of at least 125% of the federal average.<sup>27</sup> By contrast, none of the West German local government districts were in that category, and only about one fifth of the West German districts showed rates around the federal average (districts along the old inner-German border, Northwestern Lower Saxony, the central part of North Rhine Westphalia, and The Saar). By contrast, Bavaria, Baden-Württemberg, Northern Rhine Land-Palatinate, and Northern North Rhine-Westphalia, showed unemployment rates of less than 75% of the federal average (Maretzke and Irmen, 1998:5). Between December 1991 and June 1998, unemployment in the Eastern *Länder* rose by 57%, as the number of industrial jobs in existence declined by 65%. The service sector, despite going through a phase of massive

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<sup>26</sup> In Germany, the financial year is identical with the calendar year.

<sup>27</sup> In the late 1990s, the federal average remained relatively stable at around 11.6% of the overall labour pool, i.e. approx. 4.4m people.

expansion, was clearly unable to absorb that much labour. Indeed, between 1991 and 1996, employment in the service sector rose by only 2% (Maretzke and Irmen, 1998:8).

It is therefore not surprising that many East Germans saw their personal way out of this crisis in a move to the West, or, to a lesser extent, abroad. Between 1991 and 1997, the East German districts saw an average loss of population of 4.6%. Most affected were the cities over 100,000 inhabitants, where the average loss was 11.8% (Sahner, 1999:30). One could cynically argue that this was perhaps even beneficial for the Eastern communities as the welfare responsibility for these people moved with them.<sup>28</sup> However, it was often the younger generations and the better qualified members of the workforce – i.e. the most employable – who moved out of the Eastern districts, while people who were more likely to need social security benefits tended to stay put – a clear example of national policy standardization preventing welfare tourism. It is therefore not surprising that by the late 1990s, many Germans residing in the Eastern *Länder* had not only accepted the new Western-style welfare system, but had tended to become vociferous supporters of its continued existence without too many changes.<sup>29</sup>

Consistent demands for an extensive welfare state make a debate on the funding of welfare provisions inevitable. Prior to 1998, federal debates on welfare reform rarely went beyond a general agreement on the need to save money. While several federal reform steps in the two federally administered schemes, employment management and pensions, have been introduced more or less successfully in the last decade or so, the real funding crisis is prevalent on the local level. Virtually nowhere in Germany are local authorities able to meet all their expenses. The local authorities have three main categories of income: local business rates, service charges/fees, and their legally guaranteed share of federal and regional taxes (in particular income tax). A typical West German local authority may raise as much as 35% of its budgetary needs from local business rates, while comparable East German authorities are normally pleased to raise about 15% in that way. Federal and regional tax shares in the West usually account for about 25-30% of the authority's budget, in the East it may be as much as 55% (down

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<sup>28</sup> Not for pensioners and recipients of disability allowance resulting from accidents at work. Financial responsibility for those, if they moved after 18/05/90, remained with the East German authorities (Art. 20(7) and 23(4) WWSV).

<sup>29</sup> A very good analysis of this phenomenon can be found in Schaub, 1998:131-158.

from over 75% in the early 1990s).<sup>30</sup> All over Germany, local authorities have occasionally received additional support from the federation or the *Land*, often paid in the form of special support for individual projects, such as one-off help with capital expenditures associated with improving the local infrastructure. In the East German *Länder*, where infrastructure projects were often the second largest cost factors (behind personnel costs) in the early years after unification, ERDF (Objective 1), ESF and EAGGF funds also were a significant source of income, but this factor, strictly linked to developmental tasks, has declined considerably since 1999 and is likely to be phased out by 2006 in all but the worst-affected areas. The welfare bill, however, is likely to gain increased significance. As Sahner (1999:33) shows, West German authorities spend around 20% of their budgets on welfare matters. In the East, this rate is still only around 15% (up from just 4.5% in 1991), but this picture is distorted by the disproportionately higher rate of capital expenditure in the East. Still, in both East and West local authorities face an annual budgetary shortfall of 20-25%, to be covered either by the extra federal and *Land* support measures mentioned above, or by taking on public debts, resulting in interest payments of as much as 4.5% of an authority's annual budget.

Such protracted funding problems are not without consequences for the social acceptability of the welfare state. Local authorities are forced to deliver welfare provisions which are mainly set in places beyond their control, either federally or regionally. Due to a chronic funding shortage locally, hardly any community is able to deliver provisions beyond these externally set minimum standards. Not surprisingly, local authorities, in particular in the East but also, for instance, in Berlin, Schleswig-Holstein and Lower Saxony, have recently sought to reduce the financial pressures by other means. Draconian interpretations of optional clauses in the applicable legislation do help but can achieve only so much. However, an increasingly popular route over the last few years was to use the welfare recipient's labour for local authority tasks or local businesses, such as maintaining public parks and gardens, cleaning public areas, or providing a cheap source of seasonal labour in agriculture and tourism. The relevant federal legislation in this area, §§ 18-20 BSHG, constitutes a double-edged sword. The legislation allows – and indeed encourages – the use of such measures, to “accustom”

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<sup>30</sup> For a more detailed analysis see Sahner, 1999:32-34.

welfare recipients, in particular young ones, to regular work. However, work creation schemes for social security recipients are supposed to create additional work<sup>31</sup>, not to substitute welfare recipients for council workers or properly employed casual labour. Yet this is exactly what seems to happen in most East German cities, and in the rural areas of Northern Germany. In particular the “not been carried out to the same extent” and “not been carried out at this particular point in time” clauses allow enough room for manoeuvre for local authorities to cut corners on the primary service provisions and fill the gaps with welfare recipients. In one of the most incredible acts of creativity of federal framework regulation-writing, § 19(2)1 BSHG even allows the local authority to choose whether to pay the draftees the proper salary for the job *or* the standard social security benefits (plus a small allowance for additional expenses, such as for transport to and from work). No prizes for guessing which of the two options is usually chosen. Federal authorities and the local Job Centres do not complain – people on such schemes are not counted as unemployed.

## Conclusions

The first point to note is that the principle of federalism, supposedly allowing for greater regional self-determination, and the principle of striving for equality of living conditions, are now in open conflict. The current German system is in constant search for a compromise between the two ideals, with only partial success: *Politikverflechtung* as the guiding principle of co-operative federalism, initially hailed as a sound solution, has led to the joint-decision trap and thus has itself become a significant part of the problem. Putting welfare into the concurrent legislation category seemed a logical choice in the early days of the FRG. However, in practice, the system that emerged was a functional division of labour which favoured centralised decision-making while putting the implementation burden on the lower levels of government. Regional influences and freedoms regarding welfare decision-making have been eroded as federal governments

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<sup>31</sup> § 19(2)1 BSHG defines “additional work” as “work which otherwise would not have been carried out, not been carried out to the same extent, or not been carried out at this particular point in time”.

saw welfare as a key priority on their domestic policy agenda. The extensive and detailed welfare legislation incorporated in the SGB has certainly contributed to achieving a high standard of social security, with roughly equal basic standards throughout the federation. To a lesser extent, the same applies to certain federal welfare regulations outside the SGB, in particular the BSHG.

While one may well regard this as a success, some questions remain concerning the federal level's preparedness to put their money where their mouth is. So far, the federal level has become massively engaged in managing welfare matters only in the employment management sector. In a sense, this was the right way forward. After all, employment is the crucial factor in both determining a society's welfare needs as well as in generating a society's wealth which determines the level of social security which is affordable. In the other welfare fields, however, federal framework regulations have put enormous financial responsibilities – for both the actual welfare bills as well as the associated administrative costs – in the hands of local authorities, without providing adequate funding cover.

The regional and local freedom of manoeuvre would perhaps be useful to have if that meant relatively wealthy areas could afford better provisions beyond the federally fixed minimum standards. Indeed, in some other European regions, such arguments may provide the rationale for greater regional and local self-determination on welfare matters (e.g., Scotland, Basque Country). In Germany, on the other hand, even the richest regions and local authorities find it extremely hard to fund the federally required welfare expenses. These expense structures were imposed federally at a time when the FRG needed credibility as a welfare state, and when they seemed affordable as the economy was booming. However, since 1970s these structures have led to a now chronic funding crisis, becoming even worse by the rising long-term welfare costs following German unification. As a result of this, the newly emerging claims by some of the *Länder* for greater regional self-determination cannot avoid sinister connotations of de-solidarization: shedding joint responsibilities for welfare problems experienced elsewhere within the FRG, or even an intention to 'race to the bottom' directly.

What then, would be the best ways forward? At first glance, virtually all attacks on the well-entrenched German welfare system exhale a whiff of political suicide. First,

the two classic approaches: leave the system basically unchanged but lower the levels of payment and/or raise contributions to insurance-based schemes. Both strategies have been employed in an incremental way over the years as and when it seemed necessary, but as Bulmahn (1998) has demonstrated, they are no longer working effectively. Rising general living expenses, more expensive healthcare treatment and drugs, longer life expectancies and mass unemployment have offset any gains from previous hesitant reform steps since the 1980s. Using far sharper drops in entitlements is likely to result in massive political protest – not a scenario the current government with its wafer-thin majority was looking forward to, but had to engage in nevertheless following the Rürup Commission’s recommendations. Steep increases in contributions, on the other hand, would not only result in similar protests by the voters but also in even less readiness for investors to choose Germany as a location – they are already correctly pointing out that the German *Lohnnebenkosten* (non-wage labour costs, of which employer contributions to social security schemes form a significant part) are higher than anywhere in the EU. Apparently, these appeals by the BDI and other industrial organisations have been successful – neither the Hartz Commission nor the Rürup Commission went down that route, and therefore neither did the federal government in its Agenda 2010.

Secondly, altering the general taxation structure. This seems to be the flavour of the year for the Schröder government. After the 2002 elections, it has embarked on a policy – kept more or less secret during the election campaign – of tax rises to fund social ambitions. Unveiling such an approach within weeks of an election barely won has already created a volatile political climate, resulting in two massive regional election defeats for the SPD in Lower Saxony and Hesse in early 2003, plus, not surprisingly, further marginalization in Bavaria in the September 2003 elections. The government argues that the seemingly harsh financial policies are all part of a longer-term strategy not only to cover on-going commitments but also to redistribute tax burdens further down the line with forthcoming socially and economically desirable tax relief measures.<sup>32</sup> The key idea here is to use the funds raised to jump-start the employment market, as envisaged by

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<sup>32</sup> Some of these tax relief measures, originally scheduled to start in 2003, have been postponed to cover the unexpected expenses resulting from the large-scale floods engulfing many parts of Eastern Germany and Bavaria in the autumn of 2002.

the Hartz Commission. It remains to be seen whether Schröder will be more successful in this area than the Kohl government was.<sup>33</sup>

Thirdly, privatisation and liberalisation. Even in the current reformist mood, hardly anybody in Germany dares to speak openly about privatisation steps in welfare matters, preferring the phrase *plurale Vorsorge*, i.e. social needs should be covered in a variety of ways, including state, private and voluntary sector involvement. In a narrower sense, the term is in particular used to characterise new pension schemes. Acknowledging that state pensions will not be enough to cover living expenses in the decades to come (an end to the hallowed ‘generation contract’), the government has recently promoted private pension insurance schemes, run by private sector insurers, where the state will top up individuals’ contributions. Participation in these schemes is voluntary so far. However, all members of the German workforce now receive an annual review of their state pension entitlements accumulated to date, and the often quite low sums mentioned in these statements has fuelled widespread unease among the population, which – as the government hopes – may well boost take-up rates for the new top-up schemes. Another field where deregulation has taken place is sickness insurance, which was traditionally managed by the private sector already, but completely overburdened with regulatory red tape. In theory, employees can now shop around for low contribution payments and choose from varied scopes of coverage. In practice, still few schemes deviate much from federally defined minimum standards, and premiums hardly vary by more than 3%.

Nevertheless, further fields may lend themselves to similar approaches, but so far the government is determined not to alter the key defining characteristics of the social security system: employment triggers the requirement to join compulsory insurance schemes, the amounts of contributions is linked to the wage or salary earned, both employer and employee contribute to the costs, and resulting entitlements are federally regulated. The Kohl government had begun to question the link between employment and “membership” of the social security system – not because Kohl wanted a greater role for the state, but because the employer contributions put huge disincentives on employers thinking about creating jobs. Individualisation was seen as the answer, but the voters

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<sup>33</sup> Focussing on this issue, Kohl made an ill-advised pledge in 1996 that unemployment (then at 4m) should be halved by the next elections in 1998. On election day, unemployment was up to 4.6m, and Kohl lost to

rejected this idea, and in 1998 the Schröder government was quick to stop this approach.<sup>34</sup> Whether this was a wise course of action remains debatable, and its current implementation stop does not necessarily mean the end of this line of thinking in Germany, as the current reform debate shows.

However, privatisation and liberalisation cannot work in one crucial area, the social security benefits for the most needy; people on income support who for whatever reason have never been able to find work and thus were unable to build up insurance-based entitlements. The state cannot abdicate this responsibility altogether – not even the US system has dared to do that in its recent spells of conservatism – and Germany is not about to do it, lest it would spell a complete disintegration of the much hailed *Solidargemeinschaft*, a system of mutual support in a society where those who are able to contribute (through taxes as well as insurance payments) are expected to do so to the extent necessary while those in need will not be left to their own inadequate devices. What is under debate – and this is similar to what Peterson found in the US case – is the degree of solidarity deemed acceptable by sectoral and territorial interest groups, and the population in general. The level of acceptance varies in line with the economic climate, and from region to region depending on the region's social composition.

The state responsibility to look after the needy has in the German federal system been divided between different territorial holders of responsibility, involving federal, regional and local authorities. Thus, welfare matters in the FRG have always had a significant territorial dimension. However, the sheer extent of the welfare state with its copious coverage has led to significant funding problems on all levels. It is not the functional division of responsibilities between territorial authorities as such that is the key problem. Neither a full regionalisation nor a full federalisation of responsibilities would be an answer to the now chronic cash crisis. It is therefore not surprising that a reallocation of responsibilities has so far not really been discussed in Germany – not least because this would automatically open another can of worms, a complete overhaul of the redistribution system of tax revenue between the territories and levels of government, which would renege on decades of entrenched practice of co-operative federalism. But

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Schröder.

<sup>34</sup> A detailed analysis of these developments can be found in Rieger, 2002:3-12.



perhaps this is exactly what is needed at present: *Politikentflechtung*, starting with greater financial self-determination.

However, in the present system, a further devolvement of responsibilities would only be sustainable from a regional and local perspective if accompanied by federal compensation payments, or an increase in the local/regional share of federally raised taxes. Further federalisation, on the other hand, ostensibly holds a certain attraction. Since virtually no local communities are in a position to provide a far better service than the federally proscribed standards, the loss of regional and local self-determination would not really be significant, while reducing the local and regional welfare bills would go a long way to consolidate local finance structures. Yet presumably if the federation takes on greater responsibilities it would demand financial compensation by reducing federal payments to the local budgets, and possibly even by demanding a share of locally raised taxes – hence the transfer of functions may prove to be revenue-neutral to all concerned.

Having said that, there are two rather persuasive arguments in favour of a further federalisation of welfare matters. First, if the aim remains to retain a high level of national policy standardisation, if only to prevent a ‘race to the bottom’, this can be more straightforwardly achieved by federal management. The services would still be provided locally, but the financial responsibility and resource allocation for the actual expenses as well as the associated administrative costs would be managed centrally, with the aim of equalisation in mind. The Federal Employment Agency (*Bundesanstalt für Arbeit*) already works along these lines, and while its track record is far from splendid, it has proved to be a suitable instrument for implementing federal employment policies, with further improvements to their service already being part of the Agenda 2010. The corresponding further undermining of the federal principle can be regarded as an acceptable loss. After all, welfare responsibilities are a huge problem, and – in terms of subsidiarity – one that cannot be solved on the level on which it arises, i.e. the local one. The higher level(s) should therefore be duty-bound to act.

Secondly, the process of harmonisation and systematisation of applicable welfare law has already gone a long way with the recent reforms of most parts of the *Sozialgesetzbuch*. With the insurance-based schemes, federal regulation has worked very well so far, and opens up further possibilities of federal government steering, regardless

of the directions. The point however, is that federal regulation is more effective in driving through the undoubtedly necessary further systematic reforms. The only really large element of welfare legislation outside the SGB canon is the BSHG, and it is time to bring it in. Some smaller welfare matters could also be part of this drive, such as Housing Benefit, certain Childcare Allowances, and allowances for students in higher and further education and vocational training. The point here is that if this harmonisation is done, the general and procedural provisions of the SGB (SGB I, IV and X) become applicable to all welfare matters, clarifying the legal positions of all involved,<sup>35</sup> and reducing the scope for misuse by both applicants and bureaucrats, as well as reducing the scope for different “semi-official” interpretations of optional clauses by regional and local authorities – preventing an underhand ‘race to the bottom’ without placing an undue burden on regional and local authorities in terms of national solidarity. Procedural transparency and efficiency need not be costly – indeed, may well lead to savings on system management in the long run – but would be able to contribute significantly to the public acceptability of the reform contents with its unpopular measures.

The bottom line, nevertheless, is that regardless of how the welfare system is organised territorially or functionally, it needs to be adequately funded. What is required is a return to affordability. It is here that the German system is in the most urgent need of reform. The long-term future of the welfare state depends on sustainability, and how to achieve this is a matter for the intense political debate which is currently under way – but in which the territorial dimension is likely to remain a secondary issue.

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<sup>35</sup> Legal cases arising out of the BSHG would then be heard by the special Social Welfare Courts (*Sozialgerichte*), not the Public Administration Courts (*Verwaltungsgerichte*), as is the case now.

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<sup>36</sup> A non-governmental welfare service provider associated with the Catholic Church.

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