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# Job-Centers for Local Employment Promotion in Germany

Hugh Mosley

## Introduction<sup>1</sup>

The wave of reform of labor market policy in Germany, which began with the placement scandal in the PES in 2002 and the subsequent proposals of the Hartz Commission on “Modern Services in the Labor Market,” is radically transforming the public employment service’s internal organization, its relationship to the government, its management strategy, portfolio of active measures, the unemployment benefit system and the relationship between the public employment service and the local authorities in providing labor market services for the long-termed unemployed. I will focus in this paper on one major innovation, the new comprehensive “Job-Centers” charged with the implementation of employment programs at the local level. The presentation is divided into five sections: Section 1 briefly surveys the level and structure of unemployment in Germany; Section 2 describes the institutional framework of local employment promotion in Germany and recent public employment service reforms; Section 3 reports stylized facts on the institutional problem of fragmented responsibility for local employment promotion in Germany; Section 4 summarizes the one-stop-shop “Job Center” approach adopted in the “Hartz” reforms; Section 5 offers a preliminary assessment of this reform.

## 1. The German Labor Market

The overall unemployment level in Germany is currently 9.9%, which is high in comparison with the rate for the EU15 (8.0%), Japan (4.8%), the USA (5.5%) and

the average for 27 OECD countries (6.9%).<sup>2</sup> Unemployment in Germany increased in the 1990s in comparison with that in the EU and the US (Figure 1) and over the past thirty years has experienced a marked long-term secular increase in unemployment (see Figure 2). If we examine the structure of unemployment the most prominent features are a high incidence of long-term unemployment, with more than one-third unemployed for 12 or more months, and large regional disparities between East and West Germany and within West Germany. Thus in December 2004 the unemployment rate in Eastern Germany was over 17% in comparison with “only” 8,3% in Western Germany. Within Western Germany there is a North/South divide between older industrial areas in the North and the more dynamic economies of Southern Germany. While the unemployment rates exceeded 9% in Bremen, Lower Saxony, and Hamburg in 2002, it was 6% or less in Bavaria and Baden-Württemberg (see Figure 3). These regional disparities, especially between that between East and West Germany, are the most acute labor market problem in Germany today.

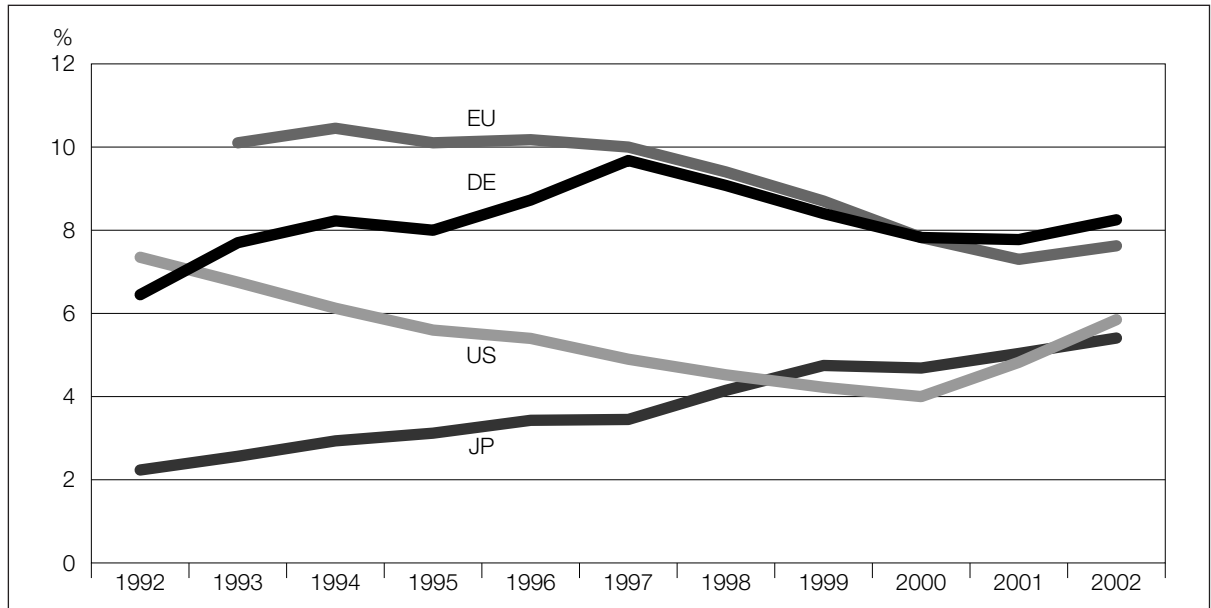
## 2. The Institutional Framework and Public Employment Service Reform

Responsibility for local economic development and employment promotion in the German federal system is divided between the German states (Bundesländer) and the national government. The central government is primarily responsible for labor market policy, including the local implementation of labor market programs

<sup>1</sup> The author would like to thank Günther Schmid and Petra Kaps for helpful comments on an earlier version of this paper.

<sup>2</sup> OECD standardised unemployment rates for the 3<sup>rd</sup> quarter 2004.

Figure 1. Trends in Unemployment in Germany and in Selected OECD Countries, 1992-2002

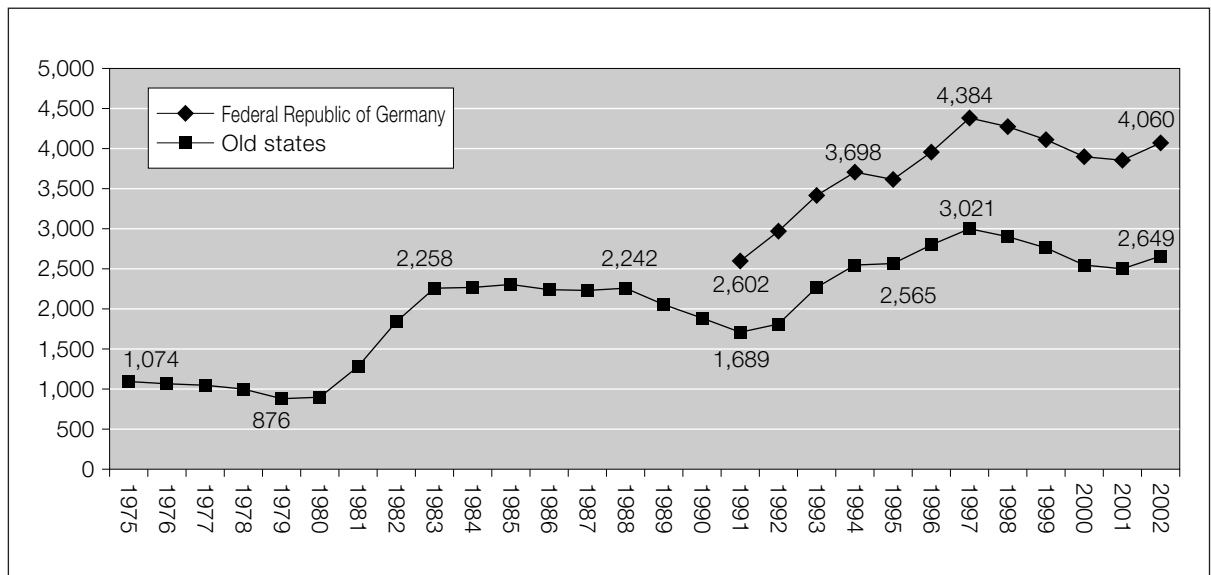


1) Harmonised Unemployment Rates, annual averages.

Source: Eurostat.

Statistisches Bundesamt 2003 - 02 - 0309

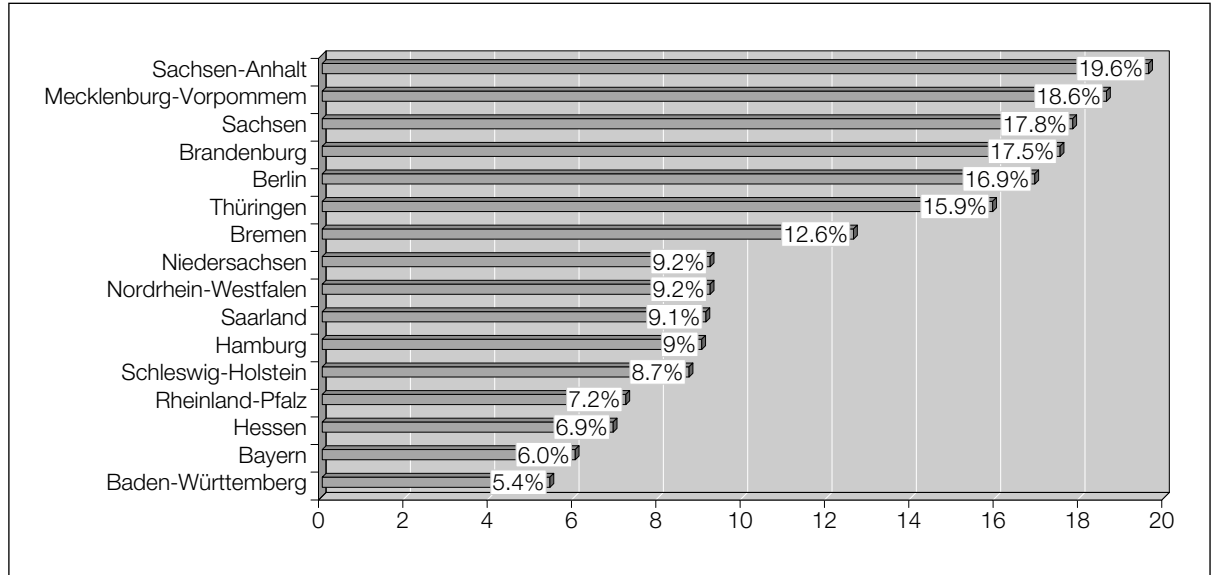
Figure 2. Trends in Unemployment in Germany, 1975-2002 (thousands)



Source: Bundesministerium für Arbeit und Sozialordnung, Statistisches Taschenbuch 2002: Bundesanstalt für Arbeit.

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Figure 3. Unemployment Rates by States (Bundesländer) in Federal Republic of Germany, annual average, 2002



Source: Bundesanstalt für Arbeit.

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through the national public employment service, whereas the 16 German state (Länder) governments, together with their some 450 local authorities (county and city governments), are responsible for local economic development. Typically, the local agencies for economic development (Wirtschaftsförderungsgesellschaften) are organized as public-private partnerships with representatives of the local business community and trade unions, chaired by a leading local government official. Their focus is on the promotion of new businesses, advisory services to existing businesses, public relations etc.<sup>3</sup>

Co-operation at the local level between the employment programs of the employment service and economic development agencies is widespread but largely on an informal and ad hoc basis. Especially training and employment programs are a potential resource for regional economic development. However, the client and welfare orientation of labor market programs makes

it difficult to link them with regional economic development. The PES has been most prominently active in regional economic development in response to mass-layoffs and plant closings (e.g. short-time work, transitional Employment Companies and other adjustment assistance) rather than in supporting existing and attracting new industries. Finally, the PES' status as an agency of the Federal government does not foster close integration with local economic development.

The German state governments engage in a wide variety of activities to promote local employment and economic development such as promotion of entrepreneurship, skills training in small and medium-sized companies and training for young people. They are also responsible for education, vocational schools and universities, which have important links to local economic development strategies. Moreover, they have developed special labor market programs for target groups such as

<sup>3</sup> A recent survey of local economic development agencies in German cities and counties in 2002 indicates that the most widespread organizational form is that of a local agency incorporated under private law (30%). Other typical forms are local public agencies (26.8%) and special staff units in local government (19.1%). Average size ranged from 2 to 5 persons for small towns and counties to 11 for larger entities with over 250,000 inhabitants, the largest had almost 70 employees. Most personnel were specialists (business school graduates, engineers, economists, geographers and only a minority (30%) had a background only in public administration (ExperConsult 2002).

women, youth and the long-term unemployed that complement those of the national PES. These activities are financed from their own revenues as well as from the European Social Fund, which allocated circa € 5.6 billion for federal and state programs in the 2000 – 2006 period.

Until recently the local authorities also played a major role in the reintegration of working-age social assistance beneficiaries, many of who were long-term unemployed. Reforms that came into effect in January 2005 have now given the national public employment service primary responsibility for administering benefits and providing reintegration assistance to all unemployed persons in the context of the new consolidate local Job-Centers. This reform is the focus of this short paper.

The German Federal government addresses regional disparities in employment and living standards, especially the regional crisis in Eastern Germany, in a number of important ways:

1) The program “Improvement of the regional economy” is a principal tool for overcoming regional disparities by creating favourable conditions for private investment through investment in infrastructure and in human capital in structurally weak regions. Since target regions are defined on the basis of employment, unemployment and income, most funding goes to regions in Eastern Germany. In 2003 € 1.7 bil-

lion in subsidies is reported to have leveraged a total of 8.8 billion in private investment. An additional € 500 million was invested in subsidies for infrastructure (Federal Ministry for Economics and Labor 2004d: 41 ff.).<sup>4</sup>

- 2) Inter-regional revenue transfers. A noteworthy feature of the German Federal system for offsetting regional disparities is the “revenue equalization system” (Länder Finanzausgleich), which provides for substantial transfers to financially weaker German states with the aim of proving the latter with approximately the average per capita revenue base of all German state governments. In 2004 about € 43.5 billion was transferred to the new German states through this program.
- 3) Target 1 regions in Eastern Germany also receive most of the € 14.5 billion allocated by the European Structural Funds (especially the European Regional Fund) to Germany for the 2000 to 2006 period.
- 4) Diverse other Federal government programs, for example, PES active programs and highway and rail transportation infrastructure investments, have gone disproportionately to support the Eastern region.
- 5) Special tax subsidies are available to promote business investments in Eastern Germany.

**PROGRAM ACTIVITIES “IMPROVEMENT OF THE REGIONAL ECONOMY”**

- “Regional Management” partnerships between all relevant stakeholders at the local level;
- Promotion of business-related investments for research departments and labs;
- Support of research- and technology-based businesses and investments of industry that strengthen the regional potential for innovation;
- Promotion of consulting measures as well as applied research and development (R&D) for small and medium size enterprises and training measures for their employees;
- Promotion of industrial investments in vocational training centres of enterprises and in vocational training, further training and retraining facilities;
- Promotion of R&D in innovative organisations with a potential for growth in disadvantaged regions;
- The program “Learning Regions – Promoting Networks” supports 74 networks with approximately €116 million until 2006.

Source: Federal Ministry for Economics and Labor 2004d.

<sup>4</sup> A much smaller amount (circa € 500 million in total) was allocated for regional assistance in Western Germany.

## Public employment service

The Federal Employment Service. (Bundesagentur für Arbeit; hereafter PES) is a quasi-independent administrative agency under the jurisdiction of the Federal Ministry for Economics and Labor Affairs (BMWA). It is responsible for the implementation of both active employment programs and for the administration of unemployment benefits. The ministry appoints its managing director after consultation with the agency's tripartite advisory council (Verwaltungsrat). The PES is organized into 10 regional directorates and 180 local PES district agencies. These local PES agencies function with a great deal of autonomy, within the budgetary and legal framework established by the national employment service and social security law.

In contrast to trends in a number of other larger OECD countries that have adopted decentralized strategies for the implementation of employment programs (e.g. USA, Canada, Italy, Spain), the German PES remains a relatively centralized, national organization. Since 1998 the German PES has, however, undergone a major transformation influenced by new public management models, especially that of management by objectives, that aim to give greater discretion to local PES offices.

The reform of the German employment service in January 1998 significantly increased decentralization by giving local PES offices considerably more autonomy in implementing active policies. The first step was to merge most discretionary active measures into a single budget; the so-called 'reintegration budget.' While the local PES districts are still obliged to offer all types of measures, the local PES is free to determine the mixture of these measures. Up to 10 per cent of the reintegration budget can now be allocated to innovative measures; i.e. measures not defined in the standard portfolio. On their face, the reforms represent a considerable step forward in terms of managerial decentralization.

In 2003 and 2004 the Hartz reforms were adopted, an even more fundamental series of PES reforms based on proposals put forward by the 2002 Commission on labor market reform chaired by Peter Hartz, the personnel chief at Volkswagen, Europe's largest automobile firm.

The major elements of this modernization strategy in placement services, which represents a belated adop-

tion of approaches already widespread in other OECD countries, are:

- Emphasis on activation of the unemployed;
- Profiling and segmentation of services by client groups;
- Emphasis on improvement of services to employers and job-matching;
- Increase reliance on outside provision of placement services;
- Merger of previously fragmented service provision in one-stop-shops, the new "Job-Centers."

Although the principal focus of this paper is on the new Job-Center approach to local employment promotion, the remainder of this section briefly sketches the other major elements of the reform in placement services.

The **activation** strategy represents a paradigm change for German active policy. Under the motto *fördern und fordern*, which roughly translates as "assistance and responsibility," the unemployed are to receive more intensive and individualized assistance but also become subject to increased pressure to search for and accept any available employment. This is to be achieved by increasing the frequency and quality of contacts with the unemployed, especially through reduced caseloads for placement counselors as well as by improved IT systems and streamlining work organization. Specific changes also include, for example, mandatory early contact with the PES for persons given notice of termination or on temporary contracts, stricter regulations requiring the long-term unemployed to accept any job offer, shifting the burden of proof to the unemployed and greater flexibility in applying sanctions, and improved availability of self-service information facilities.

A combination of quantitative and qualitative **profiling** is to be used to divide jobseekers into client segments (job-ready, counseling, and intensive service clients) according to their distance from the labor market. The classification of the clients serves as a basis for individual action plans and for allocating labor market services.

**Improved placement services for employers** in integrated service teams through individual contact persons in the agency with special services for "premium" clients, faster reaction times, prior contact to employer and jobseeker, referral of a limited number of qualified contacts, follow-up contact, improved data base on job

openings and controlling data on the matching process. The central goal is to achieve an improved image among employers and a higher market share of notified vacancies.

**Outsourcing of placement services** is promoted through new programs that permit the PES to contract out partial or complete responsibility for reintegration of the unemployed to third parties (Einschaltung Dritter nach § 37, Eingliederungsmaßnahmen durch Träger § 421i). Interesting innovations are in particular the Personnel Service Agencies (PSA) and the Placement Voucher. The PSA is a temporary work agency for the unemployed that is established on a contract basis with a local service provider, in many cases from the temporary work industry. The placement voucher is issued to persons who have been unemployed for more than 6 weeks. The private agency is paid a maximum of € 2000 for placing the unemployed person in employment of at least 15 hours per week: € 1000 after an employment duration of at least 6 weeks and an additional € 1000 after a duration of at least 6 months.<sup>5</sup>

### 3. Fragmented Responsibility for Local Employment Programs

To understand the Hartz reform of local employment promotion, it is useful to recall the problem it was intended to resolve. In Germany - as in a number of other European countries - there has been a fragmentation in responsibility for labor market programs between a nationally financed and administered PES system, on the one hand, and labor market policies financed and administered by local authorities for social assistance recipients, on the other.<sup>6</sup>

The complicated structure of the benefit system is the source of the problem and the focus of the reform. The situation up until the current reforms can be summarized as follows:

1. The PES administered two types of benefits, which de facto define its clientele for active measures:
  - Unemployment benefit, which provided benefit at a level of ca.  $2/3$ <sup>7</sup> of previous net wages

- for 12 months (older workers up to 32 months);
  - Unemployment assistance, after exhaustion of the regular unemployment benefit, which paid 53% to 57% of previous net wages for an unlimited period and was means-tested.
2. The local authorities, the counties and the larger municipalities, financed and administered social assistance, including social assistance due to unemployment for those not eligible for PES benefits. This was a means-tested benefit at the level of the existence minimum. On average, about 80 per cent of the total social assistance expenditures were borne by the local authorities, while the remaining 20 per cent are financed by the German states (Bundesländer).

The unlimited duration of the unemployment assistance benefit had a negative effect on work incentives, especially for the unemployed with relatively high prior earnings. Moreover, this complicated system of benefit provision had important consequences for the provision of job brokering and other active measures for the unemployed in Germany. The stylized facts can be summarized as follows:

- A secular increase in unemployment and long-term unemployment over the last two decades has led to a situation in which more and more unemployed are no longer eligible for regular unemployment benefit but only for means-tested unemployment assistance or for social assistance for the unemployed from the local authorities;
- This trend has been accelerated by the imposition of increasingly restrictive eligibility conditions and by cuts in the level and duration of unemployment benefits, pushing even more unemployed on to means-tested unemployment assistance or social assistance;
- The PES focused its active programs de facto on its own core clientele of unemployment benefit recipients, who are financed through the PES budget. Other unemployed are either eligible for unemployment assistance, which is

<sup>5</sup> The description of the placement voucher is based on changes that came into effect in January 2005.

<sup>6</sup> There is in fact mixed financing of local labor market programs for social assistance recipients: local authorities, German states, EU.

<sup>7</sup> Normally 60%, 67% for unemployed with dependent children.

a means-tested benefit administered by the PES but financed by the national government, or had to apply to the local authorities for social assistance. Recipients of social assistance administered by the local authorities and other unemployed persons not eligible for PES benefits were generally excluded from PES active programs.

- Parallel there has been a remarkable growth in the importance of local labor market programs for the long-term unemployed under the auspices of the local authorities. This development is largely a response to the increasing number of unemployed dependent on social assistance.

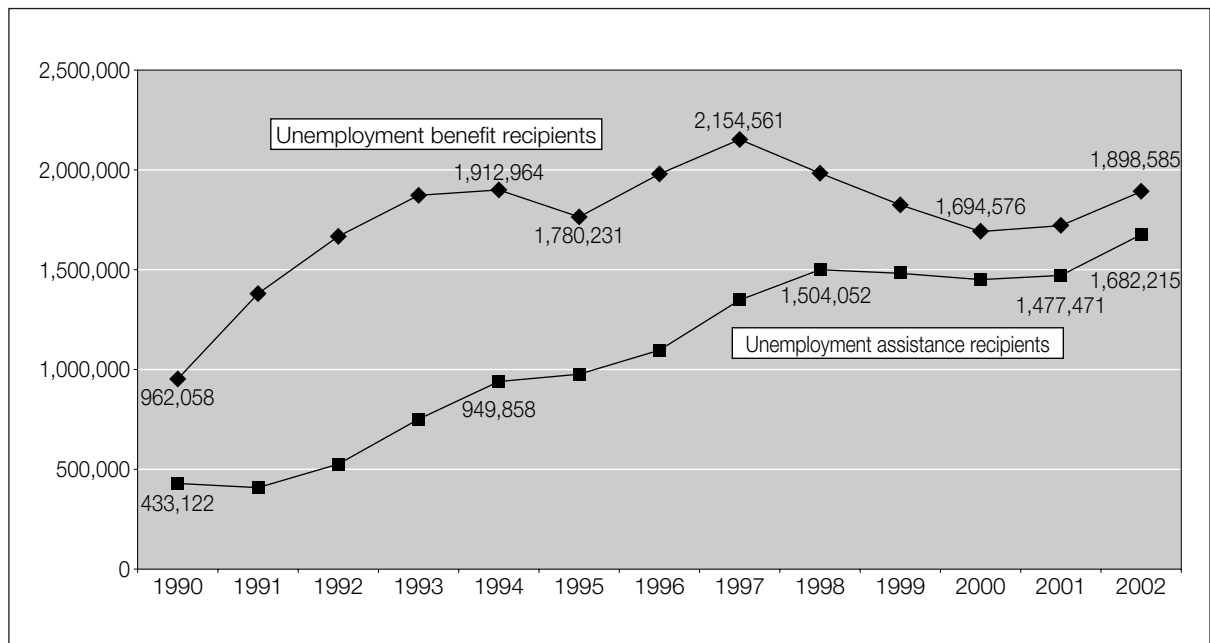
In 2004 two million of the 4.5 million registered unemployed in Germany received unemployment assistance and an additional 700,000 unemployed received social assistance. Thus about 2.7 million persons, a majority of the unemployed, are now dependent on means-tested benefits instead of unemployment insurance benefit. Figure 4 documents the relative shift from

insurance-based unemployment benefit to tax-based and means-tested unemployment assistance as the source of income support for the unemployed.

A major consequence of these trends has been a growing fragmentation of the delivery system for active labor market policy. In this problematic dual system the PES and the local authorities each regarded themselves as being primarily responsible for their separate clientelles. Locally sponsored active measures reached a considerable quantitative level. It is estimated that around 30% of all social assistance recipients receive benefits due to unemployment in recent years and about one third of these participated in active measures. According to one estimate, around 400,000 social assistance recipients were given temporary employment in 2002 (Schulze-Böing 2004). The increasing financial burden of ('passive') social assistance on local authorities is probably the main impetus for the steady growth of local labor market policies from the 'bottom-up' since the early 1980s.

The local authorities provided employment opportunities of two major types:

Figure 4. Unemployment Benefit and Unemployment Assistance Recipients, 1991-2002



Source: Bundesanstalt für Arbeit.

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1. Regular employment in a job creation measure (i.e. with a 'real' employment contract) with social security benefits and paid at a rate appropriate to the job. The work must be additional and of benefit to the community;
2. Work for social assistance recipients without an employment contract ('workfare'), which is compensated only in the form of a small supplement to social assistance to cover additional expenses.

Moreover, many local authorities have in recent years developed their own employment agencies that provide integrated labor market service, including specialized placement and counseling services for their clientele.

Unemployed social assistance recipients include not only the long-term unemployed who have exhausted normal unemployment benefits but also a large group of persons with a weak labor force attachment (e.g. recurrent unemployment) who have failed to establish eligibility for unemployment benefit, as well as a sizeable group of new entrants, e.g. youth, immigrants and formerly self-employed persons. Whereas the former clearly represent a problem group comparable with the long-term unemployed, the employability problems of the latter are frequently temporary.

Cooperation between the PES and the municipalities is hardly new. Municipalities have long been the most-important sponsors and co-financiers of PES subsidized employment programs for the long-term unemployed (ABM). But there are also potential conflicts, especially the so-called 'revolving door effect' (*Verschiebepipeline*), i.e. the use of job programs by social agencies to qualify social assistance beneficiaries for PES unemployment benefit, thus shifting the costs of unemployment back on to the PES budget.

The relationship between the PES and the local social agencies is further complicated by the fact that the existence of two separate types of benefit for the long-term unemployed (unemployment assistance & social assistance) divides responsibility for clientele with similar characteristics. Recipients of unemployment assistance, who account for about one half of all PES unemployment benefit recipients, are similar to the

unemployed on social assistance but remain clients of the PES and receive a higher level of benefits payments. Moreover, the social assistance agencies also provide a range of important social services not provided by the PES (e.g. dependent care, debt, drug, alcohol and family counseling) to which PES clients do not have ready access. Finally, a large percentage of PES benefit recipients are also eligible for supplementary social assistance or housing benefits because their PES benefit is below the subsistence level, which means that these clients must deal with two different agencies.

#### 4. The "Hartz" Reform: Local Job-Centers for Employment Promotion

Recent legislation based on proposals of the Hartz Commission provides a framework for integrated provision of benefits and labor market services to the long-term unemployed. First, the two types of means-tested benefit systems for the long-term unemployed, national unemployment assistance and local social assistance are to be merged into Unemployment Benefit II, a new consolidated benefit near the social assistance level, which is to be funded by the federal government and administered by the PES. The basic benefits is € 345 in the West and € 331 in the East for single persons with additional benefits for dependent children (60% or 80% of basic benefit) and spouse (90%) plus a housing allowance. It is estimated that a total of about 3 million persons will be eligible for the new Unemployment Benefit II, compared with about 2 million recipients of Unemployment Benefit I (regular benefit).<sup>8</sup> Housing and heating costs for all Unemployment Benefit II recipients continue to be paid by the local authorities according to the same regulations applicable under social assistance. Unemployment benefit II recipients who have exhausted the regular unemployment insurance benefit (usually 12 months) will receive a temporary degressive benefit supplement for the first two years, which partially offsets the decline in benefits payments.<sup>9</sup>

The impact of the changes on household income of benefit recipients depends on the type of household and the previous gross income. In general for benefit recip-

<sup>8</sup> The PES also becomes responsible for social benefit (Sozialgeld) payments for family members of the unemployed.

<sup>9</sup> It amounts to two thirds of the difference between unemployment benefit I and II in the first and one third in the second year.



ients with a previous income around or below the average gross earning in Germany of € 2200 there is little or no loss in benefit level as a consequence of the reform (see Figures 5.1 & 5.3). For households in which the unemployed had above average earnings (here for example € 3000), there is over three years a stepwise reduction in benefits of about 25% for single-person households and of circa 8% for a model household with two adults and two children (see Figures 5.3 & 5.4); in the latter case benefit is actually higher in the second year of unemployment and lower only in the 3<sup>rd</sup> and subsequent years. Furthermore, due to more stringent rules for counting the income of other household members, some individual may no longer be eligible.

The new Job-Centers are to be responsible for providing not only the new unemployment benefit II but also for active programs to all long-term unemployed, including social services provided by the local authorities. In Germany there was broad agreement on the need for a reform that provides integrated services for the long-term unemployed. There was, however, an intense political conflict between government and opposition over whether the PES or the local authorities should be responsible for the integrated services and over how the municipalities are to be compensated for the services they provide. The government favored giving primary responsibility to the PES with the local authorities providing supplementary services on a contract basis, whereas the opposition favored giving the local authorities primary responsibility for administering benefits and labor market services for this target group.

From a policy perspective, the advantage of assigning the PES responsibility for the long-term unemployed (Unemployment Benefit II) is that a single agency would provide integrated services for all unemployed persons. This would give them access to all PES services within a single organization and avoid the stigmatization to which a separate agency run by the local authorities might lead. The local option, to the extent that it is exercised, means that there will not be a uniform delivery system for services for the long-term unemployed, but one in which in some localities local authorities run their own service centers, whereas in others the PES would be responsible for this clientele. On the other hand, the

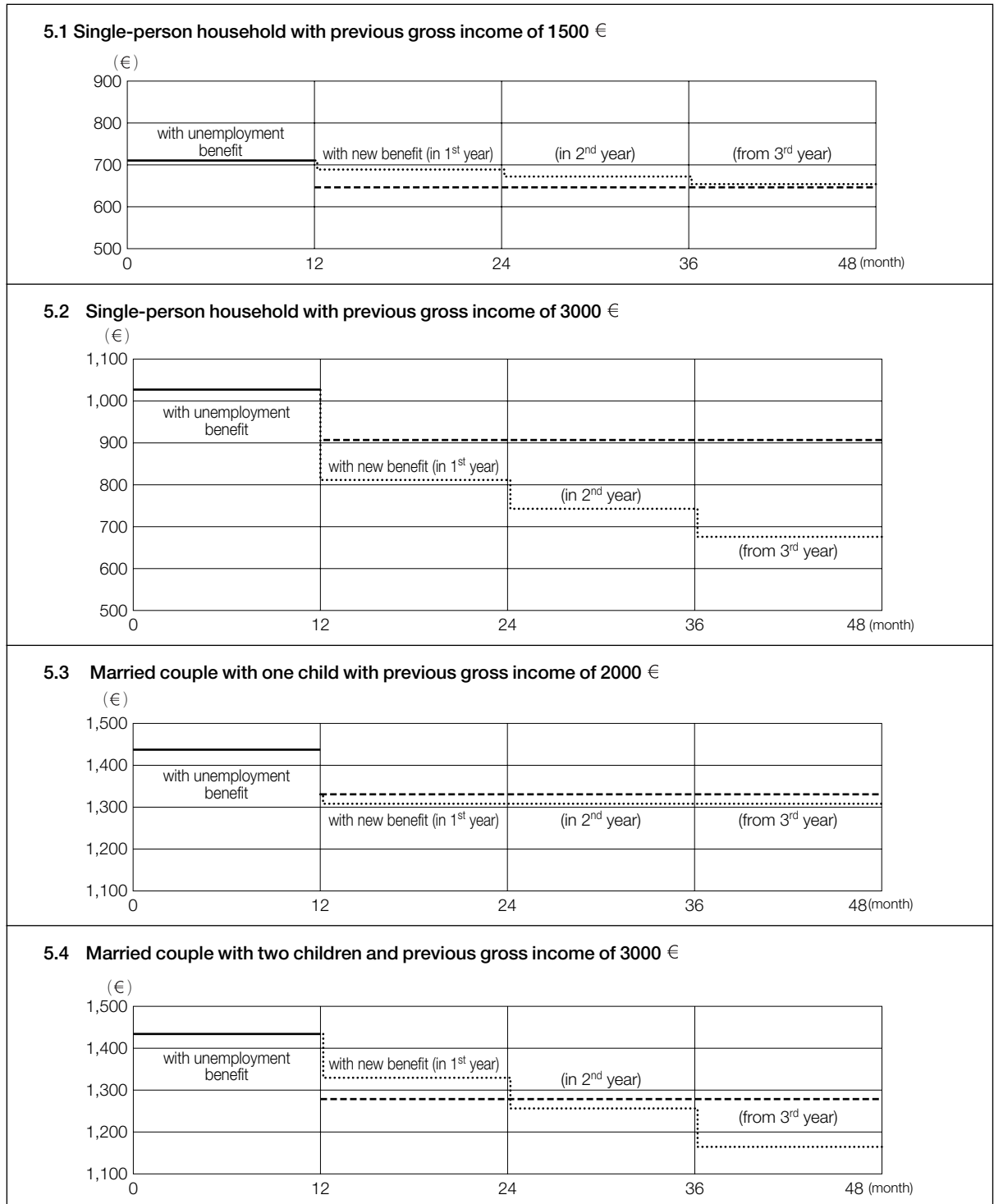
PES, in its current situation (it is undergoing a major reform of all its services and programs), is in the short run clearly overburdened by the additional task of assuming responsibility for up to one million new social assistance clients. Moreover, the local authorities have developed in many areas excellent reintegration services for the long-term unemployed, whereas the PES has in the past been focused more on the job-ready unemployed. It is thus unsurprising that the PES management itself preferred to leave the local authorities with responsibility for the long-term unemployed but was overruled by the responsible government minister.

The final legislation passed gave primary responsibility to the PES but gave 69 local authorities (municipalities and counties) the right to assume full responsibility for placement and active programs for this target group as well as for benefit administration on a local option basis. The legislation defines this local option as a limited experiment for a period of 6 years.<sup>10</sup> In 344 local areas so-called *Arbeitsgemeinschaften*, one-stop shops in which there is a co-location and close cooperation between local social agencies and the PES, are being established. Thirty-six other localities have not agreed to form a joint office with the PES and will continue to administer their local services for this target group (housing and heating allowances, counseling) separately (!). This compromise means that there will be, in some municipalities, separate specialized agencies providing labor market services and administering benefits for the long-term unemployed parallel to the PES own reformed offices (*Kundenzentren*) for job-ready clients, instead of comprehensive job agencies for all unemployed persons as originally envisioned by the Hartz Commission. Only where the local social assistance agencies participate under PES auspices can there be comprehensive Job-Center for all unemployed.

In the remainder of this section we will focus on the Job-Center model, in which the local social agency forms a so-called *Arbeitsgemeinschaft* (ARGE) or one-stop-shop with the PES. Since the reform came into effect only in January of this year, several months will elapse before the new ARGES will be fully operational and patterns of co-operation within the Job-Centers have been established. Thus we can only report here,

<sup>10</sup> The legislation also foresees an evaluation of the changes before a final decision is made on the mode of implementation.

Figure 5. Impact of Reform of Social Assistance by Income and Household type



Note: New benefit level (Alg II) — and previous benefit level ( : : : : : ) in Euros for up to 48 months of unemployment. Model calculations for Western Germany with rent and heating costs of 317 €, 482 € and 538 € respectively and children age 4 or 4 and 12 in family households. Source: Federal Ministry for Economics and Labor 2004a.

inevitably somewhat speculatively, on the planning guidelines and potential problems of this new approach to local employment promotion in Germany.

The organizational details of the Job-Center, which is composed of two relatively independent operating units, the PES' own newly reorganized Service Center (Kundenzentrum) and the Arbeitsgemeinschaft (ARGE) or one-stop-shop for the long-term unemployed, are defined only in very general terms. There is to be a common port of entry for the PES and the ARGE for initial counseling, preliminary profiling and referral to the appropriate service stream – the SGB III or PES Service Center stream for unemployment benefit I (unemployment insurance) recipients or the ARGE-stream for unemployment benefit II (SGB II): able-bodied and needy persons 18 to 65 years of age, who are not eligible for unemployment insurance benefit (see Figure 6).

The Arbeitsgemeinschaft is established on the basis of a formal agreement between the local authority and the local PES. Its legal form is that of either a public authority or a private corporation. The appointment and powers of the chief operating officer of the ARGE, and of his or her deputy, are regulated by agreement between the contracting parties. An advisory body consisting of local actors in labor market and social policy can also be established.

There is a clear division of labor in the ARGE-stream of the Job-Center: The PES is responsible for the administration and financing of active measures and for unemployment benefit II. The social agency of the local authority is responsible for the administration and financing of:

- rent subsidies and heating costs
- initial furnishing of living quarters, including appliances and clothing
- subsidies for school trips for dependent children
- care for minor or handicapped children, home care of dependent relatives
- debt counseling
- socio-psychological counseling
- drug counseling

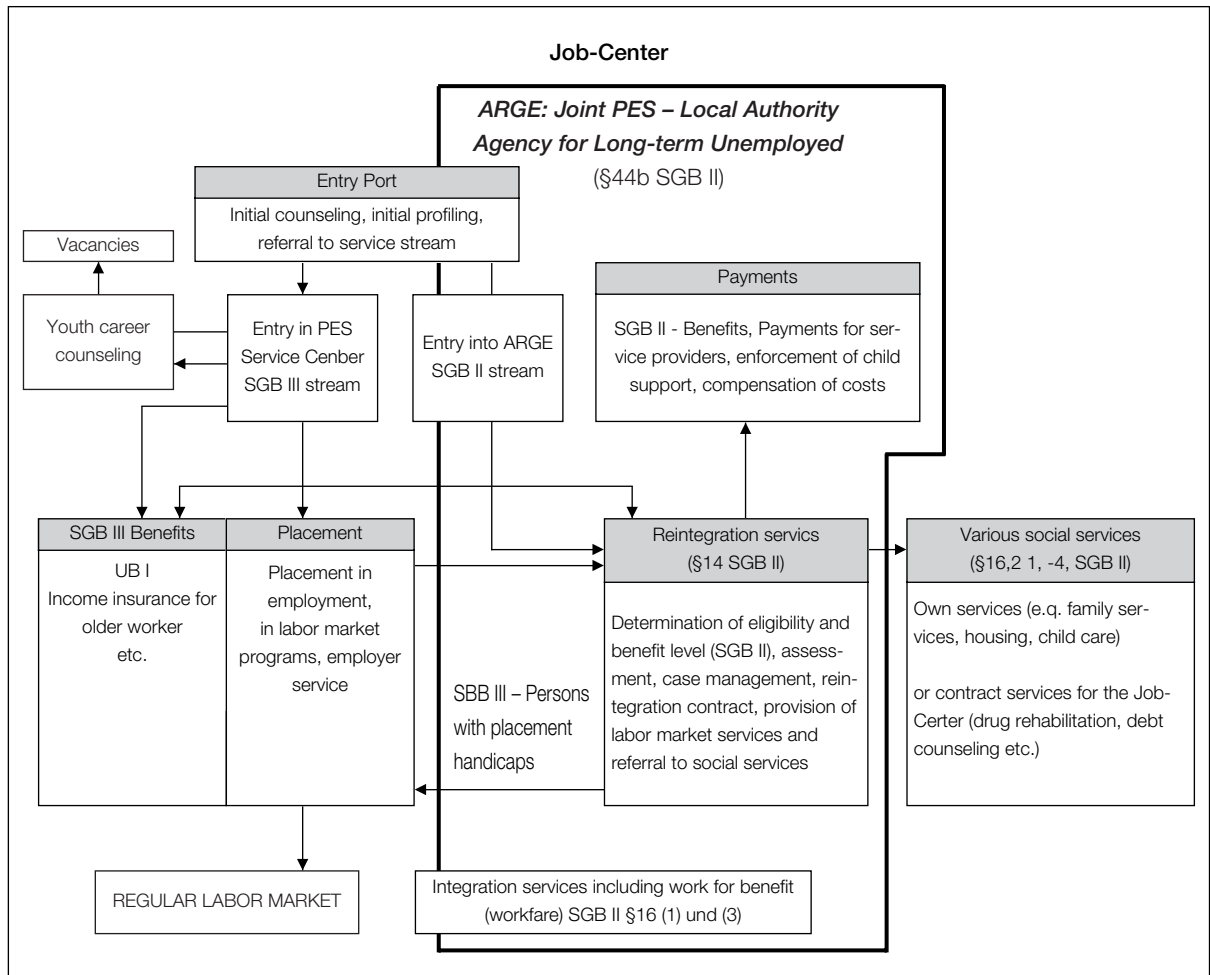
The relevant legislation also requires that clients in the ARGE be given an individual counselor (i.e. case manager) and that a reintegration agreement be concluded with the client. Except for the need for an appeals procedure and the division of labor between the partners noted above, the details of the work process are at

the discretion of the local parties. For example, the local authorities can carry out their responsibilities directly or delegate them to third parties; the ARGE may be staffed with its own employees or by personnel from the local PES and social agency temporarily assigned to it.

The actual organization of front and back office work processes is largely at the discretion of the local contracting parties, the PES and the local authority. Three hypothetical models are conceivable: 1) A fully integrated organizational model in which front office services for clients depend solely on client needs; 2) a fully separated model in which the PES Service Center and the ARGE operate fully independently, duplicating services and programs for their respective clientele of benefit recipients; 3) semi-integrated, co-operative model in which some services and programs are carried out jointly and in other cases a specialization and division of labor is agreed based on client needs. Model 1 probably fails to reflect sufficiently the special needs of the long-term unemployed and the interests of the local authorities in maintaining a visible if reduce role in local employment promotion and the importance of their contribution. Model 2 with its strict division of clientele and services according to the type of benefit received would hardly merit the name Job-Center. It is in fact close to the local option model that is being implemented in 69 localities. We assume that Model 3, the semi-integrated co-operative model, is the model of the future and it is the basis for Figure 6. The key question is then which placement services and programs should be integrated and how is co-operation between separate activities to be organized in the interest of the efficiency and effectiveness of the Job-Center and customer service.

As a rule, each partner bears the costs of the services they provide in the joint ARGE-organization. Thus the costs for active measures and placement are borne by the PES from general revenues of the Federal government and the local authorities bear the costs of the supplementary social services and counseling they provide. The new benefit (unemployment benefit II), except for the related housing subsidy, is financed by the Federal government. The housing allowance is still administered and financed by the local authorities. Their role in financing housing benefits is intended to give them a continued incentive for involvement in active reintegration measures for the long-term unemployed, although they are no longer required to participate in

Figure 6. Model of Job-Center with Arbeitsgemeinschaft (ARGE)



Source: Adapted C. Reis/H. Brülle 2004, ISR Frankfurt a.

the financing of the new unemployment benefit II for this target group.

A total of around € 10 billion was foreseen in the 2005 Federal budget for active reintegration measures (€ 6.35 billion) and personnel and administrative costs (€ 3.30 billion). The regional allocation of the reintegration budget is based on the gravity of the labor market situation as measured by ratio of projected unemployment benefit II recipients to the labor force. The resources for personnel and administration are distributed according to the number of needy households in the district.

A peculiarity of the financing of the German sys-

tem of labor market policy is that not only unemployment benefit but also active measures are financed not from general revenues but from payroll taxes earmarked for financing the Federal Employment Service. This principle has been perpetuated in the Job-Center model in that the two client streams (SGB III - insurance beneficiaries & SGB II - means tested beneficiaries of the new unemployment benefit II) are financed from separate budgets. This means that the PES' activities in the Job-Center (PES service center for + ARGE) are divided into two financial and budgetary systems — one for PES funds drawn from unemployment insurance contributions for UB I clients and one from general rev-

enues of the Federal government for UB II clients.

An unemployed person with recent work experience typically exhausts regular unemployment benefit after 12 months (for older works 18 months) and thereafter would, if eligible, receive the means-tested unemployment benefit II. In order to give the PES an incentive to provide services to unemployed with labor market handicaps the PES is required to pay the Federal government from its own budget an “exclusion contribution” (Aussteuerungsbetrag) for every client that exhausts unemployment benefit I and within three months thereafter becomes eligible for unemployment benefit II. The amount to be paid on a quarterly basis is equal to the average costs incurred for an unemployment benefit II client in the past year.

## 5. Preliminary Assessment

Since the Job-Center will only become fully operational in the course of 2005, we can at this point in time only assess its broad design features. Still a number of potential strengths and risks are apparent:

1. The focus of the reform is on the governance or mode of implementation of labor market programs and not on innovation in programs with a regional development focus. The Job-Center reform is primarily aimed at resolving a structural problem of fragmentation in the delivery system between the employment promotion activities of the PES and those of the local authorities for the long-term unemployed. The institutional merger in a formal, co-operative structure (the Arbeitsgemeinschaft) was necessary after a voluntary and cooperative approach had failed.
2. Although there are a number of new and innovative programs like the Placement Voucher and the PSA temporary work agencies for the unemployed, they are not yet of any quantitative importance. The most important shift in the program portfolio has been away from expensive temporary public employment programs in ‘real’ jobs towards ‘workfare’ (“one-Euro-Jobs”), in which unemployment benefit II recipients are expected to work up to 30 hours per week for a small hourly supplement to their benefit payments.

This was previously only selectively practiced in local social assistance agencies but not by the PES.

3. The Job-Center with its the new ARGE, a joint front and back office in which the partners (PES and social agency) retain their separate identities, may actually reinforce the basic pattern of a centralized labor market policy within a national organization (the PES) since the role of the local authorities in employment promotion is now reduced to provision of auxiliary services. Although Germany has a strong federal system of government, decentralization of responsibility for labor market policy to the Bundesländer or states, was not seriously considered as an option. At best decentralization takes place in the context of management decentralization in a system of management by objectives.<sup>11</sup>
4. The Job-Center reform of local employment policy governance does not address the problem that PES employment promotion treats unemployment primarily as an individual problem rather than one of regional economic development. The recommendation of the Hartz Commission that the 10 regional offices of the PES should become “Competence Centers” for promoting regional employment and economic development were not adopted. The limitations of this supply-side approach are most apparent in Eastern Germany, where large amounts of funding have been channeled into labor market programs that have had little longer-term impact on the employment prospects of participants or on regional economic development.
5. There is a risk that the Job-Center will perpetuate the structural problem in active policy it was supposed to overcome: a division of labor based on the type of benefit received rather than on the labor market needs of clients. What is needed is a common port of entry that steers clients toward appropriate services based on initial screening, but the design of the Job-Center appears to segment clients primarily by the type of benefit for which they are eligible. In fact many unemployed not eligible for unemployment insurance have

<sup>11</sup> Mosley 2003.

relatively good labor market prospects (e.g. youth – especially those with higher education – women reentering the labor market, highly qualified immigrants) and some unemployment benefit recipients may face a high risk of long-term unemployment (e.g. older displaced workers). How in practice the Job-Center copes with this heterogeneity in its respective clientele remains to be seen.

6. The division of the Job-Center into two organizational units based on benefit entitlement rather than on their service needs could entail a great deal of inefficient duplication between programs under the auspices of the PES Service Centers (Kundenzentrum) and similar activities by PES in the ARGE, unless cooperative solutions are found, for example, joint planning of programs for both clientele groups. Necessary co-operation is at least rendered more difficult by the fact that services for the two types of clients are financed from separate budgets.

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