

Discussion Paper

**German Self-Employment Programmes
for the Unemployed**

**Contribution to the
European Employment Observatory**

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by
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Introduction

By the 1980s Germany had already introduced a policy to promote self-employment among unemployed people. Being an exemption at that time, the instruments were refined and extended and became the most important parts of active labour market policy of today. In particular the Hartz-reform for “modern labour market services” promoted these developments. These ideas were strongly based on the theory of transitional labour markets which puts the focus of policy action on the rising risk of transition. The switch into self-employment is such a period of high risks.

The following report reviews the existing knowledge about the programmes and presents some preliminary assessments.

Features of the self-employment programmes

Germany actually applies three policy instruments to promote self-employment among unemployed people:

- A transition benefit (Überbrückungsgeld; § 57 SGB III) which provides financial support for six months to unemployed people becoming self-employed;
- A business foundation grant (Existenzgründungszuschuss; § 421 I SGB III; named „ICH-AG“¹) which supports unemployed people for up to three years with low and decreasing benefits;
- An entry benefit (Einstiegsgeld; § 29 SGB II) which provides help for recipients of the new complementary unemployment benefit (Arbeitslosengeld II).

The first two benefits are provided by the Federal Labour Office financed with unemployment insurance resource. The third one was introduced by January 2005 as part of the “Hartz-IV” reform. It is funded by Federal and communal budgets. As no detailed results are yet available for this, the report will concentrate on the first two instruments.

Both benefits are provided to registered unemployed persons or participants of job creation programmes (Table 1). While the business foundation grant is means-tested (maximum annual income from self-employment 25,000 €), the transition benefit is not. However, the transition benefit is only paid for six months, and the business foundation grant is given for up to three years (with sequential grant periods of 12 months). The two programmes also differ by the level of benefits: the transition benefit includes the previous unemployment

¹ The direct translation is „me-plc“, and means an individual working as a business company. The notion does not indicate any legal construct of a firm.

benefit plus a flat-rate contribution to social security premiums (in general 65 per cent of unemployment benefits). Social security insurance is not obligatory. The business foundation grant is a flat-rate benefit with 600 € per month in the first year, 360 € in the second and 240 € in the third year. Social security is compulsory and has to be paid by the beneficiary.

The persons can choose between the two benefit schemes. As a general rule, unemployed people who receive higher benefits and expect a rapid increase of income above the limit of 25,000 € per year will select the transition benefit while people with low benefits and low income expectations will select the business foundation grant (*Koch, Wießner 2003*).

Table 1 **Features**

	Transition benefit (Überbrückungsgeld §57 SGB III)	Business foundation grant (Existenzgründungszuschuss §421 I SGB III; ICH-AG)
Requirements	<ul style="list-style-type: none"> • Entitlement for unemployment benefits (Arbeitslosengeld I) or participation at job creation programme • Self-employment intended as main activity • Professional assessment of business plan 	<ul style="list-style-type: none"> • Entitlement for unemployment benefits (Arbeitslosengeld I) or participation at job creation programme • Self-employment intended as main activity • Professional assessment of business plan (since 2005) • Annual labour income up to 25,000 €
Benefits	<ul style="list-style-type: none"> • Monthly benefit equals the unemployment benefit plus a lump-sum social insurance contribution (65 per cent of unemployment benefits in general) • Benefits are paid for 6 months 	<ul style="list-style-type: none"> • Monthly benefits of 600 € in the first year, 360 € in the second year, and 240 € in the third year • Benefits are paid for three years at the maximum, but are granted sequentially for 12 months

Social insurance	<ul style="list-style-type: none"> • Social insurance is the responsibility of the beneficiary. No obligation to enter public social insurance. • The benefit is free of taxes; self-employed incomes are due to normal taxation. • Remaining entitlements to unemployment insurance can be claimed within 4 years. 	<ul style="list-style-type: none"> • Compulsory membership in public social insurance. • Health and social care insurance are granted at preferential rates • After the support period social insurance is the responsibility of the beneficiaries • The benefit is free of taxes; self-employed incomes are due to normal taxation. • Remaining entitlements to unemployment insurance can be claimed within 4 years.
Limitations	<ul style="list-style-type: none"> • Benefits are not paid for cut-off times or periods in which other social benefits are granted. • Beneficiaries cannot apply for additional funding before 24 months after the end of the payment period 	<ul style="list-style-type: none"> • Benefits are not paid for cut-off times or periods in which other social benefits are granted. • Benefits are not paid if the annual income of the previous year exceeds 25,000 € Granted benefits have not to be reimbursed. • Beneficiaries cannot apply for additional support before 24 months after the end of the previous payment period • The validity period of the law is limited to 31.12.2005.

Beneficiaries of the business foundation grant are given preferential premiums in public social insurance. Nevertheless, the minimum monthly rate for pension, health and social care insurance is 388 € in eastern and 425 € in western Germany (*BMWA 2005*). Great parts of the benefit therefore have to be used to fund social insurance costs. Beneficiaries of the transition benefit are free from public social insurance but also have to fund social insurance out of their own resources. For both schemes the return to unemployment insurance is only possible if existing entitlements were not fully used. The remaining entitlement periods can be claimed within four years as far as the requirements for unemployment benefits are fulfilled.

Objectives

The two instruments have the same target group of unemployed people intending to become self-employed but they address different targets. While the transition benefit primarily aims at raising the employment rate and thus maintaining the employability of unemployed workers, the business foundation grant targets exploiting the demand for low-cost services and restricting the black economy.

Transition benefits were justified in the 1980s by the argument that unemployed persons intending to become self-employed will be confronted with severe barriers on the capital and product markets (Wießner 2001). The benefits were therefore paid for subsistence needs of the self-employed during a transition period. It was not intended to substitute various public business foundation subsidies and was therefore paid in addition to these programmes.

However, the transition to self-employment was not the main task of labour market services, thus transition benefits were an exception rather than a regular instrument of active labour market policy. This has changed with the new approach of the Hartz Commission developing all bridges to the labour market. The intention was and is to raise the overall employment level through directly extending the number of self-employed persons and indirectly creating additional jobs by these new entrepreneurs.

It was the idea of the Hartz Commission to suggest the "ICH-AG" as a pre-stage to self-employed business (Hartz 2002, p. 163). The Federal Government followed these ideas and implemented the business foundation grant (Existenzgründungszuschuss) in 2003. Based on the argument that Germany has five million black-economy workers and a great demand for household services provided by the black economy, a legal form of small-scale self-employment was recommended. The great potential of low-cost services should be used to open a bridge to full-scale self-employment. With compulsory social insurance and declared incomes, parts of the black economy should be transferred into an official business. It was suggested to support this business by low income tax rates, simplified tax reporting rules, and tax-deduction of household services for private customers.

Both instruments therefore follow three principal ideas:

- Unused market potential should be exploited by promoting the entrepreneurial potential of unemployed people being able to create their own and preferably additional jobs. Thus structural transition of the German economy should be fostered with positive growth and employment effects, in particular in service sectors.

- Social insurance budgets should be improved by increasing the amount of legal low-income jobs at the expense of the black economy. Even at low tax rates the extension of the legal economy in low-income areas could positively contribute to public revenues.
- Unemployment should be reduced through opening the labour market for marginal jobs with low-volume (low-income) self-employment and marginal dependent employment in the form of “Mini-Jobs”. The introduction of the business foundation grant therefore has to be seen in connection with the more liberal legal regulation of “Mini-Jobs” and the suspension of the restrictive regulation on “quasi-self-employment”.

Implementation

Both programmes are part of active labour market policy in Germany and run by the Federal Labour Office (Bundesagentur für Arbeit). As only unemployed people eligible for regular unemployment benefits (Arbeitslosengeld I) can be supported, no other institutions are involved.

The benefits are obligatory as far as unemployed people fulfil the requirements. This means that unemployment insurance has to pay the benefits on demand disregarding the budgetary situation of unemployment insurance.

Performance and achievements

In May 2005 the stock of beneficiaries of the two programmes was 330,000, 93,935 participants in the transition benefit programme and 235,936 in the business foundation grant. In relation to total unemployment in May 2005 the programmes' share is 7 per cent. Measured by the number of participants the two programmes are the most important part of active labour market policy in Germany. Early estimates of the potential for self-employment among unemployed people came to much lower figures. About 3 per cent of all unemployed persons were expected to look for a self-employed activity (*Pfeiffer 1999*).

In 2004 2.9 billion € were spent through the two programmes (1.8b € for the transition benefit and 1b € for the business foundation grant).

The number of entries into the programmes increased continuously until 2004. In particular, the entries into the business foundation grant doubled within a year. By the beginning of 2005 the number of participants decreased in both programmes due to changes in unemployment insurance regulation.¹ The

¹ The new regulation under the so-called “Hartz-IV-Act” separates between unemployment insurance benefits (Arbeitslosengeld I) and complementary unemployment benefits (Arbeitslosengeld II) which merged the former unemployment aid and social welfare benefits to basic income for job seekers. While the first one is financed through unemployment insurance, the second is funded by Federal and communal budgets.

restriction of the programmes to regular unemployment insurance (Arbeitslosengeld I) reduced the number of eligible unemployed people considerably. Moreover, the anticipation of the programme changes triggered a run to the programmes – to the business foundation grant in particular – by the end of 2004.

Table 2 **Yearly entries**

Year	Transition benefit	Business foundation grant
2001	95,000	
2002	121,000	
2003	158,000	86,000
2004	181,000	164,000
2005	168,000*	121,000*

* estimate on the basis of Jan-May 2005

Source: Bundesagentur für Arbeit, Economix.

Early investigations of the socio-economic structure of unemployed people considering self-employment showed more similarities to the characteristics of the self-employed than those of employees. More men than women were among them and more master craftsmen than craftsmen. While in the early 1990s the group considering self-employment among unemployed people was similar to employees, the rise of unemployment levels raised the attractiveness of self-employment. The selection rules of potential entrepreneurs amongst unemployed people changed as the transition to self-employment was opened more widely. The changes are also addressed in the introduction of the transition benefits which reduced the financial risks of an “entrepreneurial adventure” (Pfeiffer 1999).

Evaluation of transition benefits

The evaluation of the transition benefits undertaken at the Institut für Arbeitsmarkt- und Berufsforschung (IAB) by Wießner (2001) came to very positive results compared to other ALP-programmes:

- 70 per cent of the participants were still self-employed three years after passing the programme. The survival function was linear in relation to time, and it was very similar to foundations of non-unemployed business founders. Further 13 per cent of participants were employed in a new dependent job, 11 per cent were unemployed, and 6 per cent were in training measures and other ALP schemes.

- 45 per cent of the new entrepreneurs employed additional workers; on average one additional job was created by every beneficiary.
- 50 per cent of the new companies were profitable in the first year, 66 per cent in the second year and 74 per cent in the third year.
- For 1/3 of the participants incomes were higher than before, 50 per cent had lower incomes.
- Average weekly working hours increased by 10 hours.
- Individual perspectives were positive: 87 per cent wanted to remain in their self-employed position; 31 per cent expected rising turnover of their company, only 8 per cent expected a decline;
- Only 5 per cent had no health insurance and 13 per cent did not pay pension insurance premiums.

Many of the founders changed their sector of activity leaving agriculture or manufacturing and entering trade, insurance, and other services sectors. Thus the programme contributed to restructuring of the German economy. Occupational mobility was partial rather than total: 30 per cent continued their former profession, 56 per cent changed their occupational activity in part, 15 per cent in total.

Deadweight losses were not significant. Only 14 per cent of the beneficiaries would have taken their step into self-employment even without public support, 44 per cent would have realised their plans with time lags or lower volume, and 42 per cent would not have become self-employed without the benefits.

Among various success factors, some were particularly important:

- vocational training as blue collar workers and a leading position as master craftsman (Meister) were highly significant for the success;
- The external assessment of the business plan was very important;
- The volume of the seed-capital was important;
- Married founders and those living in partnerships were more successful than singles;
- Older workers (55+) were less successful than younger workers;
- Foundations by men were more successful than those of women;
- The duration of unemployment spells negatively affected the success rates;

Most interestingly, a former management experience negatively affected the success rate as did former self-employment. This is addressed as a negative selection effect as these persons became unemployed in their former position. This indicates the possibility of a failure in their previous job.

The advantage of the instrument is the target group oriented approach which selects potential entrepreneurs among unemployed people rather than a broad reduction of unemployment. Therefore, the positive selection of entrepreneurial characters among unemployed people strongly explains the success of the programme.

Business foundation grant

While the evaluation of the two programmes is currently undertaken by a research group including the IAB, first results on the performance of the business foundation grant are only available from an investigation of drop-outs by Wießner (2005). Following this report, 18 per cent of the participants left the programme in 2004. These persons chose the programme because

- It was financially superior to transition benefits (61 per cent of respondents)
- It was recommended by the placement officer or consultants (40 per cent)
- It allowed an unbureaucratic entry (35 per cent) and – in 2004 – there was no obligation to establish a business plan (24 per cent).
- Regular unemployment benefits expired (10 per cent)

This indicates that the drop-outs selected the programme mainly on financial considerations and easy entry rules. These results are certainly not representative for the participants but they reveal that the programme was not targeted sufficiently to block such entries. With the new regulation in 2005 all applicants therefore have to provide a business plan.

The drop-outs ended their self-employed activity due to lack of orders (57 per cent) and/or lack of financial resources (48 per cent). Moreover, 20 per cent underestimated the cost of obligatory social insurance. One out of six evaluated the entrepreneurial idea with greater scepticism than before.

The investigation showed that self-employment was undertaken with strong commitments. For more than half of the drop-outs the activity was a full-time job, and only 5 per cent had a second job. Similarly, 56 per cent were experienced in the business from a previous job, and one third was burdened with credit obligations connected to the business.

These results confirm the impression that the recommendation to become self-employed and the support of such a re-direction of activities should not be made too easy and requires critical assessment not only of markets but also of the personal profile of beneficiaries. Without anticipating the results of the forthcoming evaluation, some scepticism seems to be justified making the entry to self-employment too broad and too easy.

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