

Discussion paper

EUROPEAN EMPLOYMENT OBSERVATORY  
GERMANY

The ambivalent life with labour market reforms

Quarterly review of labour market trends and policies  
1<sup>st</sup> Quarter 2006

by

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## Glossary

Agenda 2010	Principal economic and social reform programme of the SPD-Bündnis90/Die Grünen government coalition passed in March 2003
Hartz reform	<p>Reform of unemployment insurance under the Federal Employment Service (<i>Bundesagentur für Arbeit</i>) and active labour market policies, named after Peter Hartz, principal staff manager of Volkswagen and the president of “Hartz Commission” established by the German government in 2002.</p> <p>The reform has four parts:</p> <p>Hartz I (2002): introduction of public temporary work agencies (Personnel Service Agencies – PSA)</p> <p>Hartz II (2002): reorganisation of public employment services; mini-jobs, ICH-AG</p> <p>Hartz III (2004): restructuring of public employment services to the Federal Employment Agency</p> <p>Hartz IV (2005): merging of unemployment aid and social assistance to UB-II</p>
ICH-AG	Business foundation grant ( <i>Existenzgründungszuschuss</i> ; § 421 I SGB III) for UB-I recipients, which supports unemployed becoming self-employed for up to three years (1 <sup>st</sup> year: 600 € per month, 2 <sup>nd</sup> year 360 €, 3 <sup>rd</sup> year 240 €)
Job Summit	Agreement between red-green government and CDU/CSU opposition from 17 March 2005 on the principles of further labour market reforms.
Mini Jobs	<i>Geringfügige Beschäftigung</i> : Jobs with monthly incomes up to 400 €. These can be regular or occasional jobs and jobs in addition to regular employment. Employers pay 25 % of wages to social insurance.
Midi-Jobs	Registered employment with monthly wages between 401 and 800 € and reduced social insurance premiums.
National Training Pact	Agreement between the Federal Government and the employers associations to offer 60,000 additional dual training places in 2004, and another 30,000 in 2005.
1 € Jobs Auxiliary public jobs	Temporary jobs in the area of social and public services for UB-II recipients. They are remunerated by 1 or 2 € in addition to UB-II benefits. Jobs need to be for the public benefit and have to be additional to jobs in the premier labour market.
Rehabilitation benefit	<i>Eingliederungszuschuss</i> : a wage subsidy for employers who employ long-term or disabled unemployed. Subsidies are limited to 50 % of wages for 12 months. For disabled or older workers the limits are 70 % of wages for a maximum period of 24 months.
UB-I	<i>Arbeitslosengeld I</i> : Regular unemployment benefit
UB-II	<i>Arbeitslosengeld II</i> : Means-tested basic income for job seekers, paid after expiration of regular unemployment benefit

## Executive Summary

While the German labour market is still negatively affected by the weak economic performance of the past, the economy is already on the growth path. Growth rates of 1.6 to 1.8 % for 2006 and 1.0 to 1.2 % in 2007 will positively affect employment and reduce unemployment. Following the forecasts employment will increase by 0.3 % in 2006 and 0.5 % in 2007. The long-lasting decline of jobs registered by social insurance will come to an end and the growth of marginal jobs will be stopped. High growth rates are expected for self-employment. The Hartz reforms have a strong impact on employment performance through the creation of auxiliary public job (one EURO jobs) and supported self-employment (ICH-AG). In both measures the number of participants will continue to grow rapidly.

The waves of industrial disputes which were particularly high in 2006 are slowly calming down. The metal workers achieved a 3 % wage increase with additional lump-sum payments. Clinical doctors are close to the end of their seven weeks strike and similar signs are coming from the public sector negotiations with the Länder and municipal governments.

According to recent survey results, German citizens are determined by hope and fear as regards their future. There is a majority of the German population which is urging for further political reforms. Simultaneously, there is a majority which is scared about its economic prospects, social balancing and insufficient policy actions in the fields of health, pensions and education. Germans are very contented with their country but still have great sorrows about their future. They want a "social and achievement-oriented society".

The Federal Government took several decisions to carry on reform policies:

- An update of the Hartz IV reform is planned which should reduce overshooting expenditures through sanctions, stricter controls of beneficiaries, quicker placements and the reversal of the burden of proof for the non-existence of a partnership to the beneficiaries. This is expected to save 1.2 billion EURO out of the 28 billion budgets.
- A parent allowance will be introduced by 2007 which will support parents for 12 months with a benefit of 67 % of the last net income up to 1,800 EURO per month. The instrument particularly addresses higher income groups which have low birth rates. It was recommended by the expert group on the seventh governmental family report.
- The anti-discrimination legislation will be implemented after a long debate and will be extended to private mass-business affairs.

Within the reform policy debate, the instrument of combined wages (*Kombilohn*) was controversially addressed. While the government coalition plans to introduce this instrument, economic advisors point to the risk of uncertain employment effects and dead-weight losses. In particular if it is combined with a minimum wage regulation, the expected job creation effects might be limited.

## 1. Introduction

After the establishment of the new great coalition in Germany, governmental institutions were ameliorating existing programmes – the Hartz programme in particular – and extending reforms into other policy fields. This report therefore addresses both, the reforms of the reform and the new battle-fields of public debate. Two of these issues are described in more detail – family policies and the discussion about combined wages (*Kombilohn*).

## 2. Update on economic and labour market trends

### *Recent labour market trends*

*Employment:* The Federal Labour Agency reported in April that employment and unemployment were still affected by seasonal factors like the cold winter. At the level of 38.4 million employment is still below the previous year (-38.000). Employment registered by social insurance declined even more by 152.000 to 25.8 million. The pace of decline however decelerated.

*Unemployment:* Compared to the previous year, registered unemployment declined by 262,000 to the level of 4.8 million in April 2006. The improvement is also visible in seasonally adjusted unemployment figures which indicate a reduction by 40,000 from March to April 2006. The decline was particularly expressed in eastern Germany where a minus of 7 % was measured in comparison to the previous year. This was due to shrinking labour supply rather than rising labour demand. In western Germany the minus was 4 %. The unemployment rate was 11.5 % for Germany, 18.5 % for the eastern and 9.7 % for the western part. By ILO standards Germany had 3.72 million unemployed and an unemployment rate of 8.4 % in March 2006.

There were 1.7 million recipients of regular unemployment benefits (UB I) and 5.2 million recipients of UB II. 4.3 million of the recipients were registered unemployed. The others were actually not employable, in early retirement schemes or training measures.

*Incomes:* Only 39 % of the German population were living from labour incomes, following the latest Labour Force Survey for 2004 ([Statistisches Bundesamt 2006](#)). In 1991 these were 44 %. In particular the share among males living from work incomes declined from 56 to 47 %. Among females the share declined only by 1 percentage point to 33 %. An increasing part of the population has pensions as the major income source (25 % compared to 19 % in 1991). 3 % of the western population and 10 % of the eastern population live almost completely from unemployment benefits. Support by relatives is the main income source for 32 % in western Germany and 18 % in eastern Germany. 36 % of women are depending on family support and 25 % of men.

*Unemployment insurance:* The Federal Labour Agency (*Bundesagentur für Arbeit, BA*) achieved a budgetary surplus of 4.2 billion EURO since April 2005 (8 % of the 51 billion EURO budget). While the BA sees exceptional factors determining this result, the Kiel Institute for Economic Research (IfW) calculated a continuous surplus resulting in 6.2 billion EURO for 2006. This will be caused by savings through the Hartz reform. Further expenditure cuts can be expected from benefits reductions for UBII-recipients who do not accept job proposals. A principal agreement was achieved on that point by the government coalition. This will reduce expenditures by 1.2 billion EURO.

*Economic forecasts*

The prospects for economic development in Germany are becoming brighter. After 0.8 % GDP growth in 2005, the majority of forecasters expect 1.8 % for 2006 and 1.2 % for 2007 (Table 1). The pessimists are the public institutions, the Federal Government and the EU Commission who expect 1.6 or 1.5 % for this year. For 2007 the Federal Government calculates with 1 % growth.

**Table 1 Economic forecast for 2006 – Germany**

Institution	Date of publication	GDP (% change to previous year)	Employment (% change to previous year)	Unemployment Rate (%)
Federal Government	April 06	1.6	0.1	-
Economic Research Institutes	April 06	1.8	0.3	10.6
RWI (Rheinisch-Westfälisches Institut für Wirtschaftsforschung)	April 06	1.8	0.4	10.4
IMK (Institut für Makroökonomie und Konjunktur)	April 06	1.7	0.4	8.1
IWH (Institut für Wirtschaftsforschung Halle)	March 06	1.7	0.2	10.7
IfW (Insitut für Weltwirtschaft)	March 06	2.1	0.4	10.9
European Commission	February 06	1.5	-	-
DIW (Deutsches Institut für Wirtschaftsforschung)	January 06	1.7	-	-

Source: Economix

The forecasts are strongly determined by the expected effects from the tax reform, the VAT increase from 16 to 19 % in particular. This will shift private consumption and housing investment into the year 2006 at the expense of 2007. The overall effect of the budgetary measures (including VAT increase by 3 percentage points, the decrease of social contributions by 1.3 percentage points, and the public expenditure programme “Incentive for growth, employment and families”<sup>1</sup> is expected to be largely neutral on economic growth but positive on budgetary balance (ARGE-Institute 2006).

According the Association of Economic Institutes in Germany (ARGE-Institute), employment can be expected to increase by 0.3 % (106,000) in 2006 and 0.5 % (184,000) in 2007 (Table 2). The long lasting decline of jobs registered by social insurance will come to an end. A plus of 0.4 % (102,000) is forecasted for 2007. The number of self-employed people will continue to grow by approximately 2 % in both years. Marginal employment will shrink by 0.5 % (22,000). Public employment programmes – auxiliary public jobs and publicly promoted self-employment – will significantly contribute to the increase of employment. Unemployment will decrease by 5.8 % in 2006 (-281,000) and 3.1 % in 2007 (-140,000) in 2007. This will lower the unemployment rate by 1 percentage point to 10.2 % until 2007.

<sup>1</sup> See Economix (2006): Quarterly EEO report IV/2005, page 6.

**Table 2 Labour market forecasts for 2006 and 2007 – Germany**

	2005	2006	2007
	Million	% change to	previous year
Persons employed	38.78	0.3	0.5
registered by social insurance	26.24	-0.1	0.4
marginal employment	4.75	-0.1	-0.5
auxiliary public jobs (1 € jobs)	0.23	39.1	11.8
self-employed	4.36	2.0	1.8
publicly promoted self-employment (ICH-AG etc.)	0.33	4.6	6.7
Unemployment	4.86	-5.8	-3.1
<i>Unemployment rate (%)</i>	<i>11.2</i>	<i>10.6</i>	<i>10.2</i>

Source: ARGE-Institute (2006)

### 3. Labour market policy developments

#### 3.1. Policy actions

##### *Update of the Hartz IV reform*

The Federal Government decided to update the Hartz IV act by August 1 2006 through the following actions:

- *Rapid offers*: entrants into UB II should immediately be offered jobs or training courses in order to test their willingness to accept work. Until now these immediate offers could not be fully realised in practice.
- *Sanctions*: UB II recipients will lose 60 % of their benefits if they do not accept a job or training offer for two times within a year. This will also affect rent allowances.
- *Reversal of the burden of proof*: Until now local authorities have to prove where applicable that UB II recipients are living in non-marriage partnerships. In this case applicants would have to require income transfers from their partner. Now the burden of proof will be on the side of the applicants.
- *Control*: All local job centres will have to establish field services that control the living circumstances of UB II recipients. Moreover, matched sets of administrative data will be used to restrict benefits abuse.

The government expects to save 1.2 billion EURO annually through these measures. For 2006 savings of 400 million EURO are calculated.

Until now total expenditure for Hartz IV exceeded the budgetary plans: In 2005 25 billion EURO were spent, 10 billion more than assumed at the beginning. For 2006 28 billion EURO are expected while 24.4 billion EURO are in the budget. The overshooting of expenditures particularly affects municipal budgets which take the major part of the additional rent allowances. 12.4 billion EURO was spent for this purpose in 2005 from which 29 % were financed by the federal budget.

##### *Parent allowance*

The government coalition agreed to introduce parent allowance (*Elterngeld*) by Januar 1 2007. This will be paid in addition to the existing child care allowance or other benefits (e.g. unemployment benefits). For a maximum period of 12 months the partner who takes care of the child will receive 67 % of the former net income. The monthly rates are 300 EURO per month at minimum up to 1,800 EURO. Non-active persons (housewives, unemployed etc.) receive the minimum rate. The period can be extended to 14 months if the male partner stays at home at least for 2 months. Part time employment up to 30 hours per week is possible. The allowance is tax free.

The parent allowance substitutes the existing upbringing allowance (*Erziehungsgeld*) which provided a benefit of 300 EURO per month for 24 months to the partner who left the job or reduced working hours. This allowance was means-tested (e.g. for a couple: 30,000 EURO in the year before birth) and income limits declined over the period of support.

Comparing the two instruments, the new parent allowance favours upper income earners which will receive substantially higher benefits. In particular double earners who exceeded the income limits of the upbringing allowance will now receive support. At lowest end of 300 EURO per month the sum over the total allowance period will be only half of what is actually paid.

The rationale behind this decision is the observation that women with academic education have significantly lower birth rates than women with lower grades. The reduction of the family income is seen as an important fact determining the child decision. The positive experience with parent allowance in the Scandinavian countries was another argument to introduce the benefit (BMFSFJ 2006).

### *Anti-discrimination act*

After a multi-annual debate the government coalition decided to submit the anti-discrimination act demanded by the EU Commission. While the inclusion of the EU regulations was undoubted it was now agreed to extend the law to so called mass business affairs. These are affairs which are typically offered without reference to individual persons (like the business of warehouses, banks etc.). Following the regulation, the discrimination of homo-sexual, disabled or older persons is forbidden. It is generally expected that the anti-discrimination act will considerably change recruitment practices of companies.

### *Industrial relations*

In metal industries the social partners agreed on

- An increase of wages by 3 % until March 2007
- A lump sum payment of 310 EURO which can be altered through an agreement with the works council in the range from 0 to 620 EURO, depending on the economic situation of the company.
- The agreement on property creation which expired in 2005 will be reinforced and provide 319 EURO per worker and annum for additional private or company-based pension funds.
- Qualification needs will be checked individually. For training which is not directly related to the activity, the workers will receive support for half of the training time.

The negotiations were accompanied by strikes for several weeks. The agreement was characterised as a victory for the trade unions. Employers regretted not being empowered to counteract the strike due to the high sensitivity of business performance to labour inputs.

Clinic doctors are on strike for seven weeks with continuous demonstrations of thousands of persons. The central claims of doctors are a substantial wage increase (+30 % was the initial demand) and working hours of 42 (individually up to 48 hours) per week. Moreover surplus hours (stand-by hours) should be recorded and remunerated. The situation in clinics is meanwhile difficult and clinics are strongly interested to terminate the strike.

The strike in the public sector through which trade unions want to avoid the extension of working hours to 40 hours per week at the Länder level is not yet terminated.



### 3.2. Public and scientific debate

#### *Reform policies in the public opinion*

German citizens are determined by hope and fear as regards their expectations for future reforms of the political system. The recent population survey "[Perspektive Deutschland](#)"<sup>2</sup> reported that 61 % had the opinion that up to now political reforms were not sufficient: 83 % are for a better awarding of personal efforts and 54 % plead for less state and more individual risk taking. For 72 % ambitions and diligence are core values and the majority admits to life-long learning. However, a majority also urges for more social balancing and wants the government to act more efficiently in the fields of health, pensions and education. The labour market is the most important issue for which 75 % see urgent needs for political action. 60 % expect a deterioration of their financial position in the future and 58 % expect not being able to cover the cost of living and health care when they will get old. Every second German is scared about his job.

#### *Families*

The Federal Government published its comment to the [seventh family report](#) in April 2006 together with the decision to introduce the parent allowance. This report was demanded by the parliament and was elaborated by an expert team of seven academics since 2003. The principal theses of the report are that families are a stable institution in the German society but in a process of continuous change. The understanding of family roles of the young generation significantly differs from the older generation. However, politics did not adequately respond to these changes. This is underlined by the assessment that other European countries were more successful in promoting families and births than Germany without spending more money.

Following the report, German women have rather short periods to decide on the foundation of a family after terminating training. Due to long training periods academics are faced with particularly short "rush hours of life". With the withdrawal of many young women from the labour market, German families experience strong fluctuations in their economic position, in particular when children are born. This leads to the recommendation to introduce a parent allowance. Family policies have to promote the adjustment to a new family paradigm where task sharing of family work between men and women is more balanced, new patterns of work and family care can be practised, and the infrastructure for child care is extended. The Federal Government sees the report as a confirmation of its policy decisions.

The population survey „Perspektive Deutschland” contains a separate chapter on families which indicates that a wide gap exists between the wish to have children and the children that are born. Almost 90 % of the young Germans want or have children. On average per women 1.9 children are desired, however, only 1.4 children are born. Women with academic education want to have 1.8 children on average, but only 1.3 children are born. Women with lower education have 1.7 children.

The reason for the low number of children is deeply rooted. 53 % of the childless persons aged 20 to 39 are satisfied not having children. Parents at the same age see high costs of child care, missing child care facilities and disadvantages in their professional career as the most important impediments. A majority of 57 % urgently demands for the extension of kindergarten or day-care facilities. Two thirds of the German population think that the government should give direct support to families while half of them prefer the extension of care facilities.

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<sup>2</sup> See Section 4

According to the survey, the parent allowance will be most effective among parents who are inclined to have children but not among those who took a decision against children. In the first group the allowance might positively affect births for 39 % of the respondents. Particularly academics can be expected to react (49 %). In the second group the response is only 20 %.

As reported by [social budget](#) statistics, public institutions spent 101 billion EURO for families in 2004. These are 4.5 % of GDP. The recent calculations of the Kiel Institute summed up 240 billion EURO of family-related expenditure in 2005, including tax preferences, cost free education and health insurance for children and other direct or indirect transfers ([Rosenschon 2006](#)). More than 100 measures were counted to promote families.

### *Kombilohn*

Combined wages are part of active labour market policies in Germany e.g. through the instrument called "Midi-Jobs". For jobs within the income limits of 400 to 800 EURO per month social contribution rates for employees are slowly rising from 4.1 % to 20.8 % while employers have to contribute 20.8 % for all jobs. This was introduced to avoid marginal tax rates of 100 % for workers who had a "Mini-Job" below 400 EURO before. Moreover, a set of model projects was initiated in recent years to test the effects of combined wages (e.g. Mainzer Modell).

The government now raised the debate on combined wages (*Kombilohn*) with alternative suggestions. In principle, transfers are planned for workers in low-paid jobs in order to make a greater number of such jobs profitable and to improve the attractiveness for workers and unemployed. These transfers can either be given directly to workers, as subsidies to employers or indirectly through the reduction of social contribution rates. From the latter alternative workers and employers would profit at nearly equal shares. According to the government's plans, decisions will be taken in May and submitted to the parliament in autumn.

The social contribution variant was specified by the government of Lower Saxony in the following way: For a maximum period of 10 months employers should receive 400 EURO per month and workers 200. Employers would have to pay at least the lowest collective wage. The CDU is strongly interested to concentrate the allowance on long-term unemployed in the age groups below 25 and above 50. In these groups are 1.9 million unemployed with a share of approximately 40 % long-term unemployed. The allowance will be financed through budgetary items for long-term unemployed comprising 6.5 billion EURO in 2006.

SPD and trade unions are concerned about the negative wage effects of the subsidies and therefore suggested to introduce minimum wages in Germany.

The German Institute for Employment Research (IAB) analysed existing and planned models for combined wages and came to a sceptical but nevertheless positive conclusion ([Dietz, Koch, Walwei 2006](#)). The reduction of social contribution rates for low income earners could be a first step which would create additional jobs and improve the labour market position of less competitive workers. Combined wages are associated with positive labour supply and demand effects. Labour supply can be expected to grow due to higher net wages for workers. Labour demand will be positively affected if transfers are provided unlimited. Fixed-term allowances will be anticipated by the actors and might lead to crowding-out effects for non-subsidised workers. Unlimited allowances are expected to have stronger labour market effects but high financial risks due to dead weight losses. Combined wages will develop their effects only in the long-run but are seen as a practicable instrument to support labour market entries.

The advisory board to the Federal Ministry of Economics and Technology recently entered the debate on combined and minimum wages with a strongly negative statement

(Wissenschaftlicher Beirat beim Bundesministerium für Wirtschaft und Technologie, 2006). Combined wages will have considerable dead-weight losses and are therefore a substantial financial risk. The taxes arising from the creation of additional jobs will probably not compensate the losses through the wage subsidies. In addition, if wage subsidies are combined with minimum wages the job creation potential will be cut. The “risky financial instrument” of combined wages would be linked to an “economically damaging instrument”. The advisory board underlined the warning in a letter to the Minister and recommended the proposal of an “activating social assistance” which achieves rising employment in the low wage sector through lower collective wages.

#### 4. Recent labour market reports

*Fassbender H., Kluge J. (2006): Perspektive Deutschland. Was die Deutschen wirklich wollen. (Perspective Germany. What Germans really want) Econ Verlag, ISBN 3-430-12671-1*

The report presents the result of the most recent online-survey undertaken among the German population. The survey was organised by the consulting company Mc Kinsey, the public TV station ZDF, the STERN magazine and the web portal WEB.DE. It was conducted from October 2005 till January 2006 as an online-survey with 620,000 interviewees. In addition to internet-users 2400 persons were interviewed personally.

The focus of the 2005/06 survey was on reforms in Germany expressed by the question “Where to go Germany?” In two sections the interviewees could express their opinions: in the first section through general assessments of the present situation, the changes wanted and the strengths and weaknesses of the country. In the second section specific reform projects were addressed: labour market, economy, social security, family, education. The results are deeply classified by regions.

The findings are summarised as follows:

- Germans want a “social achievement-oriented society”
- Citizens are inclinable for reforms and have corresponding expectations to the new government
- Citizens are very contented with their country, are less pessimistic compared to the previous year but still have great sorrows about the future
- In the most important policy area “labour market”, people are ready for more flexibility and abandonment
- For public pensions people accept more individual contributions but expect the government to do more on health care
- A wide gap between wish and reality is discerned in the fields of family and children
- A stronger achievement orientation is demanded for the education sector – from kindergarten to universities.

*Sachverständigenkommission Siebter Familienbericht (2005): Familie zwischen Flexibilität und Verlässlichkeit – Perspektiven für eine Lebenslaufbezogene Familienpolitik. Siebter Familienbericht. (Seventh Family Reprpt: Family between flexibility and reliability – perspectives for a family policy oriented towards individual histories) Bundesministerium für Familie, Jugend, Senioren, Frauen und Jugend. [<http://www.bmfsfj.de/Politikbereiche/familie,did=75160.html>]*

On demand of the Deutsche Bundestag the former Federal Government initiated the seventh family report in 2003. The expert commission of seven academics worked on the report in continuous dialogue with social groups, the welfare associations, churches and social partners in particular. The report contains a comprehensive analysis of the changing role of families and the assessment of family politics in Germany with reference to European benchmarks.

The report can be grouped into four major areas:

- The comparison with other European countries regarding the development of families and family politics
- The dynamics of the role of families
- The consequences for urban development
- The future of families

The problem of the low number of children is addressed to a series of factors:

- The high share of women without children and the low number of families with several children.
- The long education and training periods which leaves only short periods for the foundation of a family. This is particularly short for academics. A parent allowance would extend this period into working life.
- The lack of a consequent policy for equal opportunities of men and women which leads to a significant competitive disadvantage of women on the labour market.

A combination of newly designed financial benefits, a new policy of life-time, and the improvement of child care facilities is seen as the adequate political response to the problems.

In its [official comment](#) to the report in April 2006 the Federal Government confesses that other European countries like France or the Scandinavian countries had more success with their family politics without spending more money. As the report points to the financial loss associated with the birth of a child, the government concludes that the suggested parent allowance is the correct answer. Moreover, the combination of this policy measure with the tax allowance for child care expenditure and the extension of child care facilities address the central issues of an effective family policy identified by the report.