

Discussion paper

**EUROPEAN EMPLOYMENT OBSERVATORY
GERMANY**

**Self-employment programmes for unemployed
- a successful programme updated**

by

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1. Introduction and objectives

Public support of self-employment has a long tradition in Germany. The social market model perceives entrepreneurs as important actors to adapt the economy to changing markets, promote innovation and sustain competitiveness. Many programmes have therefore been developed over the decades to support business foundations through consulting services and financial resources, research and development co-operations, preferential treatment in labour and tax regulation etc. SMEs in general and craft-related businesses in particular are a special concern of economic policies in Germany.

The approach fostered by the Hartz Reform was the promotion of business foundations for unemployed persons. Based on former positive experience with such programmes, not only the scale of the programmes was extended but the target group was defined much wider: small-scale businesses – even self-employment without employees – were promoted. The former focus on crafts and trade related businesses shifted towards services in general.

Self-employment programmes emerged as an important bridge from unemployment to sustainable economic activity. Evaluation results came to positive results regarding re-integration effects and budgetary efficiency. However, is this bridge also the way to rising and sustainable income? The question raised by this report refers the income effects among participants.

2. Organisation, implementation and funding

Under the label "ICH-AG" – the "solo-company" of self-employed without employees – the Hartz Reform suggested extending the transfer from unemployment to self-employment. The idea was to place unemployed not only in dependent jobs but to use their competences for business foundations. Facing limited labour demand from existing companies, unemployment insurance could help during the transition period to found a new business.

This idea was strongly related to the theory of transitional labour markets. Labour market policy should address the critical transition periods of workers rather than supporting regular pathways. Moreover, the existing transition allowance (*Überbrückungsgeld*) proved to be a successful programme which was already strongly accepted by unemployed persons. However, the idea of the ICH-AG did not survive for long as the budgetary effects appeared to be negative and self-employment was not sustainable enough.

From August 2006, a new regulation was put into force which combined the ICH-AG and the transition allowance to the business foundation allowance.

2.1. Transition benefit

Already 20 year ago, the idea of a transition subsidy for unemployed who wanted to become self-employed was promoted by the Federal Labour Office (*Wießner 2001*). The programme did not only survive under a series of regulations but its principles proved to be successful until now. Unemployed could receive a foundation subsidy for a limited transition period without losing their unemployment benefits claims. Residual entitlements could be preserved for a maximum period of four years. The withdrawal rate was zero and founders had the possibility to return to unemployment insurance in case of failure.

Benefits were paid for a period of six months at the level of the previous unemployment benefit plus social insurance contributions. In total these were about 70 % of the former net income.

Applicants had to submit a business plan which was testified by an external institution, like chambers, banks, tax consultants etc.

2.2. Start-up grant

The Hartz Commission suggested extending the transition benefit to a broad support of foundations on the smallest scale possible, the independent self-employed without employees. This became prominent under the label "ICH-AG".

Under this scheme – which was introduced in 2003 – beneficiaries with less than 25,000 EURO annual income were eligible to support for the maximum period of three years. The benefit was 600 EURO per month during the first year, 360 EURO in the second, and 240 EURO in the third year.

At the beginning, applicants were not obliged to present an approved business plan. This however was changed in 2004.

2.3. Business foundation allowance

From mid 2006 onwards the two programmes were merged. According to Social Code III, Article 57, a business foundation allowance (*Gründungszuschuss*) is paid to those unemployed who intend to become self-employed. The allowance is paid for nine months under the conditions that the person

- is entitled to unemployment benefits for a minimum period of 90 days (UB-I and UB-II). For UB-II recipients the allowance is named entry allowance (*Einstiegs-geld*).
- is able to demonstrate both, the ability to perform the activity envisaged, and the adequacy of the business plan. The latter has to be certified by chambers, business associations, banks and other institutions.

Self-employed activities – including freelance activities – are characterised by free disposal of working time and adoption of economic risks. It needs to be the main economic activity.

Payments are provided according to unemployment benefits with a supplement of 300 EURO which compensates social insurance contributions. The allowance is paid for additional six months if the beneficiary demonstrates the economic activity.

2.4. Funding

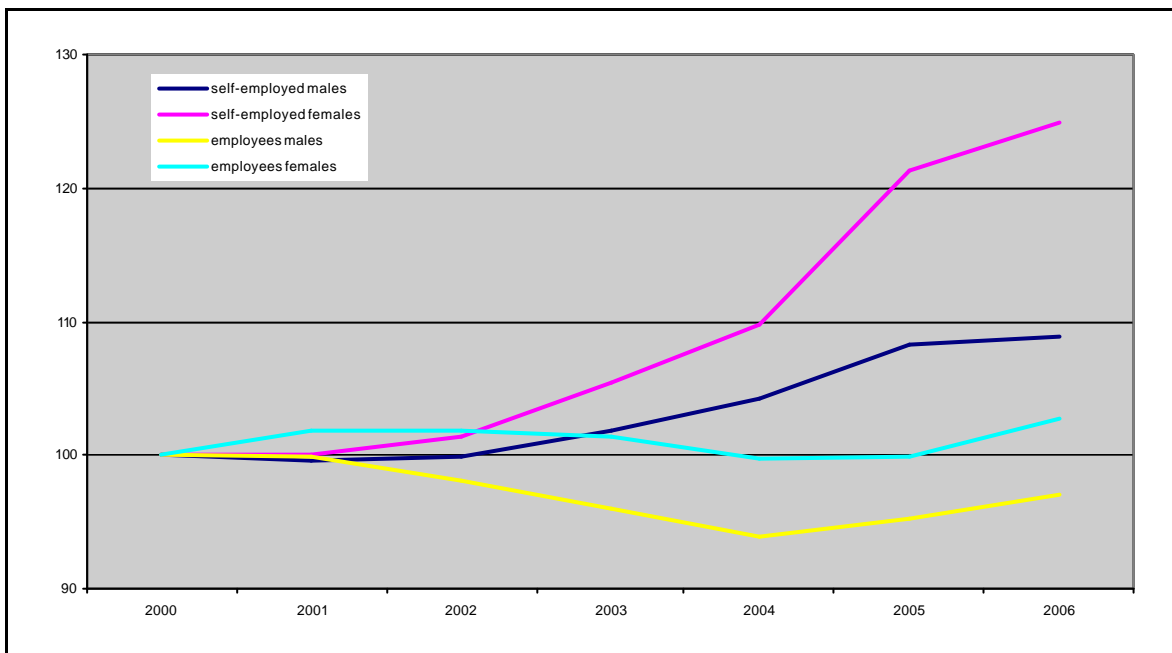
In 2007 121,924 persons used the business foundation allowance to raise their own business (91,000 persons on average over the year; see Table 1). 1.22 billion EURO were spent for this purpose (10,000 EURO per participant). In addition, 122,058 persons received the phasing-out start-up grant. 0.5 billion EURO were spent for this programme (4,100 EURO per participant). The transition benefit was almost closed with 3,000 participants in 2007.

3. Performance and achievements

3.1. Participation numbers

With the introduction of the support programme for unemployed the number of business foundations started to increase considerably (Chart 1). In particular the number of self-employed without employees achieved a maximum in 2005 which was 40 % above the level of 2000. Self-employment support became the most important part of active labour market policy in Germany. This can be attributed to both, the transition benefit and the ICH-AG benefit which experienced rapidly rising participation during these years.

Chart 1 Employment by status and gender
2000 = 100



Source: Statistisches Bundesamt.

After the reorganisation of self-employment support programmes and the introduction of the business foundation benefit, participation started to decline (Table 1). In 2007 participation in the start-up grant was only half the level of 2005 and can be expected to phase out in 2008. The business foundation benefit absorbs the target groups of the former schemes, the transition benefit in particular. Participation numbers reveal the unbroken attraction of these schemes among the unemployed.

Table 1 Participation in selfemployment programmes
Thousand participants on average per year

	2005	2006	2007
Business foundation allowance (<i>Gründungszuschuss</i>)	-	8	91
Transition benefit (<i>Überbrückungsgeld</i>)	83	63	3
Start-up grant (ICH-AG benefit; <i>Existenzgründungszuschuss</i>)	234	210	121
Total	317	281	215

Source: Bundesagentur für Arbeit.

3.2. Evaluation results

3.2.1. Transition benefit and ICH-AG benefit

Based on data until 2005, the evaluation of the two former measures came to positive results (*Caliendo 2007a*):

- Between 66 and 81 % of the beneficiaries were still self-employed 28 months after founding their business. Between 5 and 16 % were in registered employment, and 7 to 14 % were unemployed. These are impressive “placement rates” compared to other unemployment programmes.
- The founders created additional jobs: 32 % of males and 25 % of females among the transition benefit recipients had at least one employee. For start-up grants, the shares were 15 and 9 %.
- Compared to unsupported unemployed, the programmes had significant positive effects. Less of the participants were unemployed (the programme effect was calculated to 35 %). Strongly positive income effects were measured.
- Budgetary efficiency – calculated as the difference between costs and savings of unemployment insurance during the 28 months observation period – was particularly good for transition benefits. On average participants contributed to unemployment insurance budget between 244 and 2882 EURO. ICH-AG participants however burdened the budgets with amounts between 5,357 and 8,101 EURO.

The programmes had strong selection effects: The transition benefit was used by men in particular; 75 % of beneficiaries were males as compared to 60 % of the unemployed. They were better qualified and in the middle age groups. While this strongly differs from the unemployed, it coincides with the structure of founders in general.

The beneficiaries of the start-up grant, however, are much closer to the average unemployed. Their skills level is generally lower compared to the average founder and a higher share of women can be observed (48 %).

Former evaluations of the transition benefit (*Wießner 2001*) revealed that 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 % continued their former profession, 56 % changed their occupational activity in parts, 15 % in total.

Dead weight losses were not significant: Only 14 % of the beneficiaries would have taken their step into self-employment even without public support, 44 % would have realised their plans with time lags or lower volume, and 42 % wouldn't 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;

The advantage of the instrument is the target group oriented approach which selects potential entrepreneurs among the unemployed rather than targeting at a broad reduction of

unemployment. Therefore, the positive selection of entrepreneurial characters among the unemployed strongly explains the success of the programme.

Investigations on the start-up grant revealed that unemployed choose this programme mainly for financial considerations and easy entry rules.

3.2.2. Business foundation allowance

Considering the evaluation results the government decided to cancel the start-up grant and continue with the transition benefit in a modified form:

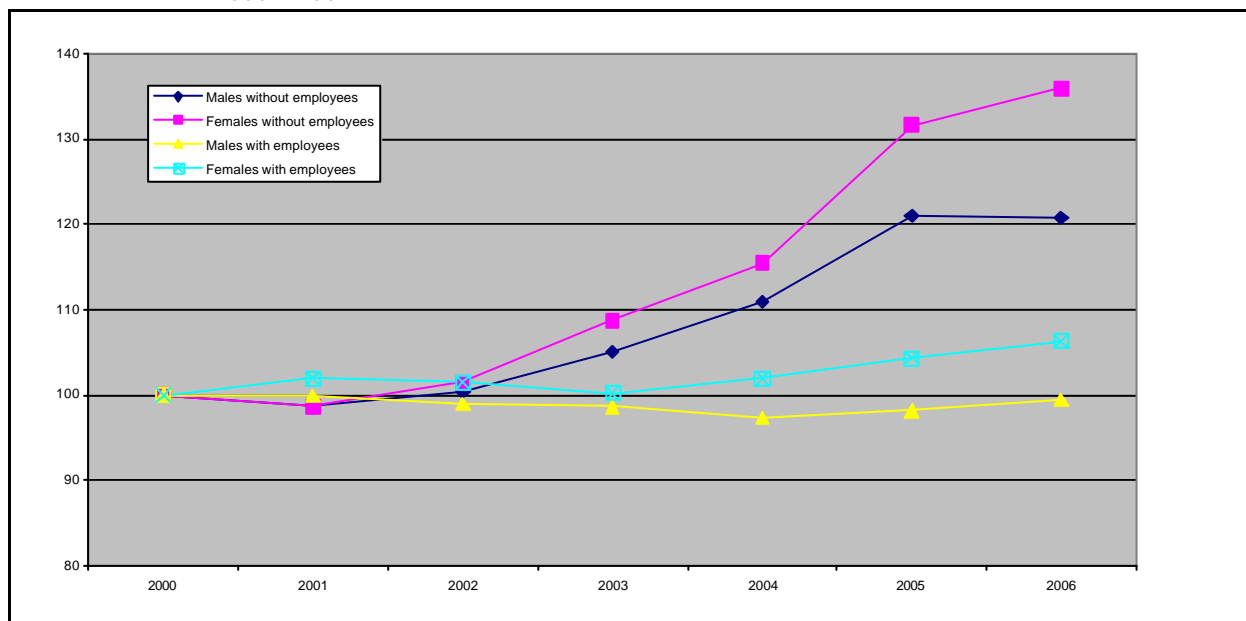
- The support period was extended from six to 15 months in the maximum.
- Beneficiaries need to have a 90 days minimum period for unemployment claims

While evaluation results are not yet available for the new type of allowance, some ex-ante considerations are available: This first change reduces the budgetary efficiency of the programme as benefits have to pay for longer. The second regulation creates an incentive to wait longer until the programme is entered, in order to lose only a minimum of unemployment benefits. This is also expected to affect budgetary efficiency negatively (*Caliendo 2007b*).

3.3. Income effects

The scenery of business foundations changed considerably when the Federal Labour Office started to promote self-employment of unemployed persons through start-up programmes. They initiated a strong rise of foundations without employees (Chart 2), both among men and women. Foundations with employees stagnated among males and showed only a slight increase among females until 2006. Only 1/3 of all foundations were undertaken with employees.

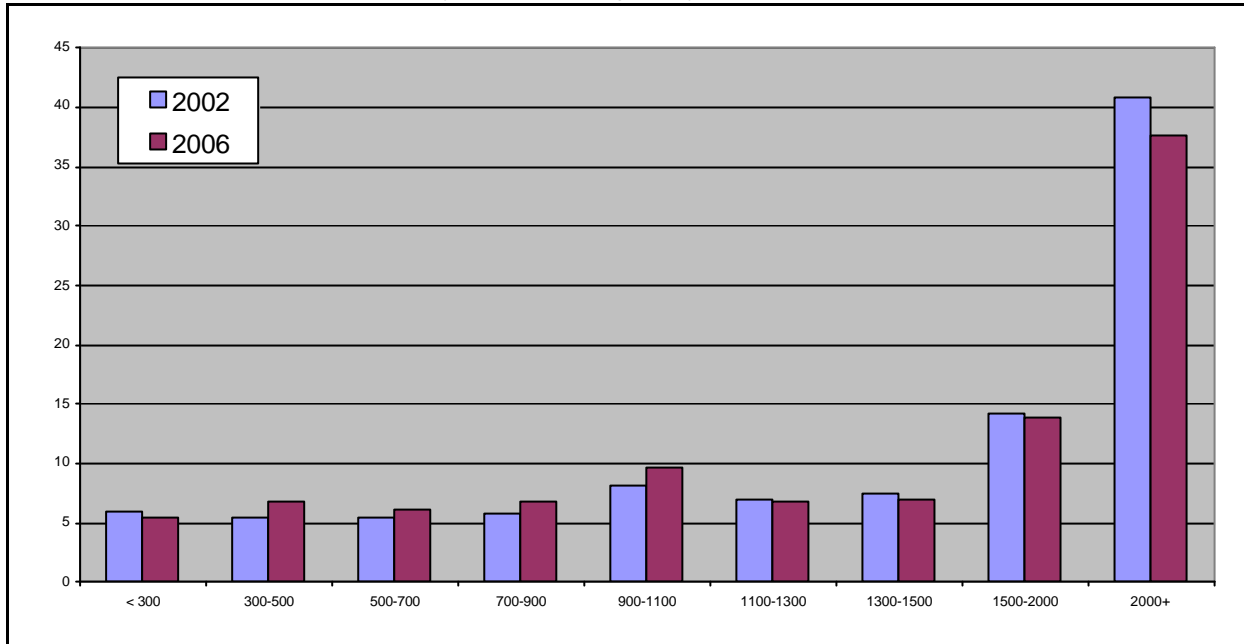
Chart 2 Self-employed with and without employees
2000 = 100



Source: Statistisches Bundesamt.

This is reflected by the income profile of self-employed which – between 2002 and 2006 – shows a clear decline of income groups with net incomes above 1,100 EURO per month and a respective increase of income groups below this level (Chart 3).

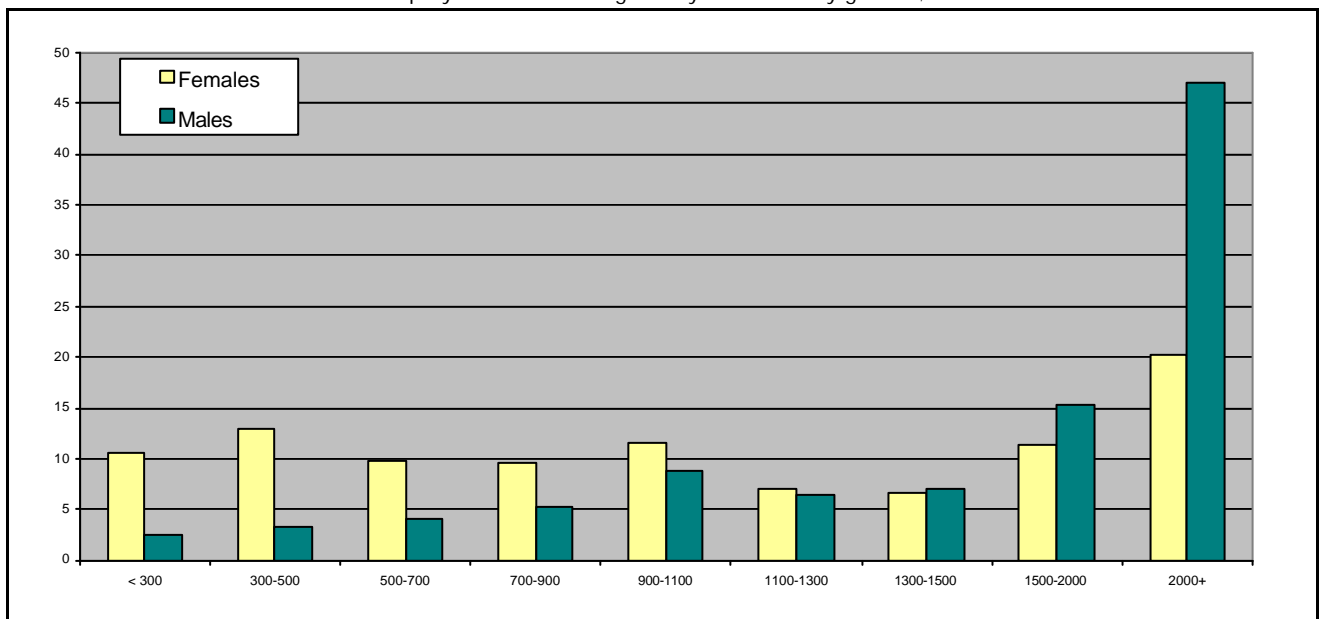
Chart 3 Monthly net income of selfemployed and assisting family members (EURO)
% share of self-employed and assisting family members



Source: Statistisches Bundesamt.

Self-employed women were much stronger affected by these changes. The monthly net income of self-employed women and assisting family members is significantly lower compared to self-employed men (Chart 4). The share of women earning less than 900 EURO per month was 43 % in 2006 – for men it was only 15 %. By contrast, the share of women earning more than 2,000 EURO per month was only 20 % compared to 47% among men.

Chart 4 Monthly net income of selfemployed and assisting family members by gender
% share of self-employed and assisting family members by gender; 2006



Source: Statistisches Bundesamt.

4. Conclusions

While the statistical results presented in the last Section are affected by all changes in self-employment rather than just the support programmes of the Federal Labour Office, the strong increase in self-employment without employees is largely due to these programmes. Nevertheless the new business foundations by unemployed appear to be sustainable, compare positively against the former unemployment situation, and provide higher incomes. The demand for these programmes – which is still strong in spite of the recent reorganisation – indicates the great interest among unemployed to become self-employed. And those who took that step seem to be successful to a large degree. The overall assessment of the programme therefore remains positive.

Literature

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