

## An Anglo-German Foundation Report

# **Non-employment and the welfare state: UK and Germany compared**

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## **Executive Summary**

This research project focuses on the so-called labour market inactive, that is, people of working age who are neither employed nor unemployed. How and why did the size and composition of this group change in the UK and Germany during the 1990s? Concentrating on men and employing a longitudinal data analysis, we have estimated the impact which changes in welfare state regulations had on flows in and out of employment and different forms of non-employment.

The main findings:

- During the first half of the 1990s, unemployment amongst both prime-age men (25–49 years) and older men (50–64) was higher in the UK than in Germany, while the extent of male inactivity was fairly similar. However, in the second half of the 1990s unemployment within the older age group dropped considerably in the UK but rose in Germany. Amongst prime-age men, British unemployment also dropped below German levels, but the gap remained fairly small.
- Despite differing economic prospects after the mid-1990s, inactivity amongst German prime-age men remained well below British rates. The reverse is the case for the older age group, with inactivity strongly rising in Germany but British rates declining.
- In the UK, non-employment (inactivity and unemployment) declined steadily during the 1990s. However, after having lost (or left) a job, prime-age men continued to enter inactivity more strongly than in Germany. Moreover, despite the economy picking up, prime-age male inactivity in the UK was higher in the late than in the early 1990s, with a larger share of men flowing directly from employment into inactivity.

- Measures to stop the decline of labour market participation amongst older workers seem to have been more successful in the UK than in Germany. However, the improved re-employment of older workers in the late 1990s originated mainly from flows out of (disability-related) inactivity rather than out of unemployment.
- With the help of hazard models, the impact of welfare-state legislation and business-cycle effects on transitions to and from employment and different states of non-employment were analysed. For prime-age British men the improving economy after 1993 coincided with a stronger transition from unemployment to inactivity (long-term sickness/disability). The Jobseekers Allowance (JSA) legislation of 1996 reduced the likelihood of transitions from employment to unemployment – but it also had a strong positive impact on the direct transition from employment into inactivity. By contrast, there were no discernible effects on transitions from non-employment to employment for either age group.
- The results for the introduction of Incapacity Benefit in the UK in 1995 are more difficult to assess. The legislation seems to have reduced the flows into long-term sickness/disability. However, simultaneous policies to reduce unemployment might have neutralised this by pushing more unemployed people towards long-term sickness/disability. It is thus difficult to gauge whether the legislation merely changed pathways into long-term sickness/disability (from employment via unemployment), or whether different groups of people were affected by different policies.
- The improved British employment and unemployment rates in the 1990s can be attributed to a more favourable economic situation, but also to stronger disincentives to become or remain unemployed for those in non-employment. In Germany, transitions in and out of inactivity seemed less affected by either the business cycle or legislative changes. In contrast to their British counterparts, and to their prime-age co-nationals, older German men did not benefit from the economic recovery in the late 1990s. The prospects of sustained re-employment did not improve and overall transitions into retirement did not decline, despite some (modest) legislative change. Findings thus indicate severe structural labour market disadvantages for older German workers.
- These results have policy implications, particularly regarding the introduction of the new unemployment allowance (ALG II) in Germany in 2005. Inferring from the impact of the JSA legislation in the UK in 1996, ALG II could potentially lead more long-term unemployed men over 50 to transfer into inactivity (early retirement) rather than back into the labour market, particularly if employment prospects do not pick up and the intensity of job placement services does not improve considerably.

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***Notes to the editor:***

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