

## CHAPTER THREE

### Unemployment Insurance and German Interwar Unemployment

During the Weimar Republic and the Nazi regime that followed, German unemployment rates rose and fell roughly in step with changes in the generosity of unemployment relief. While a similar correlation in interwar Great Britain has stimulated a heated discussion, the German case has gone unnoticed by historians.

This paper investigates the possibility that changes in the availability and generosity of unemployment benefits in Germany caused significant fluctuations in the unemployment rate by influencing workers' job search behavior. Although there are many possible explanations of the correlation between unemployment and benefit levels, induced search might be the initial favorite of many neoclassical economists. Its importance was suggested--if in somewhat guarded tones--by conservative observers at the time. Moreover, the still dominant Keynesian interpretation of the interwar German economy is confronted with a number of anomalies which a theory of induced search could help to resolve. In particular, partisans of demand-side explanations of the Third Reich's recovery from the depression have been unable to specify the source of initial stimulus. Perhaps the gutting of the unemployment insurance

(UI) system, begun by Bruening and continued under Hitler, played a significant role in hastening employment growth.'

Another reason for focusing on the induced search mechanism follows from the recent debate on the interwar British dole. In their 1979 JPE article Daniel Benjamin and Levis Kochin leaned hard on search behavior as the mechanism which supposedly translated generous relief payments into high unemployment rates. Since Germany's relief system was in many ways comparable to that of its Anglo-Saxon rival, one can reasonably hope to emerge from a study of Germany better informed about the merits of Benjamin and Kochin's claims.

The argument here is structured as follows. Section I outlines some important features of the German unemployment relief system, discusses how it changed over time, and provides a brief comparison with UI programs in interwar Britain and post-war Germany. Section II gives time series and cross sectional evidence demonstrating the correlation between the generosity of benefits and the share of the unemployed receiving them, on the one hand, and the level of unemployment on the other. It also briefly surveys interwar German opinion on the economic impact of UI. Finally,

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<sup>1</sup>While the last decade has witnessed renewed interest in what might roughly be called the "supply-side" factors at work in the interwar German business cycle, little attention has been given to the possible effects of changes in the extent of the welfare state. See Borchardt (1979), Balderston (1979 and 1983), and James (1986).

section III presents and estimates both steady-state and non-steady state search models of the labor market. The results are consistent with there having been at most a modest role for the UI system in inducing search unemployment. If the high correlation between the level of UI benefits and the level of unemployment is indicative of some causal connection, much of that causality worked through mechanisms other than that of induced search. The chapter concludes with some speculations about what those mechanisms might have been.

#### I: An Overview of the German UI System<sup>2</sup>

Before WWI, care for the unemployed in Germany was left in the hands of trade unions and municipalities. By 1907 roughly one tenth of all industrial workers belonged to unions with UI schemes, and some of the larger cities had established procedures to channel public funds into union administered relief programs (Wiggs, 1933, p. 4). But in most instances, the unemployed had to depend on their own resources or apply for poor relief.

At the end of WWI the relief situation changed considerably when the Reich required local governments to

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<sup>2</sup>There are several valuable sources on the German UI system in the interwar period. See in particular Wermel and Urban (1949), Weigert (1934), Fischer (1928), and Preller (1949).

provide relief for those left unemployed "as a consequence of the war." This largely decentralized system was maintained until early 1924, when it was significantly altered by the Gesetz ueber Erwerbslosenfuersorge (law concerning the care for those without gainful employment).

The 1924 law, which remained in effect until September 1927, stipulated that those "able and willing to work" but unemployed would receive benefits if they had logged 13 weeks of employment in an occupation covered by health insurance in the year prior to their job loss. Benefit payment was also conditional on passing a needs test which, however, may not have been too stringent.<sup>3</sup> The amount of benefit paid depended only on the beneficiary's sex, geographic location and number of dependents. Benefit duration was determined by the Minister of Labor in accordance with the state of the labor market, and the whole arrangement was largely financed by a tax imposed on both workers and employers.

During 1927 the German system of benefit provision was thoroughly transformed. In January, a program of Krisenfuersorge (emergency care) was introduced for those who had exhausted their regular benefits. In October the Gesetz ueber Arbeitsvermittlung und Arbeitslosenversicherung

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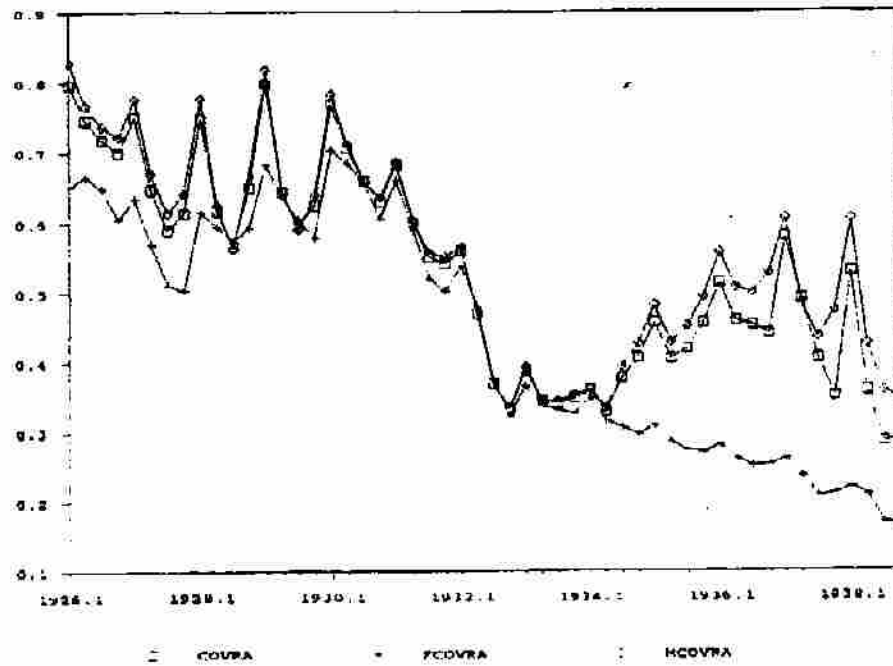
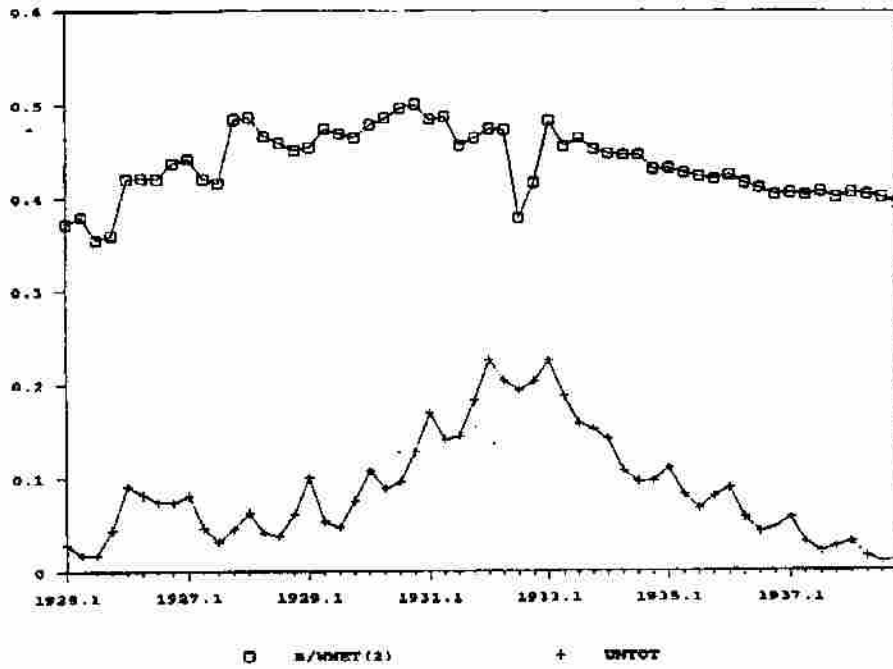
<sup>3</sup>According to an official study conducted before the needs test was dropped in 1927, only about 5% of the unemployed were excluded from benefit receipt by the test (Pribram, 1927).

(law concerning job placement and unemployment insurance) tied benefits to wages earned prior to unemployment, eliminated the needs test, lengthened the period of employment necessary to qualify for benefits, and opened the system of emergency relief to those who could not meet this prior work requirement. While a mixed bag in terms of the changes they introduced to the rules governing eligibility for benefits, the new laws resulted in a 10% increase in per-beneficiary expenditures (Egger, 1929 p. 261).

Subsequent substantive changes to UI law began when the financial foundation of the program appeared to be in jeopardy. Between 1929 and 1933, the government stiffened requirements for admission, reduced benefit levels and durations, and raised contribution rates. Graphs 1 and 2 illustrate two important aspects of the system's development over time: 1) the rise and later gradual fall of the replacement rate for a family of two with one average earner, and 2) the fluctuations in the share of the unemployed actually receiving benefits through ordinary or emergency relief. Appendix C provides a more complete overview and chronology of the changes undergone by German unemployment relief between 1918 and 1938.

In their study of the effects of the British interwar UI system, Daniel Benjamin and Levis Kochin stress the high benefit-to-wage replacement ratios, the lack of experience rating, and lax waiting period requirements of British

Graph 3.1



Graph 3.2

relief as factors contributing to a significant amount of induced search unemployment (Benjamin and Kochin, 1979). When examined along these lines, the German system appears to have been both more and less generous than its contemporary British counterpart.

Benjamin and Kochin define the replacement rate as the benefit received by a family of four divided by the pre-tax earnings of an average wage earner in industry. The use of pre-tax income for Great Britain is not too misleading, since a family of four with average wage earnings was exempt from income tax and subject only to quite low contribution rates for old age, health, and unemployment insurance (see Appendix B, Table B.1). For Germany, however, taxes cannot be ignored, since even for a family of four they amounted to between 7 and 13% of gross wage income in the period after the currency stabilization (see Appendix B, Table B.2).<sup>4</sup> Table 3.1 presents replacement rates for families of size four, calculated for both countries as benefits paid divided by after-tax earnings for an average earner in industry. The German series begins in 1924 due to the lack of earnings and taxation data that are consistent over the pre- and post-hyperinflationary periods. As can be seen from the table,

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<sup>4</sup>Although Margot von Loelhoeffel (1974) has calculated labor costs inclusive of taxes, no one to my knowledge has attempted to create a net earnings series. Loelhoeffel makes a very minor mistake in her calculations, since payroll taxes to pay for UI began in 1924, not in 1927 as she assumes. See Appendix A for a discussion of the tax rates.

the German replacement rate for a family of four with one average earner was higher than that in Great Britain from 1924 through 1935.

Table 3.1  
Replacement Rates for Families of Size Four  
In Germany and Great Britain

Year	Germany	Great Britain	
	(B/Wnet(4))	(B/Wnet(4))	(B/Wgross)
1920	NA	0.15	0.15
1921	NA	0.24	0.22
1922	NA	0.38	0.37
1923	NA	0.40	0.39
1924	0.46	0.43	0.41
1925	0.52	0.48	0.47
1926	0.58	0.50	0.47
1927	0.57	0.49	0.47
1928	0.59	0.51	0.49
1929	0.56	0.51	0.49
1930	0.57	0.54	0.52
1931	0.60	0.55	0.53
1932	0.57	0.52	0.49
1933	0.64	0.52	0.50
1934	0.61	0.54	0.52
1935	0.58	0.57	0.54
1936	0.55	0.59	0.56
1937	0.54	0.58	0.55
1938	0.52	0.57	0.55

Source: See Appendix A.

Benjamin and Kochin also emphasize that British benefit payments bore no relation to wages earned prior to unemployment and that the replacement rates for those earning less than the average amount would be considerably



higher than those reported here in Table One. In this regard the British system was more generous than the system prevailing in Germany after October 1927. The effect of the German system during this period was to allow the replacement rate to rise as income earned prior to unemployment fell, but the allowable rise was limited and the replacement rate calculated on gross income was capped at 80% (Fischer, 1928, p.470). Before October 1927, however, benefits paid in Germany were also independent of prior earnings.

As in Britain, the German system was not experience rated. With respect to waiting period regulations, however, the German system was stricter than was its counterpart across the North Sea, although there were periods when its requirements were rather loose (see Appendix C). Germany did have a special program to provide benefits to those working only part of a week, but even in the worst years of the depression there were never more than several hundred thousand workers participating (Statistisches Jahrbuch, 1926-1938). The German system also provided benefits to a smaller percentage of those unemployed than did the British one. According to Benjamin and Kochin, the vast majority of Britain's registered unemployed received either normal or supplementary benefits from the UI scheme; this was not always the case in Germany, as can be seen from the coverage rate series presented in Graph 3.2.

How does the interwar German system compare with that prevailing in post-war West Germany? Table 3.2 provides a summary comparison. A different measure of the replacement rate is used here; it is calculated as expenditures on benefits per beneficiary divided by net average earnings in industry. The coverage and replacement rates for contemporary West Germany are taken from Gary Burtless (Burtless, 1987). The replacement rates are quite comparable; again it is in terms of the coverage rate that the interwar system seems to have been rather restrictive, especially after 1930.

Table 3.2

Comparing Interwar and Postwar German Unemployment Insurance Systems:  
"Burtless" Replacement Rates and Coverage Rates.

	RRBURT	Covrat		RRBURT	Covrat
1924	0.30	0.79	1972	0.50	0.93
1925	0.35	0.50	1973	0.51	0.93
1926	0.38	0.73	1974	0.53	0.93
1927	0.30	0.73	1975	0.52	0.92
1928	0.54	0.65	1976	0.48	0.88
1929	0.50	0.68	1977	NA	0.80
1930	0.50	0.68	1978	0.45	0.77
1931	0.47	0.59	1979	0.47	0.74
1932	0.46	0.44	1980	0.46	0.75
1933	0.45	0.36	1981	0.50	0.80
1934	0.46	0.37	1982	NA	0.77
1935	0.43	0.44	1983	0.47	0.75
1936	0.46	0.49	1984	0.44	0.70
1937	0.45	0.48	1985	NA	0.68
1938	0.51	0.42			

Sources: RRBURT and Covrat are discussed in Appendix A.

## II: The Correlation Between UI Generosity and the Unemployment Rate.

Shortly after the armistice in November 1918, the

