

# EMPLOYMENT OBSERVATORY

## EAST GERMANY

Labour Market Developments and Policies  
in the new German Länder

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### EDITORIAL

Five years after the fall of the Berlin Wall, the major institutional reconstruction measures – centering on the transition from the centrally planned to the social market economy – have been accomplished. Yet even now it is still difficult to determine the risks and the potential of the new economic system in East Germany. What is clear, however, is that – to pick up on a wish expressed by Willy Brandt that has since become famous – not all that “belongs together” in the economic life of the new *Länder* has yet “grown together”.

The enterprise-size structure of the East German industrial sector has come into line with that prevailing in West Germany. This convergence has resulted from two processes: the deconcentration and privatisation of formerly state-owned enterprises (top-down transformation) and the setting-up of new small and medium-sized firms (bottom-up transformation). Sample surveys indicate that at least 80% of the newly constituted firms are genuine new firms (including one-person companies) rather than the product of formerly state-owned production units. At the same time, the failure rate among new businesses is high, so that major “turbulence”, i.e. job losses, is to be expected here in the coming years. Deficiencies in the areas of work organisation and management, and the lack of equity capital

are all problems to which government support programmes are attempting to offer a solution. The risk of small-business failure in the new federal states must be seen in the light of the fact that just 5.5% of the East German working population consists of “entrepreneurs”, whereas the self-employed make up about 10% of the West German working population. It therefore seems that there is still a considerable potential for new business start-ups in the new *Länder*.

In the coming years the East German economy will remain heavily dependent on support from West Germany. Even under optimistic assumptions, the prognoses and scenarios developed so far offer no grounds for expectations of a rapid rise in East German per-capita income to West German rates. Outward migration, together with the decline in the birth rate and in female participation rates, may well mean, however, that registered unemployment in the two halves of Germany will converge more rapidly than production levels.

*Employment in*

EUROPEAN COMMISSION  
DIRECTORATE-GENERAL  
FOR EMPLOYMENT,  
INDUSTRIAL RELATIONS  
AND SOCIAL AFFAIRS



*Social  
Europe*  
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# ECONOMIC AND LABOUR MARKET STATISTICS

	1st half- year 1989	1st half- year 1991	2nd half- year 1991	1st half- year 1992	2nd half- year 1992	1st half- year 1993	2nd half- year 1993	1st half- year 1994	Oct. 1994
<b>Economy</b>									
1. Gross Domestic Product in 1991 prices (billions of DM)	149.6	96.5	109.5	108.7	118.4	110.3	124.7	120.1	
2. Gross value added by sector in 1991 prices (billions of DM)									
2.1 Agriculture and forestry	2.6	0.1	7.0	0.4	7.1	1.0	6.8	0.7	
2.2 Energy and mining	9.5	8.1	7.1	6.7	6.9	6.8	6.8	7.0	
2.3 Manufacturing	45.5	17.8	19.1	18.1	20.6	18.7	22.0	21.1	
2.4 Construction	13.8	11.5	12.7	15.2	16.6	17.7	19.9	21.7	
2.5 Trade and transport	23.2	14.2	15.6	14.6	16.1	16.4	17.3	17.4	
2.6 Services	16.8	21.3	24.6	26.4	27.3	27.5	28.6	29.5	
2.7 Government	21.6	22.8	21.5	21.4	21.3	20.8	20.6	20.4	
3. Expenditure on the Gross National Product in 1991 prices (billions of DM)									
3.1 Private consumption	82.1	84.7	95.0	92.9	104.0	96.0	106.3	100.0	
3.2 Government consumption	39.3	39.1	48.6	43.7	50.0	43.5	49.1	44.3	
3.3 Fixed capital formation	28.5	42.1	50.0	56.0	61.7	62.7	71.6	73.6	
3.4 Exports minus imports	-4.2	-65.9	-78.4	-86.0	-91.9	-90.5	-100.3	-100.6	
<b>Labour market</b>									
4. Working-age population (in thousands)	10721								
4.1 Migrations to West Germany (in thousands)	49	102	148	94	106	78	95		
4.2 Commuters to West Germany (in thousands)		446	541	451	506		607		
5. Total employment (in thousands)	9932	7462	6903	6491	6373	6246	6310	6267	
5.1 Share of female employment (%)	49	46	46	46	46	45	44		
5.2 Employees in <i>Treuhand</i> companies (in thousands)	-	2115	1404	1070	458	296	187	132	
6. Employment by sector (in thousands)									
6.1 Agriculture and forestry	985	469	385	300	266	245	234	218	
6.2 Energy and mining	306	244	209	181	164	145	134	124	
6.3 Manufacturing	3265	2170	1725	1357	1230	1138	1115	1063	
6.4 Construction	846	701	727	797	848	887	957	998	
6.5 Trade and transport	1652	1252	1206	1160	1141	1129	1135	1115	
6.6 Services	962	920	970	1014	1057	1091	1142	1173	
6.7 Government (incl. ABMs)	1750	1514	1450	1442	1416	1359	1337	1320	
7. Employment in labour market measures (in thousands)									
7.1 Employed in job creation measures (ABMs)	-	148	390	402	355	237	177	198	222
7.2 Includes "wage-cost subsidies East" (§ 249h AFG)	-	-	-	-	-	14	63	91	99
7.3 Short-time workers	-	1899	1095	417	233	201	125	105	67
7.4 Full-time equivalent of loss of working hours in case of short-time working	-	1078	694	223	109	89	56	46	33
8. Non-active population in labour market measures (in thousands)									
8.1 In full-time further training measures		170	310	442	434	368	271	234	261
8.2 In early retirement		521	705	806	834	857	778	643	594
9. Total persons in labour market measures (7.1 + 7.3 + 8.1 + 8.2) (in thousands)									
9.1 As % of potential labour force		22	23	21	20	18	15	14	14
10. Total unemployment (in thousands)									
10.1 Unemployed women (in thousands)		482	695	715	704	708	754	784	671
10.2 Unemployed women (%)		59.5	61.6	63.6	63.9	64.4	64.1	65.7	67.1
10.3 Unemployment rate (%)		9.5	11.8	14.2	13.9	15.1	16.2	15.7	14.1
10.4 Male unemployment rate (%)		8.0	8.9	10.0	9.7	10.4	11.2	10.4	8.9
10.5 Female unemployment rate (%)		11.2	14.7	18.9	18.6	20.2	21.5	21.3	19.5
11. Shortfall of "regular" employment (9.+10.) (in thousands)									
11.1 As % of potential labour force		31	34	34	32	30	29	26	23

## Sources:

National accounts of the German Economic Research Institute (*DIW*), October 1994 (rows 1.-3.4, 5., 6.-6.7); Official Reports and Press Releases of the Federal Employment Service (rows 7.1-7.3, 8.2, 10.-10.5); Institute for Employment Research (*IAB*), *IAB-Kurzberichte* and *IAB-Werkstattberichte* (rows 4., 4.1, 5.2, 8.1); Infratest Social Research, labour market monitor for the new Federal states, Munich/Nuremberg 1991-93 (rows 4.2, 5.1); monthly information sheet of the *Treuhandanstalt* (row 5.2); calculations by the editors.

## Comments:

In general, stock data in the table correspond with figures drawn up at the end of the given half-year periods (except: rows 4.2, 5.1: data for May or November; rows 5., 6.1-6.7: averages of the 2nd and 4th quarters respectively; row 5.2: 1991 1 July and 1 January after the end of the half-years).

Row 5.2: initial figure mid 1990 ca. 4 million; row 7.4: number of short-time workers multiplied by the average amount of working time lost; row 8.1: until mid 1992 estimated; rows 9.1, 11.1: potential labour force defined as the sum of resident wage and salary earners, self-employed, unemployed and the participants in further training and early retirement; rows 10.3-10.5: from 1994 onwards the basis of the unemployment rate has been changed (dependent civilian working population in June 1993; earlier basis dated from the end of 1989, then from November 1990 and then from June 1992).

## The Transformation of East Germany's Corporate Structure

The transformation under way in the East German economy since 1990 has been coupled with a dramatic change in corporate structures. Whereas in the GDR production was confined to a relatively small number of large-scale enterprises, the number of companies has since multiplied. A previously almost non-existent small and medium-sized sector developed extremely rapidly, with the result that the enterprise-size structure in East German industry now conforms to that of western Germany. The adjustment is the result of two processes: on the one hand, a "top-down" transformation took place as formerly state-owned enterprises were privatised. On the other hand, many jobs were created when new businesses were set up, constituting a "bottom-up" transformation. However, so far the "new-business boom" in the new federal states has been confined to branches which can hardly be considered a basis for a lasting and self-sustaining upswing. Moreover, the large number of new enterprises is counterbalanced by a growing number of closures among new companies, although to a large extent this can be seen as characteristic for "normal" selection processes. Current trends suggest that it will probably take quite some time before reasonably stable sectoral and corporate structures have developed in the new federal states.

### Corporate structure: initial situation and developments since 1989

The economy of the GDR was characterised by a dominance of very large production units. As a rule, each unit was responsible for several manufacturing stages: often individual state-owned enterprises or industrial combines shaped the economic development of entire regions (cf. East Germany no. 3/4, pp. 3-6). The high degree of vertical integration had the advantage that enterprises were relatively independent with respect to suppliers and potential supply shortages; the size of the units was a disadvantage in that it was accompanied by correspondingly bureaucratic internal procedures, inefficiency, and insufficient flexibility. Small and medium-sized companies, by contrast, played only a marginal role – in comparison to the West German economy, or to other developed market economies (cf. Figure 1). The priority employment sectors of the GDR economy were those branches (e. g. agriculture, energy, and the basic goods industry) in which many jobs had been lost during the preceding decades in the old federal states. Producer-oriented services

were largely integrated within manufacturing plants; consumer-oriented economic branches were of only minor significance.

The effect of the transformation process from 1990 onwards was that as early as the autumn of 1992, i. e. only two years after German unification, one could no longer discern any significant difference between the new and the old federal states with regard to enterprise-size structures in the manufacturing sector (cf. Figure 1). Indeed there was a higher share of employees in small companies than in the West in many branches of the East German economy. Empirical studies show that during this period the East German economy had largely come into line with West German patterns with respect to the degree of vertical integration. At the same time, however, the share of manufacturing employment in East Germany's total employed labour force fell from more than one third to around 20%; this is much lower than the figure for West Germany, which is approx. 30%.

The dramatic change in the corporate structure of the new federal states is the result of two different processes. Firstly, many of the for-

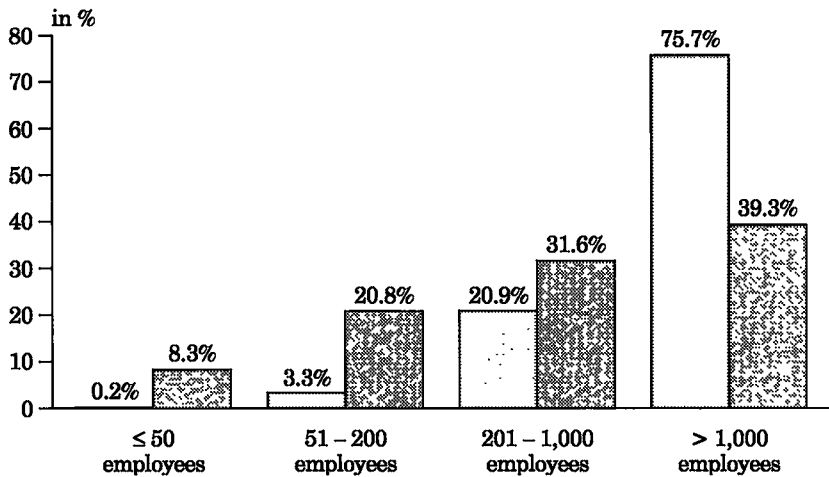
merly state-owned, large-scale companies were split up, privatised, returned to their previous owners, transferred to municipal ownership, or were closed down ("top-down" transformation); these processes were usually accompanied by huge manpower cuts. Secondly, numerous new businesses were set up, generating new jobs – at the very least for those who formed the companies ("bottom-up" transformation).

### Top-down transformation: privatisation by the *Treuhandanstalt*

The *Treuhandanstalt's* task was to rapidly convert the companies under its charge into competitive private enterprises (cf. East Germany no. 11, pp. 3-6). Before the *Treuhandanstalt* began operations in October 1990, a so-called "small-scale privatisation" had already commenced under the last government of the GDR at the start of the same year; some 25,000 properties – small hotels, restaurants, cinemas, retail outlets – were sold to private buyers under this programme.

When the *Treuhandanstalt* was set up it took over around 8,500 state-owned enterprises. This made it the largest holding company in the world and manager of a vast part of the former GDR economy. Around 4.1 million people – then about 45% of all workers in the new federal states – were employed in *Treuhandanstalt* companies. As a result, the policies pursued by the *Treuhandanstalt* had a considerable effect on the course of structural change, especially in the first phase of the transformation process. First of all, corporate units were deconcentrated horizontally, vertically, and spatially, raising the stock of *Treuhand* companies to around 12,000 individual units (cf. East Germany no. 11, p. 4). By 1 September 1994, 8,279 of these companies had been privatised, 1,570 properties had been returned to their previous owners (reprivatisation), and 264 enterprises transferred to municipal ownership. The majority of the enterprises privatised (approx. 85%) were taken over by West German firms; almost ten percent were sold

**Figure 1:**  
**Employees in mining and manufacturing industry in East\* and West Germany by enterprise-size category (1988)**



**Employees in mining and manufacturing industry in East and West Germany by enterprise-size category (1992)**



\* For East Germany Data are only available for the entire industrial sector.

Source: Federal Statistical Office.

to foreign buyers; less than 6% passed into East German ownership – mostly in the form of management buy-outs. Liquidation proceedings were started in 3,652 enterprises, though only 131 of these have been concluded to date.

On 1 September 1994, the stock of *Treuhandanstalt* companies still on offer consisted of three large-scale corporations (*Deutsche Waggonbau Ltd.* – comprising 10 individual companies, *Mansfelder Kupfer und Messing*, and *EKO Stahl* – comprising 5 individual companies), 87 individual companies grouped together in five management partnerships (cf. East Germany no. 2, p. 7), and

another 44 individual companies. Together these enterprises still provide employment for approx. 44,000 persons.

It proved relatively easy to privatise enterprises which primarily operated on regional markets and which required little in the way of modernisation; this applied to many companies in the energy, construction, and consumer-oriented service sectors. Enterprises from other sectors proved more difficult to privatise, however, especially those in agriculture and forestry, mining, and the textile and clothing industries, i. e. branches which have been marked by huge job losses during

the last few decades in many western industrial countries. Whether these enterprises will ultimately be closed down, or will survive in the medium or long term with the help of subsidies depends to a large extent on the outcome of efforts to preserve regional “industrial cores” (cf. East Germany no. 11, pp. 7-9).

The *Treuhandanstalt* will conclude operations at the end of 1994. There will then still be some 930,000 persons employed in ex-*Treuhand* enterprises – approx. 23% of the initial number of *Treuhand* employees and 15% of all persons currently in employment in the new federal states; the number of employees in *Treuhand* enterprises still for sale will amount to less than 1% of the two variables.

**“Bottom-up” transformation: new businesses and closures**

The number of new businesses set up and those closed down in eastern Germany can be estimated on the basis of business registrations and deregistrations as recorded by local authorities. Overall, almost 1.1 million businesses were registered between 1990 and mid-1994. Interpretations of this figure must take into account that, firstly, not every registration means that a new business is actually set up, and secondly, agricultural companies and the so-called “liberal professions” (e. g. doctors and lawyers) are not included in the statistics. According to estimates by the *Institut für Mittelstandsforschung* (Institute for Research on Small and Medium-Sized Businesses) in Bonn, probably less than half (approx. 43%) of all registrations are followed by actual formation of a company which operates actively in the market; it would follow from this estimation that up to mid-1994 slightly more than 470,000 new enterprises were set up in the new federal states. This figure would have to be supplemented by an unknown number of new agricultural companies and professionals. A large number of the businesses registered in eastern Germany, i. e. a good 46%, belonged to the trade and catering sectors, only 4.6% were industrial firms, and 11% were new craft businesses; these proportions remained relatively constant during this period. One can assume that many of these new businesses generated only “self-em-

ployment" – just one job for the entrepreneur him/herself, or possibly further work for family members.

Up to mid-1994 428,000 business registrations were cancelled in the new federal states, although, once again, not every cancellation indicates the closure of an enterprise which was active in the market: the figures also include many cases in which the intention to set up a company was not actually realised. Agricultural companies which closed down and a proportion of the professionals who went out of business are not accounted for. According to the estimates made by the Institute for Research on Small and Medium-Sized Businesses, the number of "real" closures between 1990 and mid-1994 was probably something in excess of 87,000. Again, the trade and catering sectors – around 50% of all cases – are particularly well-represented in the records for registration cancellations; industry accounts for only 1.7%, and *Handwerk* (craft businesses) for 11.2%. The conspicuous surplus of registrations over deregistrations in the industrial sector suggests that a relatively large share of these registrations can be rated as "real" business set-ups, and that a considerable proportion of these enterprises survives for at least some time in the market.

The net number of enterprises entering the market – calculated as the difference between registrations and deregistrations – reached its peak as early as 1990 (cf. Figure 2). It has fallen almost continuously

since then, on the one hand because the number of registrations (new businesses) has declined, and on the other because the number of cancellations (closures) has risen significantly. However, the increase in cancellations must be seen in context: firstly, the number of existing enterprises increased steadily from 1990 onwards, so that for a given probability of failure an increase in the number of closures is to be expected; secondly, it is well known that new enterprises face a particularly high risk of insolvency, i. e. a high number of new businesses will be accompanied by a high number of closures. In view of the competitive disadvantages facing the economy in East Germany, given its location, and the fact that many entrepreneurs frequently lack business know-how, it is not surprising that the risk of insolvency is particularly high in the new federal states. It will undoubtedly take quite a few years before the upheaval in East German enterprises has settled down to a "normal" level and corporate structures have achieved a stability comparable to conditions in western Germany.

Despite the "new-business boom" which has taken place during the last few years, the proportion of the working population in the new federal states engaged in entrepreneurial activities is still relatively small. If one divides the number of private enterprises in East Germany by the working population (employed and unemployed), the result is a self-employed rate of

approx. 5.5%; the current percentage in West Germany is around 10%. This is an indication that there is still considerable potential for new business set-ups in the new federal states.

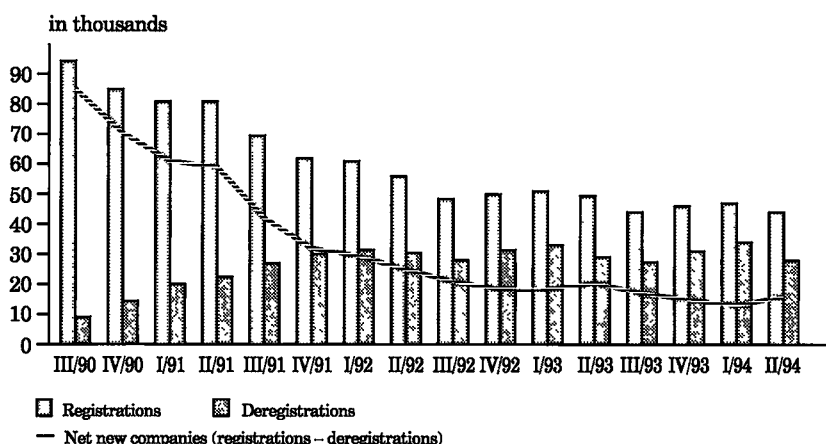
It is estimated that there were approx. 460,000 private enterprises (including agriculture and the liberal professions) in the new federal states in mid-1993. Since only around 10,000 private enterprises emerged from the stock of companies held by the *Treuhandanstalt*, and around 25,000 companies were converted by way of the "small-scale privatisation", it follows that it was the bottom-up transformation – and not the policies of the *Treuhandanstalt* – that spawned the large majority of the companies and enterprises currently in existence. Various studies based on sample surveys of new East German enterprises verify that at least 80% of these businesses are brand new establishments which are the product neither of a privatisation nor the deconcentration of former state-owned enterprises. While a larger number of jobs were preserved by top-down transformation – in terms of the total number employed – employees in *Treuhand* and ex-*Treuhand* companies still only account for approx. 20% of all the jobs in the East German private sector.

The most striking feature of the sectoral structure of the new enterprises in East Germany is that the share of industrial enterprises and industrial employees is comparatively small. Sectors which primarily cater for local demand (e. g. retailing, catering, and *Handwerk*), are already relatively well developed, while enterprises selling goods on supra-regional markets still are largely the exception.

### Problems facing East German enterprises

East German enterprises are confronted with a range of specific difficulties. Infrastructural bottlenecks (in the areas of transportation and telecommunications, for instance) still present problems, as do unresolved disputes over property ownership and the limited functional capacity of the civil service. Not only new businesses, but also enterprises which were priva-

**Figure 2:**  
Business registrations and deregistrations in the new *Länder* III  
quarter of 1990 to II quarter of 1994



Source: Federal Statistical Office.

tised must invest considerable effort in the development of business contacts, since the "old" networks of contacts and suppliers within the former GDR and the CMEA have mostly broken down. The major upheaval in existing enterprise structures makes it extremely difficult to establish stable business relationships.

A range of internal deficits can be observed in many East German enterprises; these manifest themselves in lower labour efficiency compared to West Germany. In addition to technically antiquated equipment, inadequacies in the areas of work organisation, management, and plant utilisation are particularly relevant in this respect. Thus average labour efficiency in East German industrial plants in 1992 was only 45% of the figure for West Germany, while wages had already increased to over 60% of West German rates in the same period. This resulted in significantly higher unit labour costs in East German companies, which is one important reason behind their lack of competitiveness compared with their West German and international rivals.

In addition to these difficulties, which affect more or less all enterprises located in the new federal states, businesses which were set up by former citizens of the GDR face a further severe problem: they often have only very little equity capital at their disposal – probably a consequence of the lack of incentives and opportunities in the former GDR to accumulate wealth. This lack of equity capital in turn sets tight restrictions on the acquisition of loan capital.

#### **Promotion schemes for East German enterprises**

In order to combat the above difficulties at least to some extent, the development of the East German economy is supported by a variety of government promotion schemes. The most important instruments are capital subsidies for investments, such as investment premiums and investment grants, followed by low-interest loans and special depreciation allowances. The equity-capital aid scheme specifically seeks to alleviate of the equity capital deficiency prevailing in East German enterprises. Low-in-

terest loans to East German enterprises with a grace period of several years for repayment constitute the main element of this promotion scheme. Unlike normal loans, these loans must not be serviced from the bankruptcy estate in cases of insolvency; i. e. they increase the guarantee capital and so raise the credit-worthiness of the enterprises in question. Only recently the principle of earmarking of funds was dropped for promotion under the equity-capital aid scheme; the funds may now be used not only for real capital investments, but also for other purposes – e. g. product innovation or the development of marketing strategies.

Other promotion schemes for East German enterprises directly confront common problems such as difficulty in opening up new markets or insufficient business know-how. These include subsidies for general management consultancy for small and medium-sized businesses, sales promotion schemes (e. g. participation in trade fairs, export credit insurance), and schemes promoting further vocational training – especially business training. Measures of this kind are of enormous significance in vitalising and supporting viable enterprises which both safeguard and create jobs, since they target the central problem facing most East German enterprises, namely to develop and supply products which can compete on West German and international markets.

Despite massive government aid, many privatised East German enterprises are in acute danger of bankruptcy, and – since they have not yet fully coped with the restructuring process – they are still dependent on the receipt of such support. In this sense especially, the Federal Government's recent decision to provide DM 500 million for low-interest consolidation loans to privatised East German enterprises in acute need of financing can be seen as "survival aid" for ex-*Treuhand* enterprises. However, this scheme entails the danger that its effects are largely structurally conservative.

#### **Results and conclusions**

The transformation of the stock of East German enterprises has been extraordinarily rapid since the fall

of the Berlin Wall. Many more jobs have been created due to new business set-ups than have been preserved in former state-owned enterprises following privatisation. Although the policy of rapid privatisation by the *Treuhandanstalt* led to substantial employment losses, this had the effect of liberating resources which were then available for private business start-ups. Despite the new-business boom in the new federal states, however, the proportion of the working population in self-employment is still only around half the West German level.

Up to now, the new businesses set up in East Germany have mainly been confined to economic sectors which primarily service local and regional demand (e. g. consumer-oriented services, *Handwerk*). However, in view of the first signs of saturation trends and relatively low domestic demand, no significant further potential for expansion is expected in these sectors. New companies in industrial sectors with a promising future and in service sectors oriented towards national and international markets are still the exception.

The rising number of closures in East Germany should not be cause for too much concern, since it is quite normal in a market-economy system for many new enterprises to fail during the first few years. In view of the low average 'age' of enterprises in East Germany, and the lack of know-how on the part of many entrepreneurs, one can expect considerable further upheaval in corporate structures in the coming years too.

Economic policy-makers should not fall prey to the temptation to use subsidies to sustain either new businesses which have failed or unviable *Treuhand* enterprises; rather they should start with the causes of the problems and strive to improve the skills of (potential) entrepreneurs, especially in the area of business know-how. Measures which improve access to equity capital for East German entrepreneurs are certainly beneficial too. Despite the efforts which are being invested both on the part of East German enterprises and the economic policy actors, it will probably take quite some time before a sustainable economic structure has

been established in the new federal states. This applies in particular to the core of the economy, namely enterprises which operate on national and international markets.

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## TRENDS

### Long-term Socio-economic Prognoses for the New Länder

**Various prognoses and scenarios, together with the experience of regional adjustment processes in other countries, suggest directions in which the East German economy might develop in the next 10 to 15 years and at what speed. Long-term developments will depend on domestic demand and the speed at which competitive export firms can be created. However, even under the most optimistic assumptions a rapid convergence between East and West German per-capita income is not to be expected. Outward migration, together with the decline in the birth rate and in female participation rates, may well mean, however, that registered unemployment in the two halves of Germany will converge more rapidly than production levels.**

In view of the current rapid growth of East German GDP and particularly of fixed capital formation and industrial output, many observers are now hoping, after the initial euphoria and subsequent disappointment, for a rapid expansion of East German economic activity rates to West German levels. At the same time, there is still considerable uncertainty surrounding the direction in which, and the speed with which the East German economy can be expected to develop. Many commentators have estimated that it will take a generation to transform a formerly centrally planned economy into a market economy. Meanwhile a number of long-term socio-economic prognoses have been published for the new federal states. They vary considerably, however, both in terms of their methodology and the results obtained. This article presents the prognoses made by the German In-

stitute for Economic Research (DIW) to the year 2000, the Basle Prognos AG to the year 2010, a number of scenarios developed by the Institute for Economic Research in Halle (IWH), and a demographic prognosis by the Humboldt University in Berlin (cf. the bibliography). This summary of the various prognoses focuses on the results pertinent to labour market developments in East Germany.

#### DIW: Integration or stagnation to the year 2000?

The authors of the DIW study (Görzig/Gornig/Schulz) have drawn up two separate scenarios for the German economy as a whole to the year 2000, with two corresponding prognoses for East Germany. The optimistic *integration scenario* assumes that the process of world trade liberalisation continues, and that the economies of eastern Europe stabilise and become increas-

ingly integrated into the European economy as a whole; the *stagnation scenario*, on the other hand, postulates obstacles to world trade and severe restructuring problems in eastern Europe. On these assumptions, different growth rates are derived for the German economy over the period 1992 to 2000: annual GNP growth of 2.6% for Germany as a whole in the first scenario as against just 1.4% in the second (the figures for West Germany are 1.9% and 1.1% respectively). A central determinant of developments in East Germany is western direct investment. In the optimistic *integration scenario* such investment remains at its current high level until the year 2000, leading to a far-reaching re-industrialisation process in the new federal states. East Germany's industrial output will then no longer primarily serve local markets; a growing proportion will be "exported" out of the region to West Germany and abroad. In the *stagnation scenario*, on the other hand, direct investment declines after the initial boom. In the more optimistic scenario East German "exports" – sales to West Germany and abroad – expand to the year 2000 by an annual rate of 10.6%, "imports" by just 1.7% per annum. In the *stagnation scenario* exports rise by only 6.4% per annum. As a consequence, on the more positive assumptions East Germany's foreign trade deficit narrows markedly by the year 2000, whereas under the less favourable conditions it contracts by just 19%.



For the labour market, both demographic and labour market participation trends are of central importance. In the *integration scenario* the population sinks from 15.7 million in 1992 to 15.2 million in the year 2000, a trend resulting exclusively from natural demographic developments. Although during the observation period more people will continue to migrate from East to West Germany than in the reverse direction, negative net intra-German migration from the new federal states (-300,000) will be more than offset by immigration from abroad (+400,000), primarily by ethnic Germans from eastern Europe. Under such conditions, the number of foreigners as a proportion of the overall East German population will rise from 1.3% in 1992 to 3 to 4% by the year 2000. In the *stagnation* variant migration from East to West Germany is somewhat stronger, although the same is true of immigration from abroad. The DIW authors expect female participation rates to decline – due to labour market pressures – from their current high level to the (slowly rising) West German level by the year 2010.

The most important exogenous parameters and results of the DIW prognosis are listed in Table 1. In the optimistic scenario annual GDP growth reaches 10.1% – led by exports and investment; in the pessimistic variant growth is just 5.8%. In neither scenario will the West German productivity level be even approached by East German enter-

prises. And even in the optimistic scenario industrial employment, at just under 1.4 million, will amount to just 91 industrial employees per 1000 inhabitants, i.e. below the level recorded in the least industrialised federal state in West Germany (cf. East Germany no. 11, p. 7). Even so, manufacturing output will expand at an annual rate of 18.0% (1992-2000), and even in the more pessimistic variant by 11.4% p.a.

In the integration scenario there will be no increase in employment between 1992 and the year 2000 – a reflection of the rapid rate of productivity growth; in the less favourable scenario employment actually falls further from 6 to 5.4 million. The extent to which the labour market is in disequilibrium then depends decisively on changes in potential labour supply. Under-employment – registered and non-registered unemployment – will lie somewhere between 1.6 and 2.2 million, the unemployment rate between 13 and 19%. Only in the optimistic variant is registered unemployment – slightly – lower than at present (approx. 15%). Even then the unemployment rate would be twice as high as in West Germany in the year 2000. Thus in labour market terms, even the “optimistic” scenario is hardly comforting.

#### Prognos AG: An economic miracle in East Germany

At the start of 1993 the Prognos AG published a long-term prognosis for Germany as a whole to the year

2010. It contains just one development path, which the authors consider probable, but is extraordinarily optimistic. It is very much in line with the DIW's integration scenario to the year 2000, and indeed can be seen as its extrapolation to 2010. According to the prognosis East German GDP will increase at an annual rate of 9.2% between 1991 (the base year) and the year 2000, and by 4.6% p.a. during the following decade. In this scenario, too, the growth boom results from a particularly high level of investment and a rapid rise in exports. The “catching-up” modernisation process centres on swift reindustrialisation. According to Prognos, industrial output is set to rise by 19.4% p.a. between 1992 and the year 2000 and by 4.8% between 2000 and 2010. Demand for East German industrial products is expected to come primarily from West Germany and abroad. East German exports, which by 1992 (DM 19 billion) had fallen by about half on their 1989 figure, are forecast to explode to DM 172 billion, a figure which excludes sales to West Germany. This leads to the all but complete closure of East Germany's trade deficit by the year 2010. In spite of this blustering expansion, which one is tempted to describe as a second German economic miracle, labour productivity in the new federal states is not expected to exceed 84% of the West German level by 2010. It should be borne in mind, though, that this figure is consistent with disparities between the West German federal states.

The supposed economic miracle does not leave much of a mark on the East German labour market, however, as it is based primarily on rapid productivity growth. According to the prognosis, employment will fall to 5.7 million by the year 2000, and will subsequently expand only marginally. The rate of population decline is slightly steeper than in the DIW scenario. Even so, under-employment is expected to reach almost 2 million by the year 2000, of which only a proportion will be reflected in the official unemployment figures. In the following years, it is largely the rapid contraction of the potential supply that leads to a reduction in under-employment to just over 1 million by 2010.

Both the integration scenario developed by the DIW and the Prognos

**Table 1: Demographic and Economic Trends in East Germany to the Year 2000 (DIW)**

	1989	1994	2000	
			«Intégra- tion»	«Stagna- tion»
Population (in millions)	16.4	n.a.	15.2	15.0
GDP growth in %	n.a.	5.9	10.1 <sup>e</sup>	5.8 <sup>e</sup>
Net exports	-	-195	-127	-158
Fixed capital formation <sup>a</sup>	n.a.	133	155	160
Private consumption <sup>a</sup>	48	56	80	74
Productivity growth <sup>b</sup> in %	n.a.	8.3	10.7 <sup>e</sup>	7.9 <sup>e</sup>
Potential labour force <sup>c</sup>	9,860	8,433	7,952	7,880
Total employment <sup>c</sup>	9,860	6,069	6,075	5,400
Industrial employees <sup>a,d</sup>	3,246	1,320	1,390	990
Under-employment <sup>c</sup>	-	1,989	1,637	2,190
Registered unemployment <sup>c</sup>	-	1,159	935	1,370
Non-registered unemployment <sup>c</sup>	-	830	702	820
Unemployment rate (in %)	-	15.2	12.9	19.4

n.a. = not available

a per inhabitant; East-West ratio in %

b GDP per employee

c in thousands

d manufacturing industry

e annual growth rate 1992-2000

Source: German Institute for Economic Research (DIW)



**Table 2: Key Data from the Prognos Scenario for East Germany to the Year 2010**

	1991	2000	2005	2010
Population (in millions)	15.9 <sup>a</sup>	14.4	n.a.	13.7
Growth in % <sup>b</sup>				
– GDP	9.2	6.1	3.1	
– Fixed capital formation	9.4	2.9	3.0	
– Productivity	12.0	5.8	2.6	
– Exports	13.2	6.8	3.8	
– Imports	2.3	0.2	3.0	
Net imports in DM billions	180.9 <sup>a</sup>	89.5	20.9	12.7
– of which: from West Germany	180 <sup>a</sup>	75	17	14
GDP per employee, East-West ratio in %	29.0	67.1	80.8	83.9
Potential labour force	8,929 <sup>a</sup>	7,725	n.a.	7,020
Employment in millions	7,179	5,730	5,833	5,983
Under-employment in millions	2,562	1,995	n.a.	1,062
n.a. = not available				
a 1992				
b annual averages for the periods 1991-200, 2000-2005 and 2005-2010				
Source: Prognos AG				

forecast appear overoptimistic, as they are based on long-term reindustrialisation with unrealistically high rates of growth of industrial output and exports. Too little attention is paid to the question of where the demand for the supply-side “economic miracle” is to come from. Moreover, the feedback effects on the West German economy of West German direct investment in East Germany, as a key factor behind expansion there, would appear to have been largely ignored: if, indeed, direct investment is maintained at a high level over a long period, this is likely to represent primarily a regional shift from West to East, the mirror image of which will be lower investment levels in the old Länder.

#### IWH scenarios

Researchers at the IWH have published a number of projections to 2005 and 2010. They differ in methodological terms from the DIW and Prognos studies. Neither the results nor the assumptions are fully documented, and cannot therefore be subjected to rigorous analysis. Moreover, a large number of variants covering a broad spectrum of possible developments have been put forward, whereby the authors have not made clear which they consider the most probable. At the same time, the projections reveal a number of determining factors behind economic developments which do not appear with such clarity in the prognoses discussed so far.

The study by H. Schneider et al. from the IWH begins by analysing the current situation, and comes to the astonishing conclusion that the total number of working hours per

year per person of working age (i.e. between 15 and 65) was scarcely lower in East Germany (in 1993) than in West Germany. The under-employment rate (the unemployed and those in labour market policy measures as a percentage of the employed and the under-employed), on the other hand, was 30% in the new federal states, compared with just 9% in the old Länder (cf. p. 2, row 11.1 in this volume). This suggests that the difference in the extent of under-employment between East and West Germany is due to differences not in total working hours, but in participation rates and individual working time: according to IWH, almost two thirds of the under-employment in East Germany is explained by the higher labour force participation, particularly that of women. If participation rates had been as in West Germany, East German under-employment in 1993 would have been just 1.1 million rather than the actual figure of 2.7 million. On top of this come the longer working hours in East Germany and the smaller relative number of part-time jobs. If average working hours per employee in the new Länder had been the same as in West Germany (in 1993), the number of under-employed here would – in purely statistical terms – have been 8% lower.

Clearly one possible – although arbitrary – way of interpreting these findings is to claim that East German under-employment is in fact relatively “harmless”, and that female participation rates and the extent of part-time employment should be brought into line with West German levels as quickly as possible. In their long-term prognoses,

however, the IWH authors assume that the East German propensity to work is likely to move into line with that in West Germany only gradually, and will not have adjusted fully by the year 2010. The greater part of the adjustment will have occurred, according to the prognosis, by the year 2000 (reduction in potential labour supply by around 1 million persons).

Given the gradual adjustment on the labour supply side – considered the most probable path – the forecasts for labour demand in East Germany to the year 2010 imply, depending on the assumptions made, under-employment of between 875,000 and 3.3 million. The first figure would result from a complete adjustment of East German demand and production structures to those in the west of the country (same domestic and foreign demand per capita, same productivity level). The massive job shortfall of over 3 million, on the other hand, would result if the demand and supply structures prevailing in 1993 were maintained. The projections show clearly that East Germany's economic development depends primarily on the extent to which the West German level of domestic per capita demand and West German export shares can be attained. Clearly, such a change presupposes reindustrialisation. As already mentioned, as far as the labour market is concerned, demographic trends and participation rates are also of decisive importance.

Another prognosis conducted by the IWH (*IWH Herbstgutachten* [Autumn Report] 1993, p. 69 ff.) puts forward three scenarios to the year 2005, all based on an assumed decline in the overall population to 14.3 million and a potential labour supply of 7.9 million in that year. The first scenario – “status quo” – extrapolates the developments which occurred up to 1994 to the year 2005, whereby investment activity is assumed to have fully adjusted to West German figures by the final year of the prognosis. This generates growth of 7.4% p.a. to the year 2000, declining to an annual rate of 3.4% for the five following years. During the period under consideration the level of employment falls by around 450,000; in 2005 under-employment is at around 1.7 million. In the second – “working

time" – scenario, working hours are reduced considerably – to around 32 hours per week in the non-farm sector – while the other assumptions remain unchanged. As a result, the level of employment in 2005 remains at about the level recorded in 1993; around 1.3 million persons are under-employed. In the third – "employment" – scenario, finally, the East German economy moves over to a higher investment trajectory, generating annual economic growth of 8.3% to the year 2000, and subsequently of 4.2%. Working hours again contract markedly. This leads to under-employment of just 1.15 million in 2005. Although the three scenarios have not yet been fully developed in methodological terms, they do clearly show the role that could be played by changes in working hours.

#### **Population: From 16 to 12.9 million?**

Recently demographic experts from the Humboldt University in Berlin published population forecasts for the new *Länder* which can be of considerable assistance in estimating potential labour supply trends (Münz/Ulrich 1994). The authors base their calculations on the experiences of the years 1989 to 1993: 1.3 million East Germans migrated to West Germany (migration in the opposite direction amounted to around 300,000); the number of marriages fell and birth rates declined by 65%, divorce rates by 80%. A number of scenarios have been developed to the year 2010, of which one is considered the most plausible. In this version, East Germany's population losses due to net outward migration (to and from West Germany and the rest of the world) settle at around 0.3% per annum; this currently amounts to around 45,000 individuals. From 1996 on, annual net migration remains constant. The high level of outward migration throughout the prognosis period is largely put down to the unfavourable employment situation; an additional factor is that ethnic German immigrants and asylum seekers are unlikely to settle in East Germany in large numbers. Fertility figures gradually adjust to West German levels; around two thirds of the "postponed" births are subsequently offset by women giving birth later in life.

On these assumptions, by the year 2010 East Germany's resident population will have declined by almost 20% as against 1990 (by 16.4% against 1993) to 12.9 million (2000: 14.1 million). Over the period 1990 to 2010 40% of the rapid decline in the population is due to net outward migration and 60% to the lower level of births than deaths. This trend leads to fundamental changes in age structures. Between 1990 and 2010 the number of East German residents aged less than 20 falls by 58%, while the population of greatest relevance to the labour market (the 20 to 60 year-olds) contracts by 13%; the number of elderly persons (over 60), by contrast, expands by 14%. These trends will therefore serve to ease the pressure on the labour market – somewhat but not decisively. The real pressure-easing impact will not occur until after 2010 as an "echo effect" of the massive fall in the birth rate after 1989.

It should be noted, however, that the – in general very bleak – prognosis stands and falls on the assumptions on migration, which are difficult to forecast over such a long period and which, moreover, are susceptible to the influence of suitable policies.

#### **Regional adjustment processes: Experiences from other countries**

Although the transformation in eastern Germany is a unique historical process, differing both from the upheavals in East European countries and from regional structural crises in developed market economies, it is valuable to look back on the experience of regional adjustment processes in western market economies in order better to be able to evaluate the development chances of the new *Länder*. The long-term development of regional disparities in western countries can, by serving as a reference model, possibly provide some indication of just how plausible the various long-term prognoses for East Germany are.

For the USA, in 1991 Barro/Sala-i-Martin published a thorough study of regional developments from 1880 to 1987. Their conclusion was that there is a clear trend towards a convergence of regional per-capita incomes in the USA. The in-

come disparities between the poor and the rich states contracted significantly, although only as a trend and extremely slowly, namely over several decades: on average the gap narrowed by just 2% per annum. Even so, the empirical evidence is very clear that in the longer term per capita incomes in the poor states have grown more rapidly than in the richer states. Supplementing the above analysis, the authors also analysed developments in 73 West European regions in seven countries (Germany, Great Britain, Italy, France, the Netherlands, Belgium and Denmark) over the period 1950 to 1985: the findings confirm the development trends identified in the USA. On the basis of these trends, the authors conclude, the adjustment process between the two halves of Germany would take 35 years to overcome just half of the initial disparity.

In a more recent study, Blanchard/Katz go one step further and analyse how regions in the USA have responded to regional shocks and crises since the end of the Second World War. Initially unemployment rises sharply, participation rates fall temporarily and, above all, outward migration occurs. After about seven years unemployment and participation rates return to normal and employment expands somewhat, although without coming even near its original level. Two thirds of the impact of the crisis are absorbed by labour migration. In the longer-term, the authors conclude, regional growth and employment trends are very stable over decades; the weaker states of New England, the west coast, the coal regions and the "rust belt" find themselves on a "below-average path"; above-average trends are recorded in the "sun-belt" states, the "oil states" and parts of the mid-west. Given that mobility in Europe (and Germany) is significantly lower than in the USA, it seems plausible to assume that here regional crises can be "solved" by migration to a significantly lesser extent than in the USA.

In the light of such regional analyses, many economists take a very sceptical view of intra-German developments. Hughes Hullett/Ma estimate that full convergence will take not less than 30 to 40 years. Dornbusch/Wolf take a simi-

lar view: they see the main problems as the time required to overcome the East-West productivity gap, which at the start of the Unification process amounted to around 70%. Dornbusch/Wolf point to various growth countries and phases since 1945: Japan, for instance, set up an international record in the 1960s, managing to make up 20 percentage points of the then prevailing productivity gap vis à vis the USA during that decade. Hong Kong achieved similarly fast productivity growth at times. Clearly, though, such comparisons overlook the specific situation in Germany, where a large proportion of the existing enterprises was closed down; the newly founded firms and those existing firms acquired during privatisation have attained the highest productivity levels within a very short space of time. The problem with this process is that it involved the loss of a large proportion of the existing employment opportunities. Thus a distinction should be drawn between the rapid productivity growth in terms of output *per employee* and the far slower growth of "regional productivity" (i.e. output *per inhabitant*).

If nothing else, the comparison with regional developments in developed western market economies

shows that it is unrealistic to count on an "optimistic" trend, leading to rapid full convergence with West Germany. While one must clearly beware of simply transposing experiences from the USA or western Europe onto East Germany, there is much to support the view that even with the help of government intervention and massive financial transfers, it will not prove possible to achieve full convergence of productivity levels in East and West German firms by the year 2010. If, by way of example, the growth rate expected for East Germany for 1995 of around 8.5% (compared with 2.5% in the old *Länder*) were maintained, and assuming unchanged populations in the two regions, convergence of per capita GDP would take 16 years. Yet this trend, like the Prognos forecast, seems rather unlikely. On the other hand, it does seem probable that the prevailing labour market problems will to a large extent be "solved" by outward migration, early retirement, and falling birth and female participation rates. This will enable East and West German unemployment rates – as measured by the official figures – to converge more quickly than the regional per-capita incomes.

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## INSTRUMENTS

### Amendments to the Labour Promotion Act

**Two far-reaching amendments to the Labour Promotion Act came into force on 1 January and 1 August 1994. Their main aim is to limit spending on labour market policy – and thus the size of the central government grant to the Federal Labour Office – as a contribution to controlling the rapid rise in public debt. At the same time, a range of new provisions – such as the admission of private job placement agencies, support for part-time employment and self-employment – is intended to raise labour market flexibility.**

The "First law implementing the saving, consolidation and growth programme", which came into force on 1 January 1994, has amended the Labour Promotion Act (LPA) on the following points relevant to labour market policy in East (and

West) Germany (cf. inforMISEP no. 45, pp. 7-8):

- The wage-replacement rate of unemployment benefit, short-time working allowance, bad-weather allowance and unemployment assistance is reduced by three per-

centage points; for benefit recipients with a child the reduction is just one percentage point. Unemployment benefit now amounts to 60% of previous net monthly wages for the unemployed without children and 67% for those with children.

- The maintenance allowance paid to participants in further vocational training measures is reduced to the current level of unemployment benefit. This does away with the direct financial incentive to participate in further vocational training. The legal entitlement to the maintenance allowance was abolished as was support for advanced training to gain

- promotion (*Aufstiegsfortbildung* – cf. East Germany no. 6, p. 5).
- Unemployed persons entitled to unemployment assistance because they had not worked long enough for entitlement for unemployment benefit can now only receive unemployment assistance for a maximum of one year. (Entitlement to unemployment assistance arising when entitlement to unemployment benefit expires, on the other hand, remains unlimited.)
  - The bad-weather allowance, paid in construction firms suffering loss of work due to bad weather, is restricted to three months (from December to February) and will be abolished completely in 1996.
  - In future the employer must pay the social insurance contributions of short-time workers for the lost working hours; previously, part of this sum was reimbursed by the Federal Labour Office (cf. East Germany no. 1, p. 6).
  - The special programme to integrate the particularly difficult-to-place unemployed, which has largely been used to promote the recruitment of trainers and other staff for labour market policy projects, has been included in the Labour Promotion Act (until the end of 1998). Since 1989 this programme has been financed from the central government budget, and not, unlike the rest of labour market policy, from contributions to the Federal Labour Office; subsequently, central government and the Federal Labour Office are to share the costs.

The Employment Promotion Act 1994, which came into force on

1 August 1994, has brought about the following significant changes to the Labour Promotion Act as far as East Germany is concerned (cf. *inforMISEP* no. 47, pp. 4-6):

- Wage cost subsidies under § 249h of the LPA (cf. East Germany no. 10, p. 8) are now also available to work in mass-participation sport, the cultural sphere and in preparation for measures to restore historical monuments.
- The stipulation under § 249h of the LPA that wage costs will only be subsidised if they are at least 10% below pay rates for comparable activities outside the job-creation schemes now also applies to job-creation measures (ABM). The previous restriction of this provision to job-creation schemes enjoying especially high levels of support and the possibility of concluding part-time contracts of no more than 80% of usual working hours in place of the reduced pay levels (cf. East Germany no. 6, p. 8) have been abolished.
- The unemployed are now permitted (subject to the agreement of the employment office) to participate in a short-term further training scheme (lasting up to 12 weeks) without loss of entitlement to unemployment benefit or assistance. (Previously participation in vocational further training led to the suspension of unemployment compensation entitlement, as it was then assumed that the unemployed person was not available for work.)
- Recipients of unemployment assistance are now able (on a voluntary basis and subject to the agreement of the employment of-

fice) to undertake community work without loss of benefit entitlement; this is subject to the condition that remuneration for such work does not exceed a small allowance to cover expenses.

- Unemployed persons entering self-employment are now entitled to the so-called "bridging allowance" (*Überbrückungsgeld* – de facto a continued entitlement to unemployment benefit) for a standard period of 26 weeks (previously the benefit was usually only available for 10 weeks).
- Employees moving from full-time employment to a part-time job (with less than 80% of standard working hours) and who subsequently become unemployed – within the following three years – will be treated, as far as calculating their unemployment benefit is concerned, as if they had remained in full-time employment. Their unemployment benefit will be calculated on the basis of their earnings in their previous full-time position, although the benefit may not exceed the net wages earned during the period of part-time employment.
- In addition to job placement by the employment offices, private job placement agencies have also been permitted to operate. The Federal Labour Office is obliged to grant a licence to private agencies that meet the requirements of being suitable, reliable, financially sound and with appropriate premises. Job placement agencies may as a matter of principle only charge employers for their services.

## INFORMATION

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