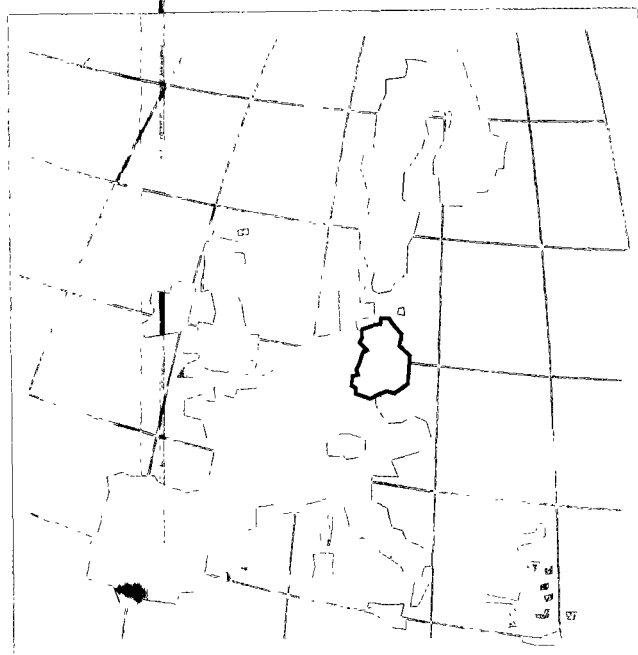


EMPLOYMENT OBSERVATORY

EAST GERMANY

Labour Market Developments and Policies
in the new German Länder

No. 16/17 – November 1995



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EDITORIAL

Five years after unification, the reconstruction of the economy and labour market transformation in East Germany have made significant progress. What remains are the efforts required to “come together”, to grow accustomed to new social conditions and the differing mentalities that continue to characterise day-to-day life in Germany. Despite the massive transfer of resources German unity cannot simply be “produced”.

Labour market policy, confronted with the loss of more than three million jobs within a short space of time, has played an important role in the East German transformation process from the outset. The relevant institutions were capable of policy action at an early stage and the massive deployment of labour market policy measures, in many cases with EU support, prevented an even more dramatic rise in unemployment. Yet labour market policy cannot solve the employment problem on its own, but must – this is an important lesson from East German developments – join forces with other policy areas related to employment. A number of innovative approaches were developed in East Germany with the aim of establishing such forms of cooperation. These should be developed further and may open up new opportunities for employment policy in West Germany, too.

To some extent at least, the lessons learnt in East Germany are potentially relevant to the other transformation countries, even though the relatively favourable conditions in East Germany – the massive provision of transfer benefits and the assumption of tried and tested institutions – do not exist elsewhere in Eastern Europe. There are growing signs, particularly in the CIS countries, that the labour market problems there, long underestimated by experts, will prove very difficult to solve.

With this double edition the “Employment Observatory East Germany” takes its leave of its readers. Since the start of 1992 we have attempted through this publication to shed light on the multi-dimensional aspects of the transformation process on the East German labour market and to bring them to the attention of a wider audience, both within Germany and abroad. The editors and the editorial advisory council would like to thank the authors from the Science Centre Berlin (WZB) and the other research institutions for their contributions and the Directorate-General V of the European Commission for its financial support for this project.

Employment in

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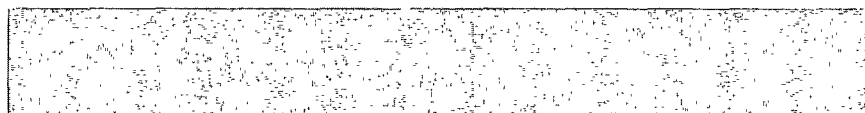
ECONOMIC AND LABOUR MARKET STATISTICS

	1st half- year 1989	2nd half- year 1989	1st half- year 1990	2nd half- year 1990	1st half- year 1991	2nd half- year 1991	1st half- year 1992	2nd half- year 1992	1st half- year 1993
Economy									
1. Gross Domestic Product in 1991 prices (billions of DM)	150.1	153.5	147.0	107.4	98.1	107.9	104.9	117.2	114.1
2. Gross value added by sector in 1991 prices (billions of DM)									
2.1 Agriculture and forestry	3.8	7.8	3.0	7.4	0.1	7.1	0.6	6.1	1.3
2.2 Energy and mining	10.1	10.4	9.9	8.9	8.7	7.3	6.9	6.6	6.6
2.3 Manufacturing	48.8	46.5	44.5	21.1	16.4	18.5	17.3	19.7	19.1
2.4 Construction	13.6	13.2	13.2	12.9	11.8	12.5	15.6	16.3	16.8
2.5 Trade and transport	28.3	29.2	28.2	17.9	14.3	14.9	14.8	16.3	16.2
2.6 Services	16.0	16.4	16.6	14.0	22.2	23.5	26.0	27.3	27.1
2.7 Government	23.6	24.0	25.4	22.4	23.6	22.6	22.5	22.5	24.8
3. Expenditure on the Gross National Product in 1991 prices (billions of DM)									
3.1 Private consumption	82.1	89.4	82.5	91.6	84.7	95.0	92.9	104.0	96.0
3.2 Government consumption	41.4	43.4	43.6	43.4	39.1	48.6	43.7	50.0	43.5
3.3 Fixed capital formation	28.6	28.7	28.7	36.6	42.1	50.0	56.0	61.7	62.7
3.4 Exports minus imports	-4.2	-4.5	-3.8	-49.3	-65.9	-78.4	-88.0	-91.9	-90.5
Labour market									
4. Working-age population (in thousands)	10721			10618		10527		10465	
4.1 Migrations to West Germany (in thousands)	49	339	257	138	102	148	94	106	78
4.2 Migrations from West Germany (in thousands)	1	4	12	24	34	47	51	61	54
4.3 Commuters to West Germany (in thousands)	-	-	-	206	446	541	451	506	-
5. Total employment (in thousands)	9836	9610	9076	8060	7462	6903	6423	6298	6183
5.1 Share of female employment (%)	49		49	47	46	46	46	46	45
5.2 Employees in <i>Treuhand</i> companies (in thousands)	-	-	4100	2979	2115	1404	1070	458	296
6. Employment by sector (in thousands)									
6.1 Agriculture and forestry	977	971	804	651	469	385	291	255	234
6.2 Energy and mining	349	351	345	320	244	208	181	164	146
6.3 Manufacturing	3509	3254	3092	2658	2171	1727	1336	1210	1120
6.4 Construction	629	622	620	640	702	728	792	840	883
6.5 Trade and transport	1500	1535	1446	1288	1251	1205	1149	1133	1116
6.6 Services	617	622	649	771	919	969	999	1039	1075
6.7 Government (incl. <i>ABMs</i>)	2040	2040	1965	1672	1505	1452	1436	1412	1360
7. Employment in labour market measures (in thousands)									
7.1 Employed in job creation measures (<i>ABMs</i>)				20	148	390	402	355	237
7.2 "Wage-cost subsidies East" (§ 249h AFG)									14
7.3 Short-time workers			656	1794	1899	1035	417	233	201
7.4 Full-time equivalent of loss of working hours in case of short-time working				866	1078	594	223	109	89
8. Non-active population in labour market measures (in thousands)									
8.1 In full-time further training measures				45	170	310	442	434	368
8.2 In early retirement				460	521	705	806	834	857
9. Total persons in labour market measures (7.1 + 7.2 + 7.4 + 8.1 + 8.2) (in thousands)				1391	1917	1999	1873	1732	1565
9.1 As % of potential labour force (11.)				15	22	23	21	20	18
10. Total unemployment (in thousands)			142	642	843	1038	1123	1101	1100
10.1 Unemployed women (in thousands)			69	352	482	635	715	704	708
10.2 Unemployed women (%)			54.6	55.2	59.5	61.6	63.6	63.9	64.4
10.3 Long-term unemployed (in thousands)								271	
10.4 Long-term unemployed (as % of unemployed)								24.4	
10.5 Women proportion of the long-term unemployed (%)								68.9	
10.6 Unemployment rate (Tsd.)			1.6	7.3	9.5	11.8	14.2	13.9	15.1
10.7 Male unemployment rate (%)				6.4	8.0	8.9	10.0	9.7	10.4
10.8 Female unemployment rate (%)				8.2	11.2	14.7	18.9	18.6	20.2
11. Labour force potential (4.3+5.+8.1+8.2+10) (in thousands)	9836	9610		9413	9442	9497	9245	9173	
11.1 As % of working-age population (4.)	92			89		90		88	
12. Labour force (4.3+5.+10.) (in thousands)	9836	9610		8908	8751	8482	7997	7905	
12.1 Activity rate (12. as % of 4.)	92			84		81		76	
13. Shortfall of "regular" employment (9.+10.) (in thousands)				2033	2760	3037	2996	2833	2665
13.1 As % of potential labour force (11.)				22	29	32	32	31	29

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., 4.3, 5.1: data for May or November; rows 5., 6.1-6.7: averages of the 2nd and 4th quarters respectively; row 5.2: 1990/91 1 July or 1 January after the end of the half-years; rows 7.3, 7.4: for first half-year 1990 figure from mid-July; rows 10.3-10.6: end of September).

Rows 5., 6.1-6.7: total employment excl. commuters to West Germany, but including employment in labour market measures (rows 7.1-7.3); row 7.4: number of short-time workers multiplied by the average amount of working time lost; row 8.1: until mid-1992 estimated; row 11: excl. "discouraged workers" outside labour market policy measures; rows 10.3-10.5: persons registered unemployed for 1 year or longer; rows 10.6-10.8: from 1995 onwards the basis of the unemployment rate has been changed (dependent civilian working population in June 1994; earlier basis dated from the end of 1989, then from November 1990, then from June 1992 and then from June 1993).



2nd half-year 1993	1st half-year 1994	2nd half-year 1994	1st half-year 1995	Sept. 1995
124.0	123.3	135.0	131.9	
6.0	0.6	5.7	0.6	
6.4	6.5	6.2	6.3	
22.5	21.8	25.4	24.7	
18.4	20.9	22.4	23.1	
18.1	17.4	19.4	18.1	
28.4	29.4	30.9	32.1	
21.3	23.3	21.5	23.6	
106.3	100.8	110.5		
49.1	44.4	49.9		
71.6	73.4	82.9		
-100.3	-99.0	-104.6		
10505		10540		
95	73			
65	60			
607		550		
6259	6237	6433	6411	
44	45			
187	132	119		
225	223	230	228	
134	120	116	106	
1085	1047	1053	1032	
963	986	1056	1063	
1136	1117	1165	1123	
1133	1161	1230	1244	
1322	1303	1299	1303	
177	198	226	213	190
63	91	103	109	111
125	105	59	72	58
56	46	29	36	33
271	234	264	255	231
778	643	569	370	308
1346	1212	1191	984	872
15	14	14	11	10
1175	1117	1015	1003	1033
754	734	660	639	658
64.1	65.7	65.0	63.7	63.7
356		361		
30.7		34.7		
74.4		77.0		
16.2	15.7	14.2	14.3	14.7
11.2	10.4	9.6	10.1	10.4
21.5	21.3	19.2	18.7	19.2
9090		8831		
87		84		
8041		7998		
77		76		
2521	2329	2205	1986	1905
28	26	25	23	22

Index 1st half-year 1989 = 100											
1st half-year 1990	2nd half-year 1990	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	2nd half-year 1994	1st half-year 1995	
98	72	65	72	70	78	76	83	82	90	88	
79	194	4	186	15	160	34	158	16	150	16	
98	88	86	72	68	65	65	64	64	61	62	
91	43	34	38	36	40	39	46	45	52	51	
98	95	87	92	115	120	124	136	154	165	171	
100	63	51	53	52	57	57	64	62	69	64	
104	88	138	147	162	170	169	177	183	193	200	
108	95	100	95	95	95	105	90	99	91	100	
101	112	103	116	113	127	117	129	123	135		
105	105	94	117	106	121	105	119	107	121		
100	128	147	175	195	216	219	250	256	289		
90	1180	1577	1876	2104	2198	2164	2399	2368	2502		
99			98		98		98		98		
92	82	76	70	65	64	63	64	63	65	65	
82	67	48	39	30	26	24	23	23	24	23	
99	92	70	60	52	47	42	38	34	33	30	
88	76	62	49	38	34	32	31	30	30	29	
99	102	112	116	126	134	140	153	157	169	169	
96	86	83	80	77	76	74	76	74	76	75	
105	125	149	157	162	168	174	184	188	199	202	
96	82	74	71	70	69	67	65	64	64	64	
Index 2nd half-year 1991 = 100											
5	38	100	103	91	61	45	51	58	55		
63	173	183	100	40	23	19	12	10	6	7	
146	181	100	38	18	15	9	8	5	6		
15	55	100	143	140	119	87	75	85	82		
65	74	100	114	118	122	110	91	81	52		
70	96	100	94	87	78	67	61	60	49		
14	62	81	100	108	106	106	113	108	98	97	
11	55	76	100	113	111	111	119	116	104	101	
99	99	100	97	97		96		93			
105	103	100	94	93		95		94			
67	91	100	99	93	88	83	77	73	65		

Sources: National accounts of the Federal Statistics Office and the German Economic Research Institute (DIW), March–October 1995 (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.–10.8); Institute for Employment Research (IAB), IAB-Kurzberichte and IAB-Werkstattberichte (rows 4., 4.1, 4.2, 7.4, 8.1); Infratest Social Research, labour market monitor for the new federal states, Munich/Nuremberg 1991–95 (rows 4., 4.3, 5.1); monthly information sheet of the Treuhandanstalt (row 5.2); calculations by the editors.

FOCUS

Labour Market Policy in East Germany: An Evaluation Five Years after Unification

Over the past five years labour market policy in East Germany has been confronted with a dramatic decline in employment totalling more than three million jobs. Despite the success – about which there can be no doubt – in having prevented a further rise in mass unemployment, the limits to labour market policy have become increasingly apparent. The one central lesson must surely be that labour market policy alone is unable to solve the employment problems facing the new *Länder* and that the links with other policy areas of relevance to employment must be strengthened, in both instrumental and institutional terms. Some innovative approaches have been developed for new cooperation models in East Germany, yet after just five years there is the real danger that they will become buried under the weight of financial constraints and the particularist forms of thinking predominant at the administrative and political levels.

The opening of the GDR economy to world markets revealed the obsolescence of its internal division of labour and of the international division of labour within the Council for Mutual Economic Cooperation (CMEA). The sudden exposure to competition subjected the previously largely autarchic economy of the GDR to a shock. This initial shock was exacerbated in mid-1990 by the appreciation of the GDR-Mark by the order of 300% to 400% as a result of monetary union with the Federal Republic.

The capital stock was antiquated. Productivity per working hour was around one third of that in West Germany (Table 1). The public administration – an important factor for economic prosperity – was unsuited to the new system of highly differentiated statutory regulations that was gradually extended, with slight modifications, to the territory of the former GDR in the wake of political union (October 1990).

The result was a massive contraction of output, particularly in industry and agriculture, a trend exacerbated by the collapse of markets in Eastern Europe. Initially as a consequence of inadequate innovation and investment, but also of the privatisation policy pursued by the *Treuhandanstalt*, the early years of the transformation were characterised by a far-reaching deindustrialisation process in eastern Germany. This has now given way to a slow reindustrialisation.

Within the space of two years GDP fell to two thirds of its starting level in 1989. Since 1992, however, it has been increasing at an annual rate of be-

tween 6 and 9%, largely due to growth in the construction and service sectors. The decline in the number of

working hours and employment was not arrested until the start of 1994, however.

In 1994 there were 6.3 million people in employment in East Germany, just two thirds of the original labour force. Although rapid economic growth is expected to continue, both short and long-term labour market projections suggest that employment is recovering only very slowly. This reflects the still serious – although narrowing – productivity gap vis à vis West Germany and the rapid rise in wages, which have surged far ahead of productivity growth (Table 1).

Following a sharp rise to mid-1991, registered unemployment in East Germany has fluctuated between around 1 and 1.2 million, with a slight decline observed of late. Yet registered unemployment has accounted for a relatively small share of overall underemployment in the new *Länder*.

Figure 1: Labour Market Trends in East Germany, 1989 to 1994

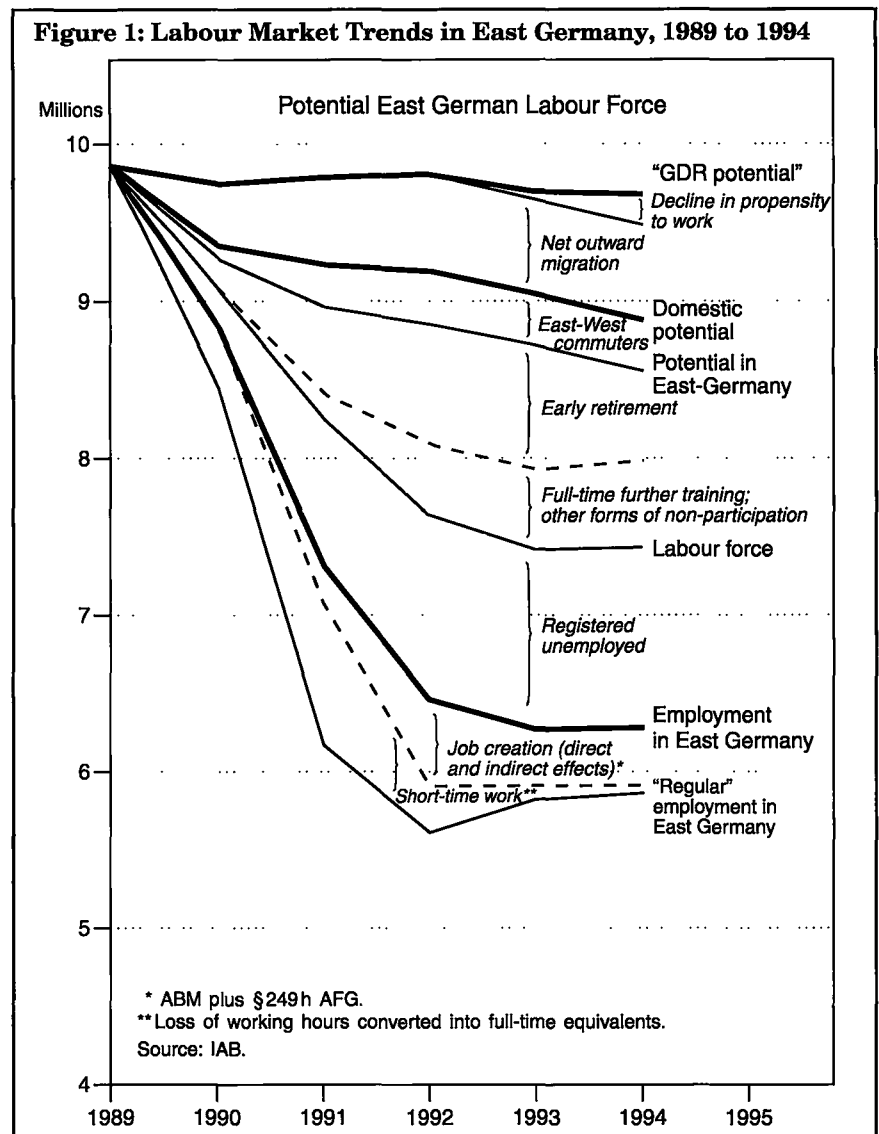


Table 1: GDP, Volume of Working Hours, Employment, Working Time, Productivity and Incomes in East Germany, 1989 to 1994

Year	GDP ¹⁾		Volume of working hours		Employment		Working time per employee ²⁾		Productivity per working hour		Productivity per employee		Working day effect		Gross wages and salaries (GWS)		Employees in employment		GWS per employee			
	billions of DM	Per-cent change ³⁾	Hours in millions	Per-cent change ³⁾	1,000	Per-cent change ³⁾	Hours	Per-cent change ³⁾	DM per hour	Per-cent change ³⁾	DM	Per-cent change ³⁾	billions of DM	Per-cent change ³⁾	1,000	Per-cent change ³⁾	billions of DM	Per-cent change ³⁾	1,000	Per-cent change ³⁾	DM	Per-cent change ³⁾
1989	302.1	-15.6	17,369	-15.5	9,747	-9.5	1,782	-6.6	17.39	-0.1	30,994	-6.7	136.13	0.0	9,558	0.0	136.13	0.0	9,558	0.0	14,243	0.0
1990	255.1	-19.2	14,682	-24.0	8,820	-17.0	1,664.7	-8.5	17.38	+6.3	28,925	-2.7	143.19	+5.2	8,647	-9.5	143.19	+5.2	8,647	-9.5	16,560	+16.3
1991	206.0	+7.8	11,151	-2.0	7,321	-12.8	1,523.2	+12.3	18.47	+10.1	28,138	+8.1	157.68	+10.1	7,219	-16.5	157.68	+10.1	7,219	-16.5	21,842	+31.9
1992	222.1	+5.8	10,924	-0.7	6,386	-3.0	1,710.6	+2.3	20.33	+6.6	34,779	+8.1	186.50	+8.2	6,307	-3.8	186.50	+8.2	6,307	-3.8	29,570	+35.4
1993	235.0	+5.8	10,842	+0.7	6,196	+1.1	1,749.9	-0.8	21.67	+8.9	37,928	+8.0	201.80	+7.8	6,069	+0.8	201.80	+7.8	6,069	+0.8	33,251	+12.4
1994	256.7	+9.2	10,879	+0.3	6,267	+1.1	1,735.9	-0.4	23.60	+3.4	40,961	+2.1	217.60	+4.6	6,115	+1.6	217.60	+4.6	6,115	+1.6	36,586	+17.0
By way of comparison: West Germany:																						
1989	2,384.4	+3.6	45,802	+0.2	27,658	+1.5	1,656.0	-1.2	52.06	+3.4	86,210	+2.1	992.81	+4.6	24,750	+1.6	992.81	+4.6	24,750	+1.6	40,114	+3.0
1994	2,709.6	+2.3	45,029	-2.2	28,619	-1.3	1,573.4	-0.9	60.17	+4.6	94,678	+3.6	1,245.01	+0.4	25,230	-1.4	1,245.01	+0.4	25,230	-1.4	49,946	+1.9

1) Real, at 1991 prices 2) Including changes in number of working days 3) Change on previous year

Source: Federal Labour Office; calculations by IAB.

In spite of the drastic decline in employment it proved possible to prevent an even more substantial rise in unemployment. This reflects the extent to which the burden on the East German labour market has been eased: by outward migration and "commuting" to work in West Germany (cf. East Germany, No. 14, pp. 7-11) and by labour market policy measures such as short-time working, early retirement, vocational training measures (further training, retraining), job creation measures (ABM) and, since 1993, wage cost subsidies under § 249h of the Labour Promotion Act (LPA). These measures are listed in figure 1.

At the end of 1991 the measures implemented served to ease the burden on the East German labour market to the tune of almost two million persons, whereas registered unemployment was "just" one million. When the special provisions on short-time working and early retirement came to an end, legal changes were introduced and budgetary restrictions imposed, this policy effect declined by almost half to 1.2 million persons (at the end of 1994). The figure is expected to sink further.

In the light of these developments, it is inevitable that investment to modernise the capital stock and infrastructure has played a key role in solving the labour market problems facing the new federal states. Indeed, a - virtually innumerable - variety of economic support programmes have been introduced to bolster investment: investment grants, low-interest loan programmes, loan guarantees, tax allowances, grants for research and development in small and medium-sized enterprises, etc. In many cases these forms of assistance can be claimed in cumulative fashion. There is little firm evidence regarding their impact on job creation and maintenance, however. Between 1990 and 1993 a total of DM 178 billion were granted in direct support of commercial and infrastructural investment. Survey evidence suggests that without these funds 37% of firms would have invested nothing at all and 33% would have invested less. The impact of such investment is, however, subject to time lags and is clearly still not sufficient to close the employment gap over the medium term, although in per capita terms investment in the new *Länder* has been

higher than in West Germany since 1993.

The functions of labour market policy

In such a situation labour market policy has an indispensable complementary role to play. More so than in West Germany, it can help push forward structural change and support the creation of new, permanent jobs; it cannot create such jobs by itself, however. In doing so it must take account of the specific characteristics of the shock transition to a market economy with all its problematic repercussions: it is not a temporary decline in employment that must be countered, but long-term, persistent mass unemployment; a trend towards a polarisation between structurally weak and favoured regions has begun (cf. Trends in this issue); and, last but not least, there are signs of increasingly pronounced segmentation and rising long-term unemployment.

The matrix reproduced on the following page can be used to systemise the central functions of labour market policy, whereby individual instruments may perform several functions.

An additional important function has crystallised in ad hoc fashion out of the transformation process under way in the new *Länder*, namely as a "labour market fire brigade". This is reflected in the implementation of preliminary measures with a rapid impact in terms of easing labour market pressure, but which do not attempt to tackle the employment problem itself. The short-time working allowance, in particular, the "measure of the first hour", fulfilled such a "fire brigade" function: preventing a rapid rise in registered unemployment in the face of the rapidity with which labour was being shed and the slowness with which new jobs were being created. The underlying aim was to gain time for more productive solutions (cf. East Germany, No. 1, p. 6).

Almost all the measures in the "tool box" of the Federal Labour Office have performed the function, vital in the context of transition, of easing the pressure on the labour market. This was particularly the case with the short-time working allowance and early retirement; both measures merely offer wage compensation without any skill maintaining or improving effect, although short-time work does at least have a stabilising effect on employment. Job creation and training measures also served to reduce labour market pressure, but only after an initial start-up phase. The im-

		Level	
		Individual	Macro/ labour market
Duration	Current unemployment-reducing effect	Social security through wage compensation	Avoiding unemployment, easing pressure on labour market
	Improving prospects for the future	Bridging function: improving individual employment chances	Bridging function: developing new employment fields

plementation of such measures is, namely, conditional on the availability of a network of policy providers and deliverers, which was developed only gradually. Despite the far smaller size of the working population, the peak number of participants in job creation and training measures – around 400,000 and 500,000 respectively – was far higher than the corresponding figures in West Germany (in 1992, for instance, around 80,000 on job creation schemes and 250,000 in full-time vocational training measures: cf. East Germany, No. 2, pp. 6-7).

After the initial start-up phase, job creation and further training and re-training measures performed a significant “bridging function” between the secondary and the regular labour market. Their task was to open up new occupational perspectives for the future, at both the individual and labour market levels. Expenditure on such “future-oriented” active labour market policy measures (including, for instance, subsidies for training on the job, mobility assistance and support for those embarking on self-employment) achieved a volume of almost DM 20 billion a year in 1992 and 1993 and has since been maintained at a scarcely reduced financial volume. In 1995 such measures are to account for almost half, namely 45%, of spending by the Federal Labour Office in East Germany; this, in turn, amounts to as much as 38% of total labour market policy expenditure at central government level.

Subordinate to active labour market policy measures, wage compensation benefits for the unemployed – unemployment benefit (an insurance benefit) and the means-tested unemployment assistance provided by central government – have played an important role in providing social security for the individual and so helping to stabilise purchasing power at the macro level (for details of financial expenditure cf. Table 2).

As the employment crisis has become more prolonged it has become increasingly apparent that labour

market policy alone is unable to close the employment gap. In addition to the traditional “accompanying” role of labour market policy, an increasingly important aim has been to provide direct support for the economic recovery using funds earmarked for labour promotion. For example, job creation measures were implemented to clean up production sites and commercial buildings and thus to help overcome obstacles to investment. The so-called “mega job creation projects” signalled something of a reorientation away from traditional support for the individual, as foreseen under the LPA, in favour of support for projects. Increasingly an attempt has been made to seek new forms of training directly related to economic needs by coordinating further training and job creation strategies.

The most obvious expression of this development is the introduction of the so-called “wage cost subsidy, East” under § 249 h of the LPA, a measure due to run until 1997. Under this scheme the principle of financing work rather than unemployment is pursued at the instrumental level: unemployment support benefits are channelled directly into employment-promoting activities. The wage cost subsidy is equal to the average level of unemployment benefit and unemployment assistance and is available for work in environmental protection, social services and youth aid, (more recently also for work to improve sporting opportunities, free cultural work and to prepare for measures to restore historical monuments: cf. East Germany, No. 10, pp. 8-10). Such measures require cofinancing by state or local government, provider organisations or other institutions (e.g. the *Treuhandanstalt*) benefiting from the structural improvements realised under the measure. Around 110,000 people are employed in such projects, largely in cleaning up the environment.

In order to address the wide variety of policy tasks and to ensure the efficient implementation of labour mar-

ket instruments it was necessary to establish a “labour market policy infrastructure” more or less out of nothing. Employment offices were established within a short space of time. In addition to the traditional deliverers of labour market policy measures (in particular educational establishments), in many cases “imported” from West Germany, so-called “labour promotion, employment and structural development” companies (ABS companies: cf. East Germany, No. 8, pp. 3-6) were set up as an innovative new component. The specific aim of such companies was to establish a “bridge” between labour market policy and structural development, for example by allowing projects in receipt of support to set up as private firms. By the end of 1994 a finely meshed net of almost 400 companies had been established, providing support for around 160,000 individuals (105,000 on job creation schemes, 42,000 in receipt of wage cost subsidies under § 249 h of the LPA, 3,000 undergoing training and 4,000 on short-time working).

How successful have labour market policy measures been?

Given the persistent lack of research findings, conclusions regarding the “success” of the labour market policy measures deployed are subject to more or less serious reservations. A number of significant indicators are available, however.

The use of simplified, special regulations for the new federal states facilitated the implementation of labour market policy instruments on a massive scale. Between November 1989 and November 1994 more than half (57%) of the East German working population participated, in some cases repeatedly, in labour market policy measures. If training measures conducted within firms and not in receipt of public support are added to this figure, as many as 81% participated in such adjustment measures. Many take the view that German central, state and local government failed to implement structural policies early enough and in the dimensions required to match the massive implementation of labour market policy. In this context the debates on the privatisation and restructuring of firms owned by the *Treuhandanstalt* and on the maintenance of “industrial cores” (cf. East Germany, No. 11) should be recalled.

Given the order of magnitude of policy deployment it is hardly surprising that, particularly in the initial

phase, labour market policy was not focused on specific target groups to any significant degree. Changes in the structure of participants do indicate, however, that the measures are now being implemented in more selective fashion, the aim being to counter the increasing entrenchment of unemployment among disadvantaged groups, in particular women and the elderly.

An important indicator for the success of labour market policy measures is whether participants remain in employment or find a job after the end of the measure. As many as 59% of those supported by means of a job creation scheme subsequently found work: 17% with the institution providing the measure, 40% in another enterprise, 2% in self-employment. Most of them look for a "regular" job during their period of ABM activity, and many leave measures early because they have found alternative employment.

More than a quarter of former participants remain unemployed after completing an ABM programme. This clearly reveals the limitations to such a "bridging strategy", when, on completion of a measure, the same employment shortfall still exists.

The last remark applies particularly to training measures. The proportion of former participants remaining unemployed after a training scheme – 45% – is significantly higher than in the case of ABM. Even so, 44% of all participants and 52% of those in employment following participation report a positive change in their occupational situation by virtue of the training provided: either in terms of getting a new job, an improvement in occupational terms or increased job security.

Selected problem areas

Based on the experiences of recent years a number of aspects appear to be of special relevance in terms of the ongoing development of labour market policy both in Germany and in the transformation countries of Central and Eastern Europe.

"Training in the dark": at best a difficult task

The difficulty of matching publicly supported vocational training measures to (regional) training needs has been a persistent problem in western industrialised countries; in East Germany the fact that the entire economy was undergoing transition exacer-

bated this problem enormously. On the one hand there was the danger that the training strategies – indispensable as they were in view of the fundamental process of economic restructuring – could run up against a "brick wall" because the required employment opportunities simply were not available. Job creation measures (including support for those entering self-employment) are more important than training in such a situation. On the other hand, the relevance of "remaining in employment" as an indicator of success must be called into question in this context: training as an alternative to long-term unemployment can – at the individual level – help to counter deskilling and destabilisation processes and thus improve the chances of employment at a later date. What is important at the regional level is to maintain and develop labour force skill potential as an important factor for regional competitiveness and as a motor for future development. Even so, the difficulties encountered in orienting vocational training to regional training needs are all too apparent: they are the more intractable, the greater the uncertainty surrounding the prospects for regional development.

Table 2: Expenditure by the Federal Labour Office (FLO) in the New Federal States (million DM)

Type of Measure	1991	1992	1993	1994	1995 H*
<i>I. Future-oriented active labour market policy measures</i>	7,863.9	19,221.6	19,505.1	15,423.1	17,203.0
Standard job creation measures (ABM)	3,075.3	7,783.6	8,585.6	6,811.5	7,294.0
Wage cost subsidy under § 249h LPA	–	–	313.9	1,325.3	1,720.1
Further training and retraining	4,267.3	10,717.0	10,306.5	6,989.1	7,194.3
Work familiarisation allowance	520.4	695.4	201.6	160.7	393.6
Other (ABM for the elderly, support for the hard-to-place, ESF)	0.9	25.6	97.5	136.5	601.0
As a % of total	26.3%	41.8%	38.5%	37.0%	44.9%
<i>II. Employment-stabilising measures</i>					
Short-time working allowance	10,005.9	2,652.5	918.8	498.7	447.9
As a % of total	33.5%	5.8%	1.8%	1.2%	1.2%
<i>III. Measures to prepare individuals for the labour market</i>					
Training	494.1	1,112.4	1,559.5	1,485.0	2,155.0
Occupational rehabilitation	352.0	676.7	923.6	865.3	1,007.9
Integration of ethnic German immigrants	100.9	324.8	526.8	602.0	1,147.1
As a % of total	41.2	110.9	109.1	17.7	0.0
As a % of total	1.7%	2.4%	3.1%	3.6%	5.6%
<i>IV. Wage compensation benefits</i>	10,558.2	21,362.6	26,596.2	22,099.7	15,339.5
Early retirement/transitory allowance for the elderly	2,680.3	9,329.8	13,459.5	9,033.0	2,452.5
Unemployment benefit	7,810.0	11,809.2	12,868.3	12,662.8	12,507.0
Allowance for workers whose employer is bankrupt	67.9	223.6	268.4	403.9	380.0
As a % of total	35.4%	46.4%	52.5%	53.1%	40.1%
<i>V. Other</i>	932.9	1,683.1	2,035.4	2,140.4	3,138.9
Miscellaneous (incl. bad weather allowance)	74.1	357.0	452.4	456.4	615.8
Special tasks of the FLO, administration	858.8	1,326.1	1,583.0	1,684.0	2,523.1
As a % of total	3.1%	3.7%	4.0%	5.1%	8.2%
<i>Total</i>	29,855.0	46,032.2	50,615.0	41,647.0	38,284.3
	100%	100%	100%	100%	100%
memo item: Unemployment assistance (federal budget)	271.3	1,488.5	3,657.8	5,056.9	7,576.0
* According to budget proposal					
Source: Federal Labour Office; IAB.					

Necessity is the mother of invention. In order to overcome such difficulties a number innovative coordination structures have been established in East Germany, such as the regional "Reconstruction Groups" (*Aufbaustäbe*) and the "Regional Qualification Development Centres" (RQZs, joined together in a supra-regional network, a working party on "Qualification Development Management – QUEM). Particularly in the initial phase, the reconstruction groups were set up within the public administration with the task of coordinating support for investment and the labour market. The RQZs, scientific service institutions financed by the Ministry of Education, were entrusted with the task of analysing qualification development at regional level and to advise local training providers and enterprises. These bodies were set up for a limited period only, however, and managed to exert only a very limited influence on developments in this area.

Job creation schemes: a balancing act on the path to competitive jobs

In view of the huge employment shortfall in the wake of economic transformation, employment promotion in the form of wage subsidies inevitably played an important role. Such job creation measures can, at the same time, also be used to improve supply-side structures, for example by developing the regional infrastructure or cleaning up the environment. They are largely "self-financing": at least 60 to 70% of the costs are recouped in the form of lower wage compensation benefit payments and additional revenue from taxes and social insurance contributions.

In order to be effective, however, such measures must be "additional" in nature, i.e. must not compete with private sector economic activities and must be such that they would not have been performed in the absence of the support. This automatically poses controversial questions as to the "appropriate" pay level, i.e. one that does not hinder participants from moving to the regular labour market, and the maximum acceptable order of magnitude for the measures as a whole. Another issue is the alternative uses to which these funds could be put, e.g. for central, state and local government programmes to improve infrastructure and so benefit firms.

In the case of East Germany the theoretical reservations relating to concern about distorting the market

order were allayed by the fact that job creation measures there have to be approved by the leading regional actors, in particular business representatives such as the craft chambers. On the other hand, financial constraints and specific regulations, for example on additionality and the level of individual support, and the short-term orientation of funding led at times to steering problems (stop-and-go policy).

Traditional job creation measures are a tried and tested instrument for promoting target groups and coping with transitory employment shortfalls. They were unable to cope with the additional structural-policy functions in the context of the transformation process, however, not least due to the fact that they are financed solely out of contributions to the unemployment insurance fund. It was thus logical that a new instrument, wage cost subsidies under § 249 h of the LPA, were introduced, which established a much firmer link between the LPA instruments and structural and economic policy. Publicly supported employment under the wage cost subsidy provisions is increasingly oriented to the regular "primary" labour market. However, this is contingent on cooperation between a variety of political spheres (e.g. with the environmental and economic policy departments) and different tiers of government (central, state and local levels), cooperation which has proved difficult at times.

Short-time working as a launching pad

While short-time working can stabilise employment, even for extended periods, and thus initially avoid the negative consequences of redundancy, it cannot by itself solve the employment problem. Even though, in the context of the transformation process, it was frequently not possible to maintain employment with the original employer – as is the case with the traditional, "cyclical" short-time working – this instrument has in many cases cushioned the transfer to a new job. Twelve months after short-time working just under half of the participants were in full-time employment; indeed, the most recent figures (November 1994) show that 75% of the short-time workers in November 1993 were in employment a year later. Between 10 and 15% were unemployed after the twelve-month period. For some, short-time working eased the transition out of the labour force, e.g. into early retirement.

The – seemingly obvious – attempt to link short-time working with training measures, and thus to improve individual labour market chances, proved only moderately successful. Despite the additional incentives created by collectively agreed provisions, only 7% of those on short-time working were participating in training schemes at the end of 1991. It was thus inevitable that, as job creation and training measures increased in importance, short time working, which was essentially merely a form of wage compensation rather than an active measure, was cut back.

Reducing labour supply through early retirement: an expensive emergency solution

Almost one million people took advantage of the special provisions on early retirement in force until the end of 1992. In the years 1992 to 1994 an annual average of more than DM 10 billion were required to finance these measures. Since then the cost of the programmes has fallen, reflecting the fact that those on early retirement are steadily reaching the age limit for pension entitlement (standard retirement age or the lower age limit granted for labour market reasons: cf. East Germany, No. 5, pp. 5-6).

Early retirement fails to build labour market bridges for the future. This is true not only at the individual level (a return to employment is only possible in exceptional cases), but also at the macro level (the use of resources is purely consumptive in nature and makes no direct contribution to creating new jobs). In the final analysis it is more "productive" means of reducing the burden on the labour market that should be sought. It is against this background that the special early retirement provisions were not extended, and the introduction of similar options, even restricted to regions with a particularly serious employment shortfall or structural problems, is unlikely.

Developing a labour market policy infrastructure as a precondition for success

A necessary condition for the successful implementation of policy measures is an adequate labour market policy infrastructure.

The "Labour and Wages Offices" of the former GDR, with around 3,600 employees, performed only very limited functions with respect to matching labour supply and demand. Their activities focused on cooperation with large enterprises, which were fre-

quently obliged to employ "problem cases". Neither quantitatively nor qualitatively were they prepared for the new tasks they were to face. Besides establishing a network of local and state employment offices (since 1992 employing around 25,000 staff) it was necessary to install an effective network of service providers, to create advisory institutions and develop organisational forms of cooperation and coordination.

In many areas the reconstruction phase was dogged by inevitable frictions, a good example being the dubious training measures offered by some commercial training establishments. At the same time, the initial "openness" created space for a number of infrastructural innovations, although now, in the consolidation phase, many of these are being scrapped. The financial support for advisory institutions such as the RQZs, for instance, is due to expire, and these institutions are also suffering from the fact that the employment offices are placing far fewer ABM resources at their disposal than in the initial phase. Also apparent is a functional shift on the part of ABS companies towards traditional providers on a "secondary labour market", who receive long-term labour market policy subsidies to provide measures for the hard-to-place. The hopes once held by both politicians and academics that ABS companies could play a key role in coordinating between structural and labour market policy have been largely – although not everywhere – disappointed. In many cases the institutional basis for a bridging function across political boundaries has been removed before it had even begun to make its effects felt.

Labour market policy as a necessary complementary strategy

The specific political and economic characteristics of the transformation in East Germany led to a transfer of public resources from West to East Germany unparalleled in any transformation country in Central and Eastern Europe. In 1995 the net transfers will total DM 150 billion, around 5% of West German GDP and as much as 40% of East German GDP. This support for purchasing power and investment was initially widely held by economists and politicians to be necessary, but it clearly cannot be increased at will and is increasingly being called into question.

Between 1991 and 1995 the Federal Labour Office spent around DM 205

billion in East Germany. Of this around DM 55 billion were financed by East German contributions to the unemployment insurance fund and around DM 60 billion by a central government grant financed out of general tax revenue; around DM 90 billion took the form of a transfer of West German contributions to the unemployment insurance fund. The financing of such costs incurred as a result of unification out of social insurance contributions has been heavily criticised, not least due to the associated rise in indirect labour costs: the contribution rate to the unemployment insurance fund was raised from 4.3% to 6.8%, subsequently reduced to 6.3% only to rise again to 6.5% (cf. East Germany, No. 3-4, p. 12, No. 10/94, pp. 4-5).

Precisely because, at the institutional level, labour market policy was the first policy area capable of policy action in East Germany, it has suffered from greater pressure to act than other policy areas (e.g. structural and economic policy) and has faced unjustifiable expectations with regard to its ability to solve the employment crisis. At the same time, it is important to be conscious of all that labour market policy has achieved and of its varied functions within the transformation process.

Other Central and East European transformation countries have also suffered declining output compared with 1989, in some cases less severe than in East Germany (e.g. in Poland and Slovenia a decline of around 20% to 1991 and 1992 respectively, followed by a sharp rise), in others far more severe (a fall of around one half in a number of Slavic CIS countries, where, moreover, there have so far been few signs of recovery: cf. Essay II in this issue). In view of the institutional and political differences between East Germany and the other transformation countries and particularly the far lower level of financial resources available in the latter, a simplistic transfer to Eastern Europe of the labour market policies practised in East Germany during the first five years of the transformation is inconceivable. Yet this does not preclude the possibility that the experiences gained in East Germany might shed some light on the scope for and the limitations on labour market policy in the transformation process. Many of the problems described above can be generalised to other countries.

For labour market policy in East Germany, the period of simplified "special provisions" with as broad a

field of application as possible have come to an end. What has remained is the gravity of the problems and the necessity of making an active contribution to solving the employment problem – in East and West Germany – rather than merely financing underemployment. The experiences so far have shown just how important it is to integrate labour market policy more closely with other policy areas of relevance to employment. East Germany has generated a number of innovative new approaches in this regard in both instrumental and institutional terms. However, in view of the increasingly tight financial constraints and the "particularist" way of thinking, a fixation with departmental boundaries, in political and administrative spheres, these approaches have increasingly been in danger of becoming buried. In this light it is all the more important to develop these approaches further and to ensure their practical testing and implementation, for instance via on-going pilot projects, while ensuring cooperation between all the policy areas bearing responsibility for employment.

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ESSAY I

The German Transformation: A Modernisation Process at Two Different Speeds in East and West

I. The "Wende"

Processes of social change can be distinguished according to their depth, speed, direction and susceptibility to steering. We use the term "revolution" if the change is radical, affects the whole of society and is very rapid; the direction is determined to the extent that the ancien régime is to be destroyed. The further course of events, however, is undetermined and, in most historical cases, cannot be steered.

The transformation processes in practically all the socialist countries went through a revolutionary phase. In most cases the direction, too, was clear: from dictatorship to democracy, from the command to the market economy, from scarcity to affluence. Since then, however, it has become evident that the social consensus on this direction has been called into question in a number of post-communist countries, or that other aims, in particular nationalist dominance or secession, have attained priority over the original goals of transformation. We have seen that "breakdowns of transformation" can occur, just as there have always been "breakdowns of modernisation".

One of the features specific to the transformation in East Germany was that, following its initial revolutionary phase, it appeared not only to have a clear direction, but also, it was believed, to be susceptible to steering: by means of the treaties on monetary and social union, the accession of the GDR to the Federal Republic of Germany and the "import" of West German institutions in virtually every sphere of life. The reconstruction of West Germany and the "economic miracle" after the Second World War would be repeated, only faster than in the years 1945 to 1965. It was widely believed that what had taken West Germany twenty years could be achieved in five. Yet sceptical voices were also raised early on: experts predicted that substantial

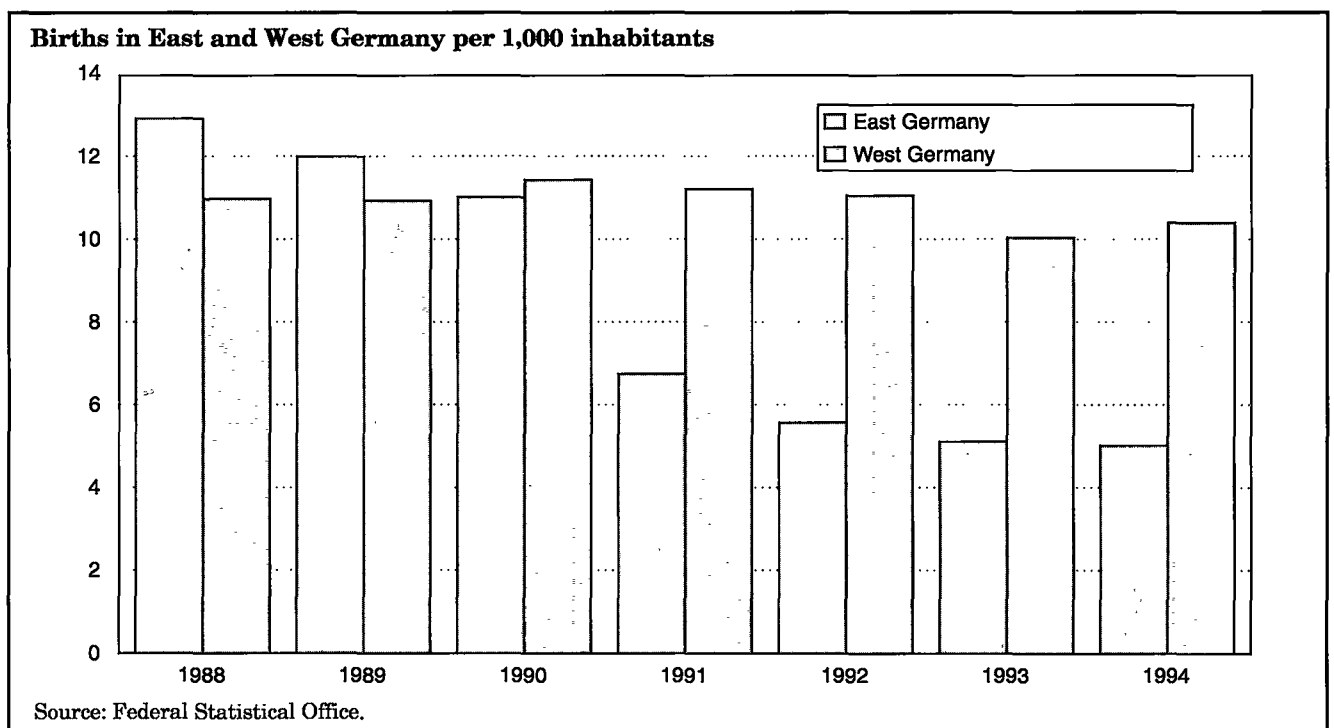
tensions and delays would occur between "institution building" on the one hand and "the formation of the political culture" on the other, just as occurred in West Germany after 1945. What is certainly now clear is that the problems of speed and susceptibility to steering were grossly underestimated.

It is possible to characterise the transformation in Germany in terms of the very different speeds in East and West: a succession of rapid changes in East Germany and a very slow reaction by West Germany to the new situation.

One of the central reasons for the collapse of the GDR were the "blockages" that impeded social differentiation and individual welfare development, particularly during the 1980s. Living standards in the GDR – as measured by per capita GDP – were 50% of those in the Federal Republic in 1950; by 1970 this figure had fallen to 36%. The GDR survived the 1970s rather well, and closed the gap on West Germany slightly. The 1980s, however, were a decade of crisis-ridden stagnation, whereas the Federal Republic experienced a renewed economic upturn beginning in 1983.

II. Acceleration processes

Stagnation in the GDR, a boom in the Federal Republic and an easing of travel restrictions for GDR citizens: this was the background to the wave of emigration that began in the summer of 1989. This, in turn, was decisive in rendering unification the most attractive option. Yet the collapse of the GDR was also the result of an unprecedented combination of "exit and voice", of mass exodus and mass protest. In this context the interesting hypothesis has been put forward that the rising wave of demonstrations over a period of weeks – and the mass exodus – represented a self-organising acceleration process, based not on leadership



but on "diffusion", namely the growing recognition that protest was possible without violence. It is well-known that the mass protests quickly subsided on the announcement of a date for free parliamentary elections at the start of 1990, while emigration stabilised at a low level.

Two further acceleration processes followed: the demographic collapse and the collapse of the East German labour market. The decline in marriages, births and divorces and the process of labour shedding reached their peak at approximately the same time in 1991, continued in 1992 and have decelerated since 1993. It might seem obvious to suppose a simple causal relationship here, namely that the employment crisis initiated the demographic crises. Yet I prefer to take a more complex interrelationship as the point of departure. The decline in the number of births amounted to 40% between 1990 and 1991, 18% (1991/92), 9% (1992/93) and to 2% in 1993/94; the birth rate is now just 48% of that in West Germany (where it has remained practically constant). The fall in the number of marriages amounted to as much as 50% from 1990 to 1991, easing rapidly to 5% between 1991 and 1992, and giving way to a slight increase of 2% (1992/93) and 7% (1993/94): the "marriage rate" is now 58% of the West German figure. (The decline in the divorce rate was even more drastic between 1990 and 1991, although the figure rose again sharply as early as 1992/93.)

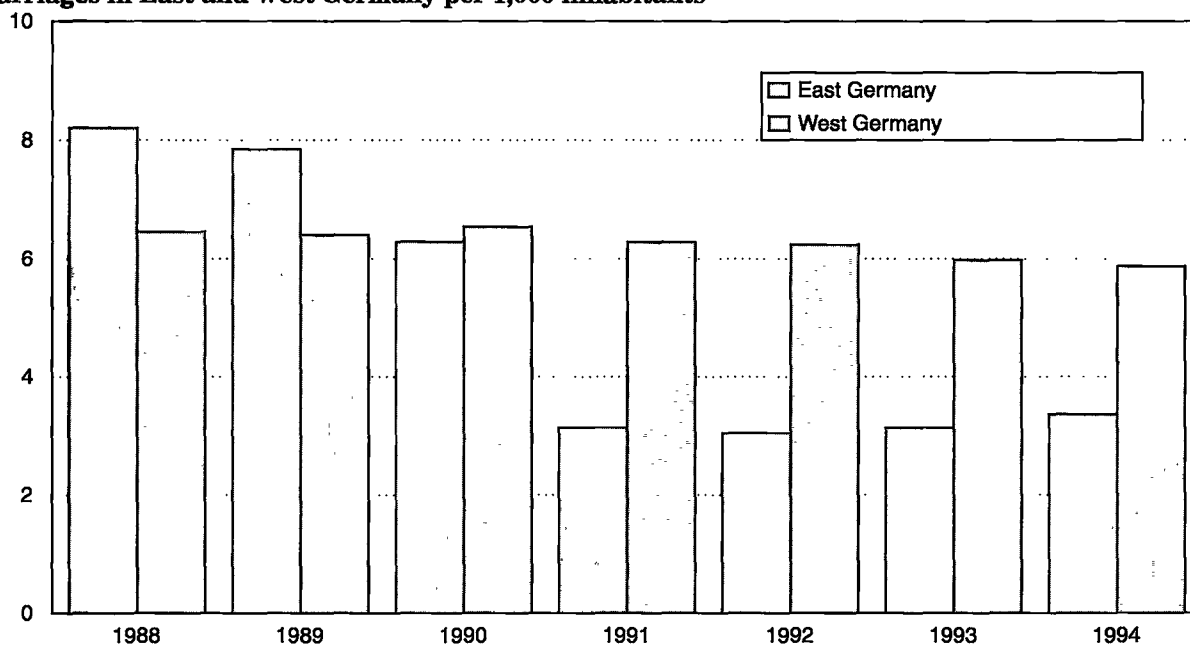
I have traced changes in marriage and birth rates back as far as 1910. Neither during the two world wars nor during economic crises did declines of even approximately the same order of magnitude occur. Can it be concluded from this that German unification marks the most fundamental upheaval – for the East German population – in recent German history? It is indeed possible to draw such a conclusion, although not in the sense of the greatest misery, but rather in the sense of the most profound individualisation process and systemic transition per unit of time, whereby the changes have brought with them not only stress and anxiety, but also previously unknown alternatives and options. In my view the demographic revolution in East Germany can be explained with respect to three components. The first is, indeed, the reaction to an

uncertain future in which – in areas of behaviour over which they exert some control – individuals seek to minimise risks: marriage and childbirth can be determined by the individual, the labour market cannot. Secondly, there has been a reaction against the system of early marriages and births in the GDR (one cemented by state housing policy) and a move towards the western model in which they are postponed. Thirdly, there is the desire to exploit the new scope for travel and consumption, and also for partnership without marriage and children. It is widely forecast that some of the marriages, births and divorces that "have not occurred" have been merely postponed and will occur later. This is already clearly apparent in the case of divorces, to a lesser extent for marriages, although not yet for births. The stabilisation of demographic trends and the gap between East and West Germany in this regard will remain a sensitive indicator of German unification.

The collapse of the GDR economy and of the East German labour market have reached similarly dramatic proportions. The decline in employment – from 9.8 million to the current figure of around 6.5 million persons – has been immense. Until the end of 1994 positive economic growth was restricted to the construction and private service sectors (cf. p. 2). In view of the order of magnitude of the employment losses – more than 3 million jobs – it is hardly surprising that scarcely any other development in Germany has given rise to such alarm and political controversy.

It is indisputable that East German women have been particularly hard hit by the contraction of employment and that, despite this, they are not prepared to abandon the aim – largely achieved in the GDR – of being able to reconcile family responsibilities and paid employment. Micro-level analysis has shown that, parallel to the rapid loss of jobs and the sectoral shifts in employment, the two thirds of the working population still in employment enjoy an unexpected occupational and status stability. Studies by the Max-Planck Institute, Berlin, show that the overwhelming majority of those in continuous employment between 1989 and 1993 remained in the same job, a comparable position or at least one with the same status. Although those in

Marriages in East and West Germany per 1,000 inhabitants



Source: Federal Statistical Office.

ESSAY I

managerial positions had to accept loss of status, few of them were made redundant. Moreover, in certain high-status occupational groups (professional, private and public services) women have fared just as well as men. Researchers put this stability in the face of upheaval down to the importance of occupational qualifications in East Germany, a phenomenon also encountered in West Germany and a unifying structural characteristic within Germany as a whole.

III. Catching-up processes

Alongside the demographic and labour market crises, growth and "catching-up" processes can also be observed, and they are occurring at comparable speed. They are particularly evident with respect to the welfare state, infrastructure and mass consumption. The rapid transfer of the institutions and benefits of the West German welfare state has been financed by massive transfers from West to East. Critics have warned, however, that these transfers have been financed to a great extent by public borrowing rather than by reduced consumption in West Germany. The transfers enabled not only the financial repercussions of mass redundancies to be cushioned in a socially acceptable way, but also the situation for East German pensioners to be improved swiftly and substantially. The modernisation of infrastructure (public utilities, transport and communications) has also made great progress. This latter trend is modernisation in its most direct, technical sense: the acquisition of the most advanced technology. It appears that the public administration is better equipped to deal with this situation than, say, to resolve property disputes, as infrastructural improvement measures can be planned in an integral fashion and implemented by means of a "campaign". The number of telephone connections in East Germany, for instance, trebled between 1989 and 1994, accomplishing in five years a process that took around 15 years in West Germany (from 1960 to 1975). The number of private cars has virtually doubled, equivalent to the West German trend between approximately 1970 and 1983.

On the other hand, a central process of the social market economy has proved immune to acceleration: the creation of new and the modernisation of existing productive plant. Instead of market development what occurred was the "market shock"; the collapse of markets, networks and production locations. Many economists had suffered from the illusion that merely dismantling the command economy and privatising productive enterprises would initiate an economic expansion. It has been an important lesson that markets do not arise spontaneously, but must be laboriously constructed.

IV. Reactions

How have East and West Germans reacted to the rapid changes in East Germany? Indeed, have there actually been perceptible changes in West Germany? West Germany, the "old" Federal Republic, did not experience a dramatic acceleration of social developments, neither during the 1980s nor after 1989. The most striking socio-structural trend was the rise in female employment, although it remained far below the level in the GDR or in Scandinavian countries. In the short term labour market problems arose due to the influx of asylum-seekers and ethnic Germans from Eastern Europe. At the political level the Green Party and ecological topics managed to establish themselves. In economic terms the "unification boom" overshadowed the global economic recession for a year or two.

West Germany were not especially interested in the GDR. As late as December 1989 a minority of just 37% were

in favour of the formation of a "single state", while 50% argued for a confederation of "two separate states". This split within public opinion is partly explained by differences in the degree of personal contact among West Germans. Only a third of them had relatives or friends in the GDR and just 20% of them had visited the GDR or had received visitors from there during the past few years. Even after unification, in 1993 70% of West Germans stated that they would not wish to repeat unification again in its 1990 form. For more than 50% unification occurred too quickly, around 20% considered, in retrospect, the retention of two states to be the better solution.

In 1993 the author conducted, within the framework of representative surveys, two tests aimed at evaluating German unification. The first consisted of a simple question within the context of a comprehensive survey of objective living conditions and subjective well-being (Welfare Survey 1993): "Have your living conditions improved, deteriorated or remained more or less stable since 1990". The responses in East and West differ strikingly (responses in %):

	West	East
Improved	10	48
Deteriorated	31	23
No significant change	59	29

No great difference for the majority of West Germans: this is in line with the impression of West German indifference. Yet 31% reported a deterioration, significantly more than in East Germany. This largely reflects a feeling of discomfort with the uncertainty of the general situation, as personal living conditions were generally described as good, and an optimistic view was taken of personal prospects for the future. This disenchantment was more pronounced among women than men, correlates positively with age and is greatest among the lower status, income and educational groups. It is closely correlated with individual anxiety, fears and symptoms of anomie.

The picture for East German respondents, by contrast, is overwhelmingly positive; to an above-average extent for men, the younger age groups, employees in the service sector and the better educated. How can this positive overall evaluation in East Germany be squared with the upheaval and destruction described earlier? It is the consequence of a significant improvement in welfare for the majority of people, in terms of both objective living conditions and subjective well-being. At the same time, this means that the minority of – objective and subjective – "losers" become even more marginalised. In a society that suffered from scarcity for many years, the rise in real incomes and opportunities for consumption are clearly of central importance. Yet environmental and housing conditions have also improved perceptibly. As far as subjective well-being is concerned, anxiety, uncertainty and anomie (phenomena that are by no means seldom in West Germany!) are on the decline. This implies that self-confidence is now growing; East Germans are "finding their way around" the new institutions.

An additional interesting insight is provided by a second test. We questioned East and West Germans as to their evaluation of the economic and political system "prior to unification", "today" (April/May 1993) and "in five years". West Germans take a very positive view of both the economy and politics of the "old" Federal Republic, and perceive a massive current deterioration, one that is scarcely expected to improve in the next five years. East Germans take a clearly negative view of the economic and political system of the GDR; their evaluation of the current

situation is more positive and they expect a further improvement in the future. There is, however, a significant difference between the evaluation of the political and of the economic situation. East Germans already take a more positive view of the economic system than West Germans. But with regard to the political system there is only a slight improvement at present, one expected to gradually continue in future. West Germans perceive a serious threat to the political and economic system familiar to them. East Germans appreciate the market economy, but are not enthusiastic about democracy as practised in Bonn. This is paradoxical in that the contribution to reconstruction made by public transfers and the public administration are much greater than that of private investment. Here, too, the explanation is to be found in political culture. The statement "The state is responsible for ensuring basic subsistence" is accepted by 32% of West Germans, compared with 61% of East Germans, whereas 68% of West Germans but just 39% of East Germans believe that "individuals are themselves responsible". Thus, in East Germany, collectivist attitudes and fears of economic problems combine to produce an unfavourable evaluation of the political system of the new Federal Republic. Whenever questions are posed relating to social security one encounters criticism, but 47% of West Germans regard social security as sufficient, compared to just 24% of East Germans, of whom no less than 97% report, retrospectively, that social security had been guaranteed in the GDR. As many as 42% of West Germans believe that public order is secure, compared to just 13% of East Germans, 80% of whom reported that public order had been guaranteed in the GDR.

It seems, therefore, that East German citizens are moving more rapidly towards the institutions and values of the market economy than towards those of democracy. West Germans have long accepted both, although they detect a significant deterioration since unification.

V. Stabilisation

In 1989 everyone was surprised by the pace at which the GDR collapsed. In 1990 the velocity was maintained by popular exit and voice and by pressure from West German government. Since then, criticism of the way in which East German transformation and German unification took place has largely been a critique of the speed at which it occurred. In retrospect it is widely believed that a slower speed and thus greater scope for steering would have been better and should be sought for future developments. What is certainly clear is that the aim of a rapid equalisation of living conditions in East and West Germany is unrealistic and thus counterproductive. In the course of a hopeless race, endogenous development potential will only be buried and, more especially, alternatives to western practices will be blocked, as will the reform of the western model itself. It therefore seems more realistic for East Germany to "go its own way" rather than merely to "catch up". The prime minister of the state of Saxony, Kurt Biedenkopf, in particular, has championed this position. "The model calculations show that a rapid equalisation of living conditions, defined in economic terms, in East and West Germany is objectively unattainable. It is totally unclear how a population that is to experience within the

space of less than a decade, an economic development for which western Germany took 30 to 40 years will react." Consequently Biedenkopf argues for greater regionalisation of the unification process and for a different "mix" of economic and non-economic factors in determining the quality of life. He believes that competition between regions offers the best hope for overcoming "sclerosis and stagnation" in West Germany.

In my view we have now, five years after unification, in any case reached the point at which the rapid pace of change in East Germany is weakening, while the pressure for change in West Germany is perceptible increasing. The demographic and labour market contractions have, to a certain extent at least, come to an end, migration now occurs in both directions and even the party political structure has now become established to a surprising degree. Further indications of a perceptible stabilisation are provided by a survey conducted in October 1994 in which the questions as to "living conditions since 1990" and the evaluation of the economic and political system were repeated. The proportion of West Germans reporting that their situation had on balance "deteriorated" fell (to 19%), while the improvement in East Germany became even more apparent (59%). Meanwhile East German scepticism regarding the political system weakened and West German pessimism regarding the economic system eased. East Germans and West Germans are drawing closer together.

In international comparative terms East Germany is in the front ranks as regards the level of popular support for the market economy and democracy, although it is not the leader among the post-communist countries. If satisfaction with one's personal economic situation is added to this to form an "index of transformation", East Germany moves up to second place behind the Czech Republic. Thus the direction seems to be clear. Yet it appears equally clear to me that the differences between East and West Germany in terms of a "regionally specific consciousness" will not disappear in the near future. The question is whether it really will take an entire generation before, alongside the already tangible benefits, the losses that inevitably accompanied a transformation at such speed can be overcome.

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The author is scientific director of the WZB. The article is an abridged and revised version of an essay published in E. Holtmann/H. Sahner (ed.), *Aufhebung der Bipolarität*, Opladen 1995, pp. 69-81. Additional references are also to be found there.

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TRENDS

Neither Convergence nor Mezzogiorno: Regional Disparities in East Germany

Regional labour market disparities have arisen very swiftly in East Germany. Rural areas and the areas situated close to the former border with West Germany exhibit a particularly unfavourable development. The situation in regions with large urban centres is relatively favourable. In the light of these findings, developments in East Germany conform neither to a "convergence" nor to a "Mezzogiorno" scenario. Most appropriate to describe the future development of East Germany would appear to be a divergence scenario: some areas in the new *Länder* will reach western standards relatively quickly, whereas others are destined to lag far behind.

The academic and public debate on the economic development of East Germany is characterised by both positive and negative expectations. In their extreme form, these can be expressed in the form of two scenarios. Within the framework of a convergence scenario it is expected that East Germany will achieve western productivity and employment standards within the space of a few years. Indeed, in the initial euphoria immediately after unification it was widely believed that an "economic miracle" would occur, quickly bringing about convergent development.

Proponents of the opposing view believe that such a catching-up process will take many years if, indeed, it comes about at all. They point to the political and economic burdens that could be imposed on German government, particularly West German government, if a large area of the country remains economically backward in the longer term. Given that the economic division of the country in such a scenario is reminiscent of the situation in Italy, this pessimistic view is sometimes termed the "Mezzogiorno scenario".

Both scenarios have one thing in common: they treat East and West Germany as two separate units, permitting no differentiation within each part of the country. This undifferentiated view will be abandoned in the following contribution, which will look at the development of regional labour markets within East Germany. Is it really to be expected that East Germany will, as a relatively homogeneous unit, develop in one or other of the two directions? Or is there evidence of regional disparities, rendering both scenarios inappropriate?

The empirical basis for determining regional disparities

The spatial unit of analysis used in the following are the so-called labour market regions, as used within the framework of regional policy in order to delineate problem areas. Labour market regions are based largely on analyses of commuter movements and consist of a labour market centre with its corresponding catchment area.

The data have been derived from the Workforce Survey of the former GDR State Central Administration for Statistics, the "employment statistics" (*Beschäftigtenstatistik*) of the Federal Labour Office (which do not include the self-employed and civil servants) and the unemployment statistics. The observation period begins with the survey date of the Workforce Survey, 30 September 1989, and ends on 30 June 1993. Thus the study is restricted to the initial transformation phase. In 1994 the boundaries of many regions (districts) in East Germany were altered, so that more recent data are no longer comparable with those of the Workforce Survey.

An additional problem in comparing the Workforce Survey (WS) with the new employment statistics is the top secret, so-called "Area X" in the GDR, which covered, among other things, the military, the police and the secret service. Given that Area X, with an estimated 700,000 employees is not included in the Workforce Survey, the following analyses understate the real decline in employment. Our analysis is based on a fall in employment of 37.7%, from 8.5 million (WS 1989) to 5.3 million (employment statistics 1993); in both cases the figures do not include trainees. If the estimated figure for Area X is

added to the WS, the decline in employment amounts to 42%.

The contraction of employment

As can be seen from the Table, the decline in employment between September 1989 and June 1993 was substantial in all regions. Even so, significant differences are revealed. The decline in employment was least severe in Potsdam, at 18%, and in Dresden (31%). At the other extreme we find Klötze/Salzwedel with employment losses of 50%. Sharp differences in regional development have clearly emerged within the space of less than four years.

If the labour market regions are divided into three types according to their settlement density and centrality, and the extent of the decline in employment is compared in the three groups, it is apparent that the heavily urbanised areas, with an average figure of 36%, performed marginally better than the areas of medium urban density (37%; excluding Potsdam: 39%) and significantly better than the less urbanised regions, where employment losses averaged 43%. A marked gap between town and country is thus evident with respect to the extent of the decline in employment; given the largely agrarian structure of the North and the heavy industrialisation of the South of the former GDR, this is at the same time a North-South divide.

Regional unemployment

In June 1993 the regional unemployment rates varied between 10% in Potsdam and 25% in Ueckermünde (cf. Table). The incidence of unemployment varies only marginally with settlement structure. The average unemployment rates in the three regional groups are 14%, 15% and 17%.

The statistical correlation between the regional unemployment rate and the regional decline in employment is not particularly close; the correlation coefficient is 0.58. This shows that regional job losses are reflected to varying degrees in regional unemployment because commuting, migration and labour market policy measures partly compensate for the decline in employment (cf. East Germany, No. 3-4, pp. 14-15). This is particularly apparent in the areas along the former border with West Germany. Here, employment losses and the unemployment rate differ markedly; a

Regional Labour Market and Income Indicators			
Labour market region	Employment change 9/1989-6/1993 (%)	Unemployment rate 6/1993 (%)	Daily income per capita 1993 (DM)
Potsdam	-18.1	9.8	87
Dresden	-31.3	13.0	82
Frankfurt (Oder)	-33.4	14.4	81
Berlin	-34.3	13.1	91
Magdeburg	-34.7	15.8	83
Halle/Merseburg	-34.8	15.5	82
Rostock	-34.9	16.4	84
Schwerin	-34.9	13.6	82
Leipzig	-35.0	13.5	84
Erfurt/Weimar	-35.0	15.6	82
Jena	-35.5	11.3	81
Cottbus	-36.1	14.8	85
Neubrandenburg	-36.3	17.4	81
Gera	-37.4	16.4	79
Zwickau	-38.5	14.7	77
Stralsund	38.9	17.9	78
Eisenhüttenstadt	-40.0	12.3	81
Eberswalde	-40.3	17.3	80
Greifswald	-40.5	17.8	80
Chemnitz	40.6	15.1	77
Bautzen	-41.0	15.5	79
Schwedt (Oder)	-41.3	20.8	80
Plauen	-41.4	13.8	75
Finsterwalde	-41.6	16.9	76
Brandenburg	-42.9	17.6	79
Stendal	-43.2	17.4	79
Wittenberg	43.9	15.8	76
Suhl	-44.0	14.5	78
Wismar	-44.4	15.6	81
Riesa	-44.7	15.7	76
Quedlinburg	-44.8	18.3	78
Eisenach	-45.0	16.3	77
Dessau	-45.7	19.3	80
Nordhausen	-45.7	18.8	78
Neuruppin	-46.0	19.5	78
Pritzwalk	-46.6	20.6	76
Görlitz	-47.0	15.9	77
Saalfeld	-47.2	13.4	77
Mühlhausen	-47.4	17.7	76
Ueckermünde	-48.4	24.5	76
Klötze/Salzwedel	-49.7	13.8	78
East Germany	-37.7	15.2	82

Sources: Employee Survey 9/1989, Employee Statistics 6/1993, Unemployment Statistics 6/1993.

good example is the Klötze/Salzwedel region, in which the employment losses were the highest in the whole of East Germany, while the unemployment rate was below average. These results primarily reflect the large number of East Germans commuting to work in West Germany (cf. East Germany, No. 14, p. 10).

Regional average wages

Regional income disparities – here measured in terms of average daily wages in 1993 – are relatively minor in the new federal states (cf. Table).

East Berlin stands out from the rest in terms of income level. Here wages are already rapidly approaching West German levels. This is

hardly surprising given that East and West Berlin form a single labour market and that spatial wage differentiation cannot be sustained in a single market for long.

Even so there is an unexpectedly strong correlation between the regional average wage and the regional decline in employment: the greater the extent of job losses the lower the average regional wage (the correlation coefficient is 0.76). Clearly, regional labour market problems have a greater impact on the regional wage level than in West Germany.

Consequently the regions suffering the largest employment losses face cumulative disadvantages. Workers in such areas not only face a higher

risk of losing their job, the monetary return on their labour is also lower. The state, too, is affected in two ways: due both to the unfavourable employment trend and the lower wages the tax revenue for state and local government is particularly low in the disadvantaged areas.

Analysis of regional employment trends

Of the three problem trends described above, the regional decline in employment is of central importance as it exerts a decisive influence on regional unemployment and also on regional wage disparities. This justifies closer analysis of regional employment losses. In which regions are branch-specific employment trends in line with the East German average, in which have they been more, and in which less favourable?

In order to provide an answer to these questions it is necessary first to determine, for each region, the employment trend that would have occurred if all the branches located in the region had expanded or contracted to the same extent as in East Germany as a whole ("shift-share analysis"). As the result of this first step we obtain the so-called "structural effect" of the employment trend. If this is then subtracted from the trends that actually occurred in each region, we obtain the so-called "location effect". The location effect describes the deviations by each region from the branch-specific developments in East Germany as a whole. To put it another way, the location effect measures the developmental strength or weakness of individual regions (largely) independently of their industrial structure.

The map (p. 16) shows which areas enjoyed a positive and which suffered a negative location effect. The following results are of note. The figures for regions located near the border to West Germany tend to be unfavourable (Suhl, Mühlhausen, Nordhausen, Quedlinburg, Klötze/Salzwedel). This is a surprising result. It would seem plausible to have assumed that those areas bordering on – prosperous – West Germany would perform better. Yet precisely the opposite is the case. The West German border regions do not appear to have provided a positive impulse for developments in East Germany.

Moreover, the analysis also shows that those areas situated near the Polish border also tend to be in a less favourable position (in particular Ueckermünde, Görlitz, Eberswalde).

Urban areas perform markedly better than rural areas. During the observation period the urban centres, particular those in the South (Dresden, Leipzig), while clearly suffering from labour market problems, enjoy a far more favourable labour market situation than the remaining areas.

The figure for East Berlin, on the other hand, suggests an unfavourable trend. The same is true of many rural areas, particularly those situated north of Berlin (in Brandenburg and Mecklenburg-Vorpommern).

The role of public capital spending

Detailed comparison between the overall location effect and the regional development of individual branches (branch-specific location effect) reveals an interesting picture. Generally the location effect is correlated with the development of services in the following areas: government, transport/communications, financial institutions/insurance companies and trade. These, then, are the branches that determine the relative position of regions in East Germany.

Surprisingly, manufacturing industry is not among the branches considered "important" for regional employment trends. Thus the rela-

tive favourable development of many urban areas is due only to a minor extent to the existence of traditional industrial production locations. What is decisive, rather, is that administrative responsibilities are concentrated in the state capitals of the new *Länder* and that services, which expanded rapidly as a result of the bottled up demand and inadequate supply, have grown primarily in urban areas.

Consequently, public capital spending clearly plays a key role in economic stabilisation at regional level. The modernisation of the material infrastructure and the establishment of a new public administration, particularly in state capitals, exerts a positive impact. Such developments then induce additional economic activity as the demand financed out of public funds induces additional demand: firms receiving government orders pay their employees wages and salaries, income that is to a large extent spent in the immediate region. Regional multiplier processes of this type indicate that to a large extent regional development differentials reflect political decisions.

The role of the private sector

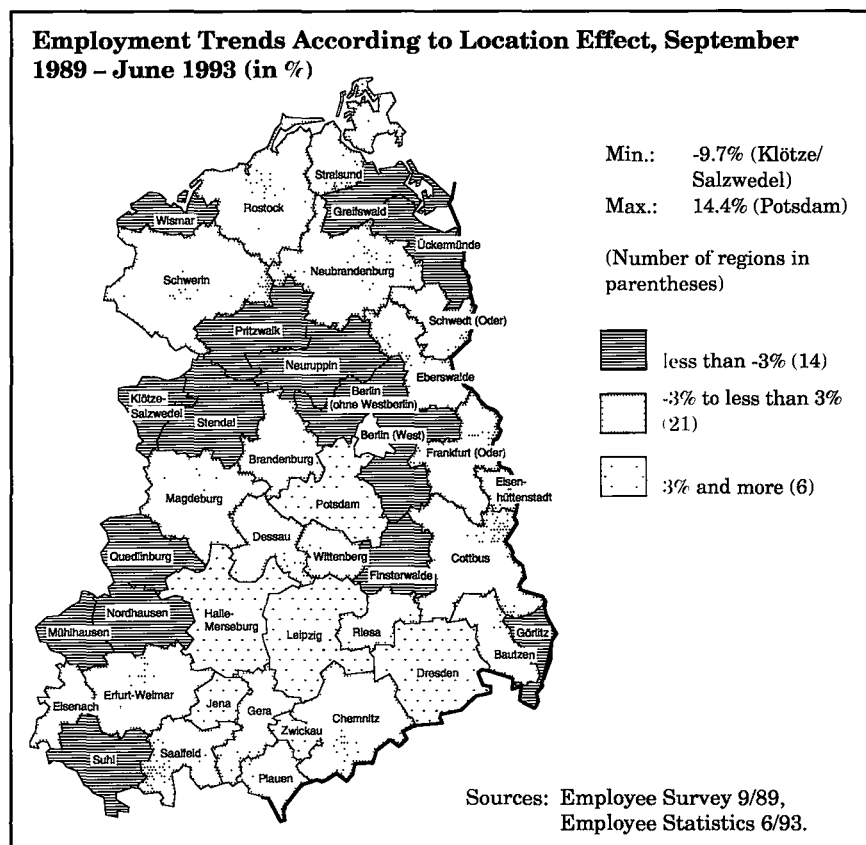
The central role played by government must come as a disappointment

to those who had pinned their hopes on the private sector. For even in the relatively well-off regions – during the observation period at least – there is no evidence of the "economic miracle" that had originally been anticipated, one based on an economic dynamic emanating from the private sector.

At the same time the results suggest that, in addition to government activity, endogenous economic processes have also exerted a polarising effect on regional labour markets. It seems that areas containing urban centres are better able to withstand the crisis, irrespective of public sector activity. Agglomeration effects play an important role here: areas in which a certain volume of economic activity has remained or – even better – more than marginal progress has been made in reconstruction tend to attract additional investors seeking to take advantage of the proximity to already developed markets. They expect that progress in infrastructural development is more likely to be made in such areas. Networks of interaction develop between firms and between firms, institutions and the regional labour force that are conducive to further economic activity.

This is in contrast to the largely rural areas and those areas situated on the western and, to a lesser extent, on the eastern border of the new federal states. Here the economic collapse assumed even more dramatic forms than elsewhere. The West German border regions – in themselves structurally weak – provided no impulses for economic development east of the former border. Even in those areas in the West where industrial centres were situated near the former border, they failed to exert a positive effect on development in neighbouring areas in the East: Wolfsburg, for example, dominated by the VW automobile plant, borders on Klötze/Salzwedel, the East German region with the most serious job losses.

The problem is revealed particularly starkly in Berlin. The labour market region "East Berlin" recorded a negative location effect. In this case the positive tendencies linked with East Berlin's position as the largest urban centre in the new federal states are actually more than offset. This is at least partly explained by the role of West Berlin as East Berlin's economically "overbearing" neighbour, although the western half of the city is still struggling with the legacy of its former "island" status: the end of the government subsidies granted over decades in order to offset the loca-



tional disadvantage faced by West Berlin exposed the lack of competitiveness of many branches operating in the city. Yet despite this the eastern half of the city has proved unable to keep pace with West Berlin (cf. East Germany, No. 8, pp. 10-12).

The same applies to regions located near the border or lacking an urban centre. They are unable to compete with urban areas, not to mention the West German regions. In many cases the decline in the border areas has hit services particularly hard because services can be purchased in West German regions located just across the border. The near-by centres in West Germany and the small or medium-sized towns in East Germany do not constitute growth poles in the sense that they pull along the surrounding area at a faster pace. Thus the results suggest that it is withdrawal and crowding-out processes that have predominated in such areas, exacerbating regional polarisation.

Here too, there is evidence that this process has been influenced by political decisions. In those areas situated close to the former border with West Germany the East German population has the option of seeking employment opportunities in the West. Consequently, supportive action by economic policy is not considered to be as urgent as in other areas.

Outlook

One thing is certain: the existing disparities will not disappear as quickly as they have arisen. International comparative studies have, it is true, shown the existence of a generalised trend towards the equalisation of regional differences. Barro et al., for instance, have estimated that regional productivity differences halve over a period of around 35 years (cf. East Germany, No. 13, pp. 10-11). Moreover, in the case of East Germany it can be assumed that the massive provision of public financial resources will exert a

strong influence on the pace of development. Yet even so, the processes of equalisation are proceeding far more slowly than the polarisation processes that set in after the overnight exposure of the new federal states to the global market. Consequently, the regional disparities observed within East Germany will initially be maintained.

The new *Länder* are currently enjoying relatively high growth rates. Although it is not to be expected that these rates will remain at this level permanently, high levels of investment (investment in plant and equipment is estimated at 52% of GDP in 1994 and 54% in 1995) and the massive support coming from West Germany (estimated net transfer in 1994: DM 126 billion; 1995: DM 150 billion) will ensure a development trend that will continue to reduce the gap between East and West.

From these developments – high rates of growth for East Germany as a whole and the continuation of regional disparities within the area – it can be concluded that the East-West divide will increasingly give way to smaller-scale spatial disparities. It seems plausible to expect a scenario in which the large urban centres steadily approach western standards in terms of productivity and infrastructure, while large areas of East Germany lag far behind.

Thus neither a convergence nor a Mezzogiorno scenario, but rather a divergence scenario is appropriate to East German developments, whereby the term “divergence” refers not to the relationship between East and West Germany, but rather to developments within East Germany itself: some areas will reach western levels relatively quickly, whereas others lag way behind.

To a certain extent regional development differences are normal in a market economy. Such differences also exist in West Germany, although they are less pronounced here than in other West European countries. Di-

rect comparisons with the situation in East Germany are, however, difficult in view of the on-going process of transformation. Given the depth of the regional disparities observed, though, it seems probably that they will remain more pronounced than in West Germany.

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INSTRUMENTS

The EC Structural Funds – The Integration of East Germany into the European Support System

The transformation process in the new federal states has received substantial financial support from the European Community since 1991. Due to the specific conditions characterising the transformation and the necessity of establishing new administrative structures, the activities of the structural funds encountered a number of problems during the first support period from 1991 to 1993. Besides such procedural-technical difficulties, fundamental criticism of the utilisation of EC funds within the framework of a national support policy was raised, as the argument over the cofinancing of Regional Fund measures has shown. To some extent this has led to modifications in the way support is being provided during the second support period (1994 to 1999).

Over the past five years wide-ranging economic and labour market policy programmes have accompanied the East German transformation process. From an early point in time national efforts were supplemented by funding from the European Community; aid was made available quickly and unbureaucratically in 1991 once the adjustment difficulties had become apparent. Of central importance in this context are the European structural funds: the economic policy oriented regional fund (ERDF), the labour market policy oriented social fund (ESF), the agricultural fund EAGGF, which focuses on agricultural developments, and, since 1994, the newly created guidance fund for the fishing industry (FIAF). They are the most important instruments of European structural policy, their aim being to reduce regional imbalances within Europe and to promote economic and social cohesion in the European Union.

During the first support phase (1991 to 1993) the new *Länder* and East Berlin were initially treated as a special case for EC structural policy and were integrated into the European support measures in the middle of the current programme period. The time-consuming planning procedures were dispensed with and an additional budgetary allowance was made. EC resources of around ECU 3 billion (approx. DM 6 billion) were made available via the structural funds during this period. Not until the start of the second support period, from 1994 to 1999, did East Germany become a target area under standard EC structural policies. This not only increased the number of instruments that can be deployed, more importantly the funding volume was also

expanded substantially. Following the special treatment in the previous period, the new *Länder* including East Berlin now officially enjoy the status of a target 1 region and thus, alongside other underdeveloped regions in the EU, are accorded top priority in the provision of funding and the maximum support conditions. A total of almost ECU 14 billion (DM 27 billion) has been earmarked for the second support phase.

In accordance with the principle of "additionality" the structural funds are deployed in support of the efforts made by federal and state governments. The ERDF, for instance, is linked to the joint federal-state government programme "Improving regional economic structure" (GA). The agricultural fund, EAGGF, provides supplementary funding for the joint programme "Improving agricultural structure and coastal protection". The resources of the ESF are divided between federal and state governments. Around a quarter are made available to the Federal Labour Office in order to finance measures that cannot receive support under the German Labour Promotion Act (LPA), in particular for preventive further training for those still in work, and additional benefits for unemployed participants in further training schemes. The remaining ESF resources are made available directly to state governments in support of their labour market policy efforts and programmes (cf. the reports on the structural funds in East Germany, No. 3-4, pp. 9-10 and, No. 10, pp. 10-12).

Including national cofinancing, the European Commission estimates that between 1991 and 1993 overall spending of around ECU 14 billion was real-

ised. A total of 300,000 people are estimated to have participated in labour market policy measures supported by the ESF. According to figures provided by assisted firms, the investment support provided by the ERDF has maintained or created around 200,000 jobs; in view of the lack of adequate evaluations and the possibility of deadweight, however, this figure should be treated with great caution. In retrospect the Commission took a "positive overall" view of the results achieved during the first support period. However, the deployment of European structural support experienced a number of problems, and criticisms were raised, in particular by the European Court of Auditors; most of them were due to the difficulties of the transformation process in the wake of unification and the inadequacies of an administration that at the time was only just being established. As the disagreement pertaining to the ERDF showed, however, there was also fundamental criticism of national support policies.

The disagreement surrounding cofinancing of the Regional Fund

Criticism of the first support period centres on the integration of resources made available by the ERDF into the joint programme "Improving regional economic structure" (GA), a regional policy programme in existence in the Federal Republic since 1970 and planned and financed jointly by federal and state government. In view of the urgency of the problems and the lack of alternatives, there was initially no controversy over the decision to resort to this national cofinancing instrument, in particular as it enabled the available resources to be distributed as quickly as possible. In the course of negotiations on the second support period, however, this procedural approach led to sharp disagreement between the Commission and the federal government.

Underlying the dispute are different approaches to support policy and a critique of the GA that was voiced not least by German institutions, in particular the environment ministries, environmental groups and a number of federal states, especially Saxony. Experts were of the opinion that the strict incorporation of ERDF resources into the GA restricted the flexibility and the breadth of EC support deployment and thus unneces-

sarily tightened the conditions under which EU funding could be granted. In addition, in contrast to the approach taken in West Germany, regional support through the GA in East Germany was not concentrated on specific regions or areas, nor were the conditions of entitlement differentiated to take account of regional economic strength; critics have taken the view that this amounts to support on the "watering-can principle". The central bone of contention between the Commission and the federal government were the tight limits on the spectrum of support under the GA, which focuses on promoting industrial firms and economically relevant infrastructure and thus in particular on the now highly controversial creation of trading and industrial estates on greenfield sites. In the view of the European Court of Auditors, among others, this has served to finance the creation of a significant oversupply of commercial sites and has failed to focus efforts on the creation of jobs with a viable future.

In the light of this, the Commission considered that the national policy approach lacked differentiation and it favoured a concept for the second support period in which the ERDF and the GA would have been largely "decoupled", enabling EC funding to be used for other areas, such as agriculture, research and technology, education and the environment. In East Germany this critique was taken up by the state of Saxony, in particular, which has sought to tie ERDF resources more closely into areas it considers most urgent within the context of state-level policies and, especially, environmental policy.

In the end the federal government and the Commission reached a compromise under which state governments are permitted to decouple ERDF funding from the GA to some extent. For 1995/96 the state governments can decide whether the framework of GA regulations is to remain in force or whether at least a partial decoupling should occur. So far Saxony has taken the most far-reaching step: from 1995 it is state funds that will provide the national cofinancing; only 40% is to come from the GA. Support is to focus on measures to improve the environment and in the area of research and development. The other new federal states, however, have made scarcely any use of the so-called "flexibility clause".

In a report for the Commission the *Deutsche Institut für Wirtschaftsfor-*

schung (German Institute for Economic Research – DIW) argued for the new, more flexible solution and proposed that between 5% and 10% of ERDF resources should be made available outside the GA. The Institute took the view that for pragmatic reasons the remainder of the structural fund resources should remain tied to the GA: in view of their tight budgetary situation, most federal states would experience problems in finding national cofinancing resources, if the funds were decoupled to a greater extent, and they are concerned about additional administrative burdens, if new state-level programmes need to be set up and then coordinated with the ERDF. Change is required, according to the DIW, es-

pecially in certain specific areas, such as support for technology and innovation transfer and environmental protection. In the medium term it is also argued that the degree of regional differentiation should be increased in such a way to allow for the creation of regional economic centres.

Objections raised by the European Court of Auditors

Particularly in the initial support period, numerous "procedural-technical" problems arose due to the need to set up new administrative structures and the lack of specialist know-how among those administering the funds in the relevant departments. The European Court of Auditors conducted

Table 1: The Activities of the European Structural Funds in East Germany: Earmarked Resources and Resources Placed, 1991-1993

	Fund	Earmarked resources (million ECU)	Resources spent as of 31.12.1993 as a % of earmarked resources
East Germany	Total	3,147.1	84.4
	ERDF	1,598.5	83.1
	ESF:		
	– state programmes ¹⁾	695.5	89.7
	– FLO ²⁾	248.2	92.5
	EAGGF	595.0	77.9
	Technical assistance ³⁾	10.0	100.0
Federal states:			
Berlin (East)	Total	214.9	54.1
	ERDF	162.7	43.6
	ESF	51.4	87.1
	EAGGF	0.7	69.5
Brandenburg	Total	489.5	84.7
	ERDF	250.7	86.4
	ESF	114.4	92.3
	EAGGF	124.4	74.5
Mecklenburg-Vorpommern	Total	426.6	84.6
	ERDF	185.3	86.4
	ESF	88.4	74.5
	EAGGF	152.9	88.2
Saxony	Total	773.4	86.6
	ERDF	464.1	86.4
	ESF	201.6	92.5
	EAGGF	107.6	76.3
Sachsen-Anhalt	Total	529.3	84.4
	ERDF	280.3	86.4
	ESF	126.8	92.1
	EAGGF	122.2	72.0
Thuringia	Total	455.3	89.6
	ERDF	255.4	93.2
	ESF	112.9	92.5
	EAGGF	87.1	75.3

1) ESF resources distributed by the federal states
2) ESF resources distributed by the Federal Labour Office
3) Financed supplementarily by the ERDF

Source: European Court of Auditors.

INSTRUMENTS

an investigation in the new federal states which revealed numerous deficiencies in the way resources were granted and the structural funds administered; in certain cases the findings were even passed on to the public prosecutor. The criticisms centred on inadequate controls and project evaluation, inadmissible accounting procedures and the frequent infringement of regulations governing the placing of public orders and environmental protection. Accordingly, the recommendations made by the Court of Auditors called for improved resource administration and more intensive controlling.

At the end of the first support period, around 84% of the structural fund resources earmarked had been spent; this is broadly in line with the European average. The only exception to this was ERDF funding in East Berlin, of which just 44% was actually placed (cf. Table 1). This was due, among other things, to the relative preponderance of non-privatised *Treuhand*-firms, whose investment activity was extremely restrained. Moreover, the fact that a disproportionate number of the firms supported there were in the service sector meant that the capital intensity of the jobs promoted was low. Very few new firms have set up in East Berlin, reflecting the unfavourable conditions for production in an urban conglomeration: the lack of commercial sites and high real estate prices. Firms in branches requiring large sites were attracted to other regions or to the area around Berlin.

Little coordination of the use of resources from the structural funds

According to the principles of the 1989 reform of the structural funds, the European Community places great emphasis on interaction between the structural funds, in particular between the ERDF and the ESF in measures related to human capital development. Just as in West Germany, this linkage was seldom achieved in the new federal states during the previous support period. According to the DIW, integrated support has so far been provided only in isolated cases, largely confined to structurally weak areas in Brandenburg, Mecklenburg-Vorpommern and Saxony. Here, for example, training establishments were equipped with the assistance of ERDF funding, while the retraining measures subsequently implemented were supported by the ESF. In addition to the work overload of fund administrators, the lack of integrative policy approaches is put down to the largely uncoordinated planning of support measures in the various administrative departments responsible. Last but not least, the close links between the ERDF and the GA have exacerbated the problem of ensuring the integrated deployment of resources from the structural funds.

Principle of "social partnership" not adequately respected

Due to the urgency of the problems and the difficulties associated in establishing administrative structures,

virtually no attempt was made to incorporate local government and the social partners in drawing up the state-level support programmes (operational programmes) in 1990/91. Thus a second basic principle of the reform of 1989 was not adequately respected. Experts are of the view that it is unlikely that in the future the relevant social actors will be enabled to play a wider role in structural promotion, and, in particular, that this role will not extend significantly beyond federal state level. Although the institutional framework required for such cooperation does exist in East Germany – as revealed, for instance, by the efforts to maintain "industrial cores" and the associated initiatives of the "industry policy discussion and working circles" (cf. East Germany, No. 11, pp. 7-9) – the political requirements for greater decentralisation and for the participation of the relevant social actors in structural promotion work on the ground have not been met.

The new support concept 1994-1999

Because of the conflict over the linkage between the ERDF and the GA, the Community Support Concept (CSC) for the support period 1994-1999 was delayed and not finalised until July 1994. The CSC is drawn up jointly by the Commission and the federal government. It sets the framework for the deployment of structural support funds, the development objectives and the focal points for support in the coming years. It is supple-

Table 2: The Activities of the European Structural Funds in East Germany 1994-1999: Planned Distribution of Resources and Cofinancing (million ECU)

Priority support area	Resources from the structural funds				Cofinancing			Total expenditure
	Total	ERDF	ESF	EAGGF	Loan EIB/ECSC ¹⁾	National funding		
						public	private	
1. Productive investment	2,430.6	2,375.2	55.4			2,439.9	12,689.7	17,560.2
2. Small and medium-sized enterprises	2,317.9	2,064.7	253.0			1,990.8	13,073.4	17,382.1
3. Research, development, innovation	613.1	485	128.1			433.7	1,045.0	2,091.8
4. Environment	1,105.7	805.7	300.0			948.7	714.5	2,768.9
5. Labour market policy	3,648.2	584.0	3,064.1			2,659.7	519.5	6,827.4
6. Agriculture	3,224.3	425.3	107.3	2,691.7 ²⁾		1,664.4	5,966.5	10,855.2
7. Technical assistance	300.2	80.0	183.9	36.3		118.5	2.0	420.7
Total	13,640.0	6,820.0	4,092.0	2,728.0	4,300-5,400	10,255.7	34,010.6	57,906.3

1) EIB: European Investment Bank; ECSC: European Coal and Steel Community

2) Including ECU 83.5 million from the fisheries fund

Source: European Commission.

mented by specific, so-called "operational programmes" presented by the state authorities responsible.

Instead of the previous eight priority areas for resource deployment, the new support concept contains six (Table 2):

1. support for productive investment and complementary investment in infrastructure relevant to economic activity;
2. measures in support of small and medium-sized enterprises;
3. measures in support of research, technological development and innovation;
4. measures to protect and improve the environment;
5. measures aimed at reducing unemployment and promoting labour force potential, vocational further training and employment measures;
6. measures in support of agriculture, rural development and fisheries.

In addition to the six priority development areas, "technical assistance" measures are to be provided at federal state level. Such assistance includes preliminary studies, guidance and evaluation of the support, the exchange of experience, publications and information on support from the structural funds.

The principle of national cofinancing remains in place. Including this cofinancing, which is to come from both public and private sources, the ECU 14 billion from the structural funds are to generate total spending of almost ECU 58 billion (cf. Table 2). As in the previous support phase the ESF is to support the labour market programmes implemented by the federal states and the measures implemented at national level by the Federal Labour Office. Within this framework the following measures which go beyond the instruments covered by the LPA are to receive support:

- training opportunities not linked to a specific employer;
- social guidance for participants in training measures;
- support for the inclusion of foreign languages in vocational training measures;
- German language courses for immigrant workers from non-EU countries and ethnic Germans from Eastern Europe;
- practical training abroad as part of vocational training schemes;

- training in social skills;
- measures to improve placement prospects;
- ESF maintenance allowance and child-care costs for participants in training schemes;
- supplementary support for work familiarisation allowance and benefits for those setting up their own business.

In view of the lessons learnt during the previous support period, stricter regulations have been imposed for the new programme period, offering less scope for administrative decisions. For instance, it is now virtually impossible to carry over resources into the next financial year, a practice initially tolerated in view of the administrative difficulties in the start-up phase. Greater attention is being paid to a "concentrated deployment of resources", and closer links with other EC support instruments (training programmes, community initiatives, etc.) are being sought. Finally, special emphasis is to be given to the preventive aspect of training measures, particularly within ESF support.

Newly introduced: the Community Initiatives

In contrast to the first support period, the various "Community Initiatives" are now also starting to play their part in East Germany. Within the framework of such initiatives - examples include the vocational training initiative HORIZON, the NOW initiative, whose aim is to promote women, and branch-specific initiatives such as RETEX for the textile industry and RECHAR and RESIDER for coal and steel regions - community-level tasks are promoted and transnational measures involving other regions within the European Union are implemented. During the first programme period no financial support for such initiatives in East Germany was made available, with the exception of the KONVER initiative, started in 1993, and its predecessor PERIFA, in which the new federal states also participated. The aim of KONVER is to mitigate the negative economic consequences of military disarmament. In the new *Länder* this enabled, among other things, environmental hazards on former military sites to be investigated and removed. The resources made available through the Community Initiatives account for around 9%

of the structural fund resources spent in East Germany, and do not supplement such resources as was originally demanded by the new federal states.

Expert opinion is ambivalent on the question of the opportunities provided by the resources from the Community Initiatives. In view of the decade-long geographical isolation of the former GDR, it is widely accepted that there is a great need for transnational measures with other regions of the Union in order to promote occupational, geographical and cultural mobility with a view to developing the Single Market. On the other hand, each new support option requires national cofinancing, leads to additional coordination problems and administrative expenditure, and renders the already complex support system even more impenetrable ("support jungle"). In the light of this, the DIW, in its report to the Commission, pointed out the critical aspects associated with the new support opportunities provided by the Community Initiatives. It should be borne in mind, the Institute emphasised, that in many cases the objectives of the initiatives could be promoted within the framework of the normal structural fund programmes.

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ESSAY II

Transformation Shocks in Eastern Europe

Unemployment in Europe is rising at an alarming rate. A plea for a realistic assessment.

To outside observers at the time, reunification of Germany seemed to offer the prospect of a more rapid and less painful economic revival than for many other former centrally planned economies, simply because the capacity to subsidise the investment required and to assist those directly affected by the upheaval seemed so much greater than anywhere else, and because the legal, administrative and regulatory procedures were well established. But this image gradually gave way to the perception, among many observers, that rapid economic, social and political restructuring in the eastern part of Germany was creating a sharp "J-curve": only after a drastic fall in output, employment and income would there be a revival, during which privatisation and restructuring, cushioned by labour market policies and hefty subsidies, would enable the phoenix to rise from the ashes of the former GDR. Yet even this is now widely considered overoptimistic.

Whatever the eventual outcome, what has been happening in the economy and in the labour market in the eastern part of Germany has vital relevance to the major countries of central and eastern Europe. Many economists, politicians and others involved in the region have looked to Germany for models, lessons and harbingers of revival to encourage their own reform efforts. In particular, the privatisation experience has been followed keenly, and everywhere high hopes have been placed on labour market policies to overcome what Janos Kornai, one of the best-known east European economists, called – somewhat optimistically, as it has turned out – the "transition recession". But in late 1995 it is time to make a sobering assessment of what has been happening in the labour markets of all countries of the central and eastern European region. It is now appropriate to differentiate between the few countries of central Europe, such as the Czech Republic and Hungary, where economic dynamism is evident, and the countries of the former Soviet Union, where the economic slump continues to be awesome. Above all, this means taking stock of what has been taking place in the Russian Federation and Ukraine, which between them have over 200 million people, whose plight will affect the labour markets of most countries of Europe for many years to come.

It needs to be made very clear that the unemployment and labour market impoverishment in eastern Europe is much worse than anywhere else in Europe. Of course, the official east German unemployment rate of 15%, or thereabouts, is a terrible medium-term outcome of the so-called "transition", especially bearing in mind the many not counted as unemployed, those on job creation schemes, training or in early retirement. But the situation in Russia and Ukraine is undoubtedly worse, and in Poland (the third largest country of the region, in terms of population) unemployment and poverty are at least as bad. Only in the Czech Republic can one say with confidence that the labour market outcomes of reform have been tolerable. One uses the word "tolerable" advisedly, since some apologists for "shock therapy" have claimed

that the situation in eastern Europe cannot be so bad because people have not been taking to the streets in large numbers in violent demonstrations. The reality is that the tragedy has been one of "implosion"; people have turned in on themselves, have fallen ill or died prematurely or have been struck by social ills such as alcoholism and mafia-style crime. In the Russian Federation, life expectancy has fallen dramatically, with male life expectancy at birth falling by seven years within the space of just seven years, to about 58 years. In Ukraine, life expectancy has also been dropping, as it has in various other parts of the region. This clearly reflects the adjustment stress due in large part to labour market dislocations that have given little prospect of employment security.

Labour surplus and unemployment in eastern and central Europe will continue to be chronically high for the remainder of the century. The gravity of the situation must be emphasised, calmly and realistically. For far too long, advocates of "shock therapy" have been claiming that the labour market situation in eastern Europe is not serious. Thus, economic advisers to Russian and Ukrainian governments have persistently claimed that unemployment in those two countries was about 1% or 2%, and that there was no rapid growth in unemployment taking place. This was nonsense when they claimed it, and is certainly nonsense in late 1995. Careful empirical assessments put the current figure at 13% and rising rapidly.

The actual number out of work is a matter of judgement, in part because the major development over the past three or four years has been the growth of informal lay-offs, with hundreds of thousands of workers being put on "unpaid leave" or not being paid wages for many months at a time. Perhaps a third of all workers in Russian and Ukrainian enterprises have been in this state, and they are counted as employed, thus artificially deflating the unemployment rate doubly. The drag on restructuring that such practices represent cannot be exaggerated. Some well-known labour economists have claimed that the responses of firms in those countries demonstrate a vibrant and flexible labour market. This too is a regrettable interpretation. Labour market and employment restructuring require *mobility* and they require that whatever developments take place in firms have the effect of raising labour *productivity* in the short, medium and long term. Yet what has been happening is that the workers directly affected have been pushed into idleness, or into the informal and black economy in order to survive, while they have been impoverished by a lack of entitlement to labour market benefits. Workers hit by the fall in production, incomes and employment have not been protected through state benefits, and one of the reasons for that is that the gravity of the situation has not been recognised, or indeed has been concealed, particularly by economic advisers. This has meant that labour market policies to respond to high unemployment and severe employment dislocation have been underdeveloped and given inadequate resources.

Here, the lessons from Germany are important. First, labour market statistics have revealed the major trends more clearly than in many other countries. Second, considerable attention has been given to labour market measures to help ameliorate the mass unemployment, and income-support and job creation schemes have held down the level and growth of unemployment. Yet still the unemployment and job losses have been massive. In countries such as Bulgaria, with about 20% unemployment, and Russia and Ukraine with worse underlying labour market problems are to move in the direction of Germany, the prospects for unemployment are grim. It will require a massive mobilisation of resources, and a coordinated approach from the international community. At present, the resource transfer is too small, the technical assistance is very uncoordinated and the process suffers from almost comical duplication of effort, advice and resource transfers.

Consider some areas where reform is most urgently required. Among the ironies of the unfortunate dichotomy of "active" and "passive" labour market policies is that governments have been encouraged to cut back on measures that they have been induced to call "passive", which has meant, most of all, unemployment insurance benefits. In every country of the region, initially fairly generous unemployment benefits have been curtailed, with levels of benefit being cut in real terms and with conditions for entitlement being made much tighter. A dire consequence has been that a dwindling proportion of the unemployed have been receiving benefits, the remainder having been pushed onto social assistance, to the extent that it exists. And the benefits have been minimal in almost all the countries. Less than 20% of the unemployed in eastern European countries such as Russia and Ukraine receive unemployment benefits, and the amount received by those few who receive them is typically well below the amount needed for a minimal subsistence.

However, a further irony is that while governments have been urged to shift from "passive" to "active" policies and have been trying to do so, the rise in unemployment and the need for welfare transfers have made it hard for them to shift in that direction. This has led some of them to cut benefits even more, resulting in more intense poverty and sharply growing income inequality.

What of a terrible legacy of the labour markets of the old system, the lack of modern skills? There has been much interest in encouraging adoption of German training systems in countries of central and eastern Europe. However, the reality is that throughout the region old training systems have collapsed much faster than new systems have grown. There are essentially four forms of training and skill formation – vocational education, apprenticeship training, enterprise-based job training and labour market training. The first refers to training in colleges and universities by those outside the labour force. There has been a dramatic decline in numbers of students enrolled in such institutions in Russia and Ukraine and some other countries. Apprenticeship training has not really spread, and the type of jobs that have been emerging have not made this likely. Enterprise-based job training has been decimated, as our factory surveys in Bulgaria, Russia, Ukraine and elsewhere have documented. So, great hopes have been placed – or much emphasis has been placed – on labour market training, that is, training provided to the unemployed.

It is time for realism here, too. The lessons from Germany and from western Europe generally are that such training must be carefully targeted on creating skills in short supply and that they must be monitored. Too often, the content of the schemes is of dubious quality, and there are surely substantial deadweight and substitution effects that make the economic cost of such schemes much greater than commonly believed, and the value in assisting in labour market restructuring much less. In the absence of proper evaluation, considerable sums of money are likely to be spent on providing "training" that scarcely improves the skills of participants, while many of those "trained" will merely displace other workers who were doing jobs as well or almost as well. The same shortcomings characterise so-called public works, popular responses to unemployment but which require all sorts of unlikely institutional safeguards and conditions if they are to make any substantial dent in unemployment.

Turning from labour market policies to institutional developments in labour markets, a feature across the region has been de-unionisation. This has enormous ramifications. We know that under the old system, the trade union was a "conveyor belt" for the Party and was mainly an intermediary of management focusing on the provision of social benefits through the enterprise. Since the late 1980s, those roles have been whittled away and unions have found it hard to secure a sense of legitimacy. Real membership levels have shrunk in all countries, while bargaining over wages and benefits, as well as over working conditions and much else, has been decentralised, if not removed altogether.

A second feature impinging on labour market trends is that public administration reform has been neglected, in part because of the "state desertion" underlying the shock therapy approach to economic policy. To achieve economic restructuring requires a strong, legitimated state apparatus, yet in many places cutbacks in public expenditure have left salaries and working conditions in the public sector so bad that they have almost guaranteed opportunism and corruption and meant that the public sector has failed to attract or retain good employees. This has eroded the capacity to implement and refine labour market and other policies.

This and de-unionisation have contributed to the longer-term process by which labour regulations have become loose guidelines rather than rigid constraints on enterprise behaviour. Having visited dozens and dozens of enterprises in our surveys over the past five years, one feels confident in concluding that far too much attention is paid to the alleged impact of labour regulations, particularly by those who wish to attribute the growth or persistence of unemployment to such regulations. In the labour markets of eastern Europe, employers can and do bypass regulations with impunity.

The insecurities and inequalities that characterise the labour markets of the region should not be allowed to continue for very long, for societies in which large minorities are condemned to live in penury and insecurity are scarcely what democratic reformers should have in mind. The word that comes extraordinarily often into conversations about labour market developments in eastern Europe is "mafia" – a term covering a very wide spectrum of criminal, illegal and unregulated activities, raging from

violent gangster capitalism to the opportunistic survival activities of impoverished bureaucrats to the pitiful street-side pursuits of the hungry and impoverished.

The policy response to this, and to the chronic unemployment that fuels its growth, is likely to be more heavy-handed policing of civil society, unless proper income support schemes can be developed and institutional mechanisms can be encouraged that will provide new, more democratic modes of governance. In this regard, new forms of "tripartism" will have to emerge, in which representative bodies voice the interests of those in employment, those on the margins of the labour market and those moving in and out of it. New forms of industrial and economic democracy will have to emerge alongside new

labour market institutions so as to allow the Voice of those affected by restructuring to help shape the policies for ensuring that, in the necessary drive to improve productivity and efficiency, distributive justice is never overlooked.

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