

# EMPLOYMENT OBSERVATORY

## EAST GERMANY

Labour Market Developments and Policies  
in the new German Länder

No. 10 – February 1994

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## EDITORIAL

Election years are a good time to take stock. This is all the more true in 1994, Germany's "super election year": the German economy is stuck in the deepest recession since the Second World War, unemployment is rising sharply, not only in East, but also, indeed above all, in West Germany, and the burden of public debt is growing rapidly. This provides ample justification to take a closer look at the financial aspects of German Unity, their costs and the consequences for labour market and employment policy.

Unification indeed presents an enormous challenge to Germany's public finances. It has led to an immense debt burden, one which, however, is spread over diverse budgets and special funds (so-called "shadow budgets"), so that its actual order of magnitude is difficult to determine. One thing, though, has certainly become clear: the concept according to which German Unification has been financed, based on short-term borrowing to pump-prime the East German economy, has not worked out. There is still no sign of a self-sustaining recovery in the new federal states, and West-East transfers of billions of D-Marks – around DM 163 billion in 1993, almost two thirds of East Germany's GDP –

will continue to be necessary. The failure of the financing concept has had serious consequences, especially for labour market policy. Despite growing need, cut-backs are being concentrated in this area.

The last edition of the Employment Observatory looked, from an empirical-statistical perspective, at the anomaly of slowly increasing wealth coupled with growing dissatisfaction, particularly in East Germany. In this edition we take up the theme again, this time in the form of an essay: for even supposedly "objective" numbers sometimes call for additional reflection.

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*Employment in*

# ECONOMIC AND LABOUR MARKET STATISTICS

	1st 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	2nd half- year 1993
<b>Economy</b>									
1. Gross Domestic Product in 1991 prices (billions of DM)	149.1	150.1	105.2	85.0	95.9	92.8	105.6	98.6	
2. Gross value added by sector in 1991 prices (billions of DM)									
2.1 Agriculture and forestry	2.6	2.5	4.9	-1.7	4.2	-1.0	4.0	-0.6	
2.2 Energy and mining	9.5	9.3	8.3	8.1	7.1	6.6	6.7	6.3	
2.3 Manufacturing	45.6	42.4	19.4	14.6	16.9	17.4	19.6	18.2	
2.4 Construction	13.3	13.0	12.9	10.9	11.7	13.9	15.1	16.3	
2.5 Trade and transport	28.6	28.3	18.3	14.1	15.3	13.8	14.8	14.1	
2.6 Services	21.5	22.4	18.8	21.7	24.2	26.1	27.5	27.0	
2.7 Government	22.3	26.9	23.8	22.3	21.3	21.2	21.4	21.4	
3. Expenditure on the Gross National Product in 1991 prices (billions of DM)									
3.1 Private consumption	82.1	82.5	93.0	84.8	94.6	92.0	100.6	93.9	
3.2 Government consumption	39.3	44.3	44.1	38.4	47.2	42.6	49.1	43.1	
3.3 Fixed capital formation	28.6	28.7	36.7	39.8	47.4	51.5	56.6	57.6	
3.4 Exports minus imports	-4.2	-3.8	-49.5	-74.0	-88.2	-89.3	-92.8	93.5	
<b>Labour market</b>									
4. Working-age population (in thousands)	10721								
4.1 Migrations to West Germany (in thousands)	49	257	138	102	148	94	106		
4.2 Commuters to West Germany (in thousands)			206	446	541	451	506		
5. Total employment (in thousands)	9932	9130	8035	7369	6767	6354	6276	6146	6091
5.1 Share of female employment (%)	49	49	46	46	46	45	45		
5.2 Employees in <i>Treuhand</i> companies (in thousands)	—	4000	2979	2115	1404	1070	458	296	
6. Employment by sector (in thousands)									
6.1 Agriculture and forestry	985	830	656	379	356	296	278	195	185
6.2 Energy and mining	306	296	271	238	204	176	158	139	125
6.3 Manufacturing	3265	3055	2653	2432	1845	1453	1378	1330	1325
6.4 Construction	846	746	660	569	570	629	667	693	751
6.5 Trade and transport	1652	1547	1320	1331	1269	1209	1194	1180	1187
6.6 Services	962	751	670	765	926	975	988	1025	1045
6.7 Government (incl. <i>ABMs</i> )	1750	1745	1705	1556	1467	1479	1476	1446	1371
7. Employment in labour market measures (in thousands)									
7.1 Employed in job creation measures ( <i>ABMs</i> )	—	—	20	148	390	402	355	252	241
7.2 Short-time workers	—	656	1794	1899	1035	417	233	201	125
7.3 Full-time equivalent of loss of working hours in case of short-time working	—		866	1078	594	223	109	89	56
8. Non-active population in labour market measures (in thousands)									
8.1 In full-time further training measures			45	170	310	442	434	368	271
8.2 In early retirement			460	521	705	806	834	857	778
9. Total persons in labour market measures (7.1 + 7.3 + 8.1 + 8.2) (in thousands)			1391	1917	1999	1873	1732	1565	1346
9.1 As % of potential labour force			15	22	23	21	20	18	15
10. Total unemployment (in thousands)		142	642	843	1038	1123	1101	1100	1175
10.1 Unemployed women (in thousands)		69	352	482	635	715	704	708	754
10.2 Unemployed women (%)		54.6	55.2	59.5	61.6	63.6	63.9	64.4	64.1
10.3 Unemployment rate (%)		1.6	7.3	9.5	11.8	14.2	13.9	15.1	16.2
10.4 Male unemployment rate (%)			6.4	8.0	8.9	10.0	9.7	10.4	11.2
10.5 Female unemployment rate (%)			8.2	11.2	14.7	18.9	18.6	20.2	21.5
11. Shortfall of "regular" employment (9.+10.) (in thousands)			2033	2760	3037	2996	2833	2665	2521
11.1 As % of potential labour force			22	31	34	34	32	30	29

## Sources:

National accounts of the German Economic Research Institute (*DIW*), October 1993 and January 1994 (rows 1.-3.4, 5., 6.-6.7); Official Reports and Press Releases of the Federal Employment Service (rows 7.1, 7.2, 8.2, 10.-10.5); Institute for Employment Research (*IAB*), *IAB-Kurzberichte* and *IAB-Werkstattberichte* (rows 4., 4.1, 5.2, 8.1); Infratest Social Research, labour market monitor for the new Federal states, Munich/Nuremberg 1991-93 (rows 4.2, 5.1); Federal Ministry of Finance, *Finanznachrichten* (row 5.2); calculations by the editors.

## Comments:

In general, stock data in the table correspond with figures drawn up at the end of the given half-year periods (except: rows 4.2, 5.1: data for May or November; rows 5., 6.1-6.7: averages of the 2nd and 4th quarters respectively; row 5.2: 1990/91 1 January and 1 July after the end of the half-years; rows 7.2, 7.3: for 1st half-year 1990 figures are from mid-July).

Row 5.2: figure for the 1st half-year of 1990 is a rough estimate; row 7.1: from 1993 includes "wage-cost subsidies East"; row 7.3: number of short-time workers multiplied by the average amount of working time lost; row 8.1: until mid 1992 estimated; rows 9.1, 11.1: potential labour force defined as the sum of resident wage and salary earners, self-employed, unemployed and the participants in further training and early retirement; rows 10.3-10.5: from 1993 onwards the basis of the unemployment rate has been changed (dependent civilian working population in June 1992; earlier basis dated from the end of 1989, then from November 1990).

## Financing German Unification – Implications for Labour Market Policy and Employment

**In the first few years after Unification, public spending in the new federal states was financed without either a realistic assessment of the actual resources required or a long-term financial concept. The result has been a rising level of public debt with grave consequences for economic and employment policy. As far as labour market policy is concerned, the decision to finance all benefits and policy measures out of the tightly restricted budget of the unemployment insurance fund has had particularly negative consequences. This joint financing is the main reason why active labour market policies have now become a prime target of spending cuts.**

Unification presents an enormous challenge to Germany's public finances. The new federal states require a large volume of public spending to extend and modernise infrastructure, to promote private investment, clean up environmental damage, finance labour market policy, service outstanding debts etc. At the same time, the weak state of the East German economy means that the new *Länder* generate little by way of fiscal revenue. Consequently, public spending in East Germany must be primarily financed by financial transfers from West Germany. In 1992 and 1993 these financial transfers amounted to between DM 150 and 170 billion per annum, a figure corresponding to around two thirds of East German GDP (table 1). All the available prognoses indicate that there will be no decline in the level of support in the near future.

### The public debt and "shadow budgets"

The need for massive financial resources in the new federal states has largely been met by borrowing. Back in 1990, at the start of the Unification process, the Federal Government based its policies on the view that the adjustment crisis in East Germany would be of short duration, rapidly giving way to a broad-based, self-sustaining recovery. Government would merely have to provide initial finance – pump-priming – which could be covered by a temporary increase in public borrowing. In the general election campaign which took place at the end of 1990 the governing parties even claimed that no tax increases would be required to finance the transforma-

tion process in eastern Germany. As, in the subsequent years, the recovery failed to get under way, the Federal Government was forced successively to revise its expectations and its policies, and to raise taxes. First of all, in mid 1991, a "solidarity supplement" of 7.5% on income and corporation tax was introduced for one year; at the beginning of 1993, and with reference to the need to harmonise taxation within the EC, value-added tax was increased by one percentage point. Petroleum taxes were raised sharply in two stages, and, finally, the re-introduction of the solidarity supplement in 1995 was announced. Although these changes in taxation law increased fiscal revenue by DM 15 billion in 1991 and DM 28 billion in 1992, the additional revenue fell to DM 23 billion in 1993 (due to the expiry of the solidarity supplement), and the additional revenue generated was in no way sufficient to meet the sharp rise in spending. As a result – and, since 1993, also due to the recession-induced fall in fiscal revenue – public spending had increasingly to be financed by borrowing. Within the space of three years – from 1989 to

1992 – the public debt increased by more than half. As can be seen from table 2, however, this rising debt did not primarily occur in central and state government budgets, but rather in various "special funds", most of which were set up in the wake of Unification. The most important are described below.

- the "German Unity Fund" (*Fonds Deutsche Einheit*) was set up in 1990 in order to support, until 1994, state and local government in East Germany in the fulfilment of their tasks and to compensate them for their lack of fiscal revenue. 60% of the Fund's resources – totalling DM 161 billion – are financed directly on the financial markets, the remainder provided by central and (to a lesser extent) state government. From 1995 over two thirds of the debt servicing payments will be made by state and local government in West Germany and just under a third by central government.
- the *Treuhandanstalt*. Although this institution, the provisional owner of the formerly state-owned enterprises of the GDR (cf. East Germany no. 1, p. 5), receives income from the sale (privatisation) of its enterprises, its expenditure – supporting, liquidating, restructuring its firms – far exceeds its income. The *Treuhandanstalt* must cover its deficit on the financial markets. By the end of 1994 its overall debt (including the outstanding debts of its firms) is expected to total DM 275 billion. In 1995 these debts, together with those of the "*Kreditabwicklungsfonds*" (see below) and some of the debts incurred by the East German housing sector are to be brought together in one fund (the "*Erb-lastentilgungsfonds*" – roughly: inherited debt servicing fund). This fund will take on a debt of at least DM 435 billion, with the Federal Government bearing responsibility for interest and principal repayments.
- the *Kreditabwicklungsfonds* (debt servicing fund). This fund brings together outstanding debts originating from the GDR's government budget and liabilities incurred by the state when the East German Mark was converted to the D-Mark.

Table 1: Public Financial Transfers from West to East Germany, 1990-94

1990	DM 45 billion
1991	DM 129 billion
1992	DM 150 billion
1993	DM 163 billion
1994	DM 166 billion

Source: Deutsches Institut für Wirtschaftsforschung (DIW)

Currently, interest on this debt is being paid jointly by the Federal Government and the *Treuhandanstalt*. In 1995 this fund is to be succeeded by the *Erblastentilgungsfonds*.

- The “special assets” (*Sondervermögen*) of the European Recovery Programme. These resources originate from financial returns from the Marshall Plan (European Recovery Programme). Since the Second World War they have been used to provide loans at favourable conditions to small and medium-sized firms within the framework of regional policy. Between 1989 and 1992 the debts incurred by the fund more than trebled due to the huge demand for such loans by East German firms. Still, in absolute terms it is less important than the other funds.

As can be seen from table 2, past trends are expected to continue in the near future. According to the prognosis made by the German Institute for Economic Research (DIW), the public debt will rise rapidly until 1995, by which time it will have reached twice its 1989 level.

### Negative consequences of the “Unification boom”

The swift expansion of credit-financed public spending in East Germany was in effect a Keynesian demand management programme for the West German economy: to a considerable extent the additional demand so generated was met by West German goods and services. At times this led to a doubling of West Germany's rate of growth, and to employment expansion of 1.5 million persons between 1989 and 1991. Unfortunately the demand boost occurred at a time when capacity utilisation in German industry had just hit record levels and overall growth was strong, so that the West German economy did not require a demand impulse, certainly not one of this magnitude. The ensuing “Unification boom” generated inflationary expectations (and did in fact contribute to a rise in consumer price inflation from 3.5% in 1991 to 4.0% in 1992), forcing the *Bundesbank* to adopt restrictive monetary policies: German base rates rose by around two percentage points between 1990 and the start of 1992. Despite the growing signs of a recession, rates were subsequently

**Table 2: Public-Sector Debt<sup>1)</sup> in Germany (DM billions)**

	1989	1992	1995 <sup>2)</sup>
Central government	491	607	837
State government	308	384	510
West	308	374	
East	—	10	
Local government <sup>3)</sup>	118	151	210
West	118	139	
East	—	12	
ERP Special Assets	7	24	29
German Unity Fund	—	74	95
<i>Kreditabwicklungsfonds</i>	—	92	435 <sup>4)</sup>
<i>Treuhandanstalt</i>	—	107	
Rail assets <sup>5)</sup>			70
<b>Total</b>	<b>924</b>	<b>1,439</b>	<b>2,186</b>

1) The *Treuhandanstalt* does not belong to the public sector according to the official financial statistics. It is nevertheless included in these calculations because from 1995 its debts will become public debt (a part of the *Erblastentilgungsfonds*) which must be served by central government.  
2) Prognosis by the DIW.  
3) Local government including special-purpose associations.  
4) The *Erblastentilgungsfonds* including DM 31 billion of outstanding debt from East German housing associations.  
5) Debt incurred by the Federal Railways and assumed by central government.  
Source: DIW; calculations by the author

reduced only hesitantly from this level.

Clearly the underlying conception of the financing of German Unification, based on short-term pump-priming covered by additional borrowing, which seriously underestimated the volume of resources required, has induced negative economic and employment effects which have reached far beyond East Germany itself. The high level of interest rates to which it gave rise accelerated the recession which began in 1992 and was a prime cause of the de facto collapse of the European Monetary System in the summer of 1993. Simultaneously it has tied the hands of German government to pursue anti-cyclical fiscal policies in the face of recession. The rise in the level of debt and the rate of interest together meant that interest payments increased from 9% to almost 11% of fiscal revenue between 1989 and 1993; by 1995 this figure is expected to rise to over 14%. This has dramatically narrowed the scope for deficit spending to counter the recession.

### Funding labour market policy

Labour market policy has enjoyed a special status with regard to the financing of Unification-induced public spending in East Germany. As early as 1990 it was apparent that the Federal Labour Office would have to bear

the dramatic rise in the costs of labour market policy measures in the new federal states, while its receipts of insurance contributions there would be relatively small. In order to close the inevitable “gap” resulting from these trends two basic options were available: the Federal Government, with parliamentary approval, could cover the deficit by providing funds from the central government budget, i.e., in the final analysis, fund it out of tax revenue or additional borrowing, or it could increase the contribution paid by both employees and employers to the Federal Labour Office (“unemployment insurance contribution”). It was this second option which was finally taken: on 1 April 1991 the contribution paid equally to the Federal Labour Office by employees and employers was raised from 4.3% of gross wages to 6.8%. This decision meant that the labour market policy adjustment and support measures in East Germany – on top of those in West Germany – were, in principle, to be financed solely out of social insurance contributions (cf. East Germany no. 3/4, p. 12).

The prime motive for the decision to finance labour market policy in East Germany by means of social insurance contributions rather than taxes was clearly the election promise made in the autumn of 1990 that German Unification would not lead to tax in-

creases. It is now all too apparent that this decision has had negative consequences for labour market policy and employment trends. The most important of these are as follows:

- raising the cost of labour as a factor of production: The increase in the rate of contribution to the unemployment insurance fund has meant higher indirect wage costs for employers and thus raised the cost of labour – absolutely and relatively – as a factor of production. This represents a barrier to expanding employment in East Germany, providing an incentive for labour-saving rationalisation.
- Vertical redistribution: On the receipt side, the increase in the rate of contribution to the unemployment insurance fund places a more than proportional burden on low income earners. This is because contributions are only made on wage and salary income up to a current maximum of DM 7,600 per month in West and DM 5,900 per month in East Germany; entrepreneurial and property income are not affected at all. On the spending side, on the other hand, the contributions are used to finance measures whose effects reach far beyond the group paying contributions and which are of benefit to those on high incomes: further training and job creation schemes, for example, help to overcome skill shortages, improve infrastructure, render commercial sites suitable for production and rectify environmental damage. In doing so they help to overcome barriers to investment, promote new job creation and thus benefit the economy and society as a whole.
- Pro-cyclical labour market policy: as early as the 1970s and 1980s it became evident in the "old" Federal Republic that financing both unemployment benefit and active labour market policies out of the contributions to the unemployment insurance fund tended to mean that active labour market policies followed a pro-cyclical course: whenever unemployment rose, so did the costs of financing unemployment benefit; simultaneously the Federal Labour Office's receipts fell. Although the resulting deficit in the Office's budget was covered by central government funds, the Federal Government and Parliament often attempted, when faced with this situation,

to keep central government funding to a minimum by passing legal amendments restricting the benefits and services provided by the Federal Labour Office. These cutbacks usually hit active labour market policy measures hardest, as they were seen as more "flexible" than unemployment benefit. The consequence was that spending on active labour market policy tended to follow a pro-cyclical course: when unemployment rose over an extended period, or remained at a high level, spending on active labour market policy fell (as a proportion of GDP); when unemployment was falling it rose (cf. figure, especially the years 1976/77 and 1982-85, 1978/79 and 1986-88).

#### Active labour market policies – a prime target for spending cuts

This pattern, characteristic of the "old" Federal Republic, is now repeating itself in the unified Germany. Although the rise in contribution rates of April 1991 initially met the increased spending requirements of the Federal Labour Office in East Germany, enabling active labour market policies to be implemented at a level which is almost certainly without historical precedent, since 1992 contributions have not been sufficient to finance spending; ever increasing transfers from the central government budget have been necessary. In line with the pattern described above,

these transfers have now become a prime target for spending cuts. The laws accompanying the central government budgets of 1993 and 1994 have cut spending by the Federal Labour Office more than in other areas (cf. East Germany no. 6, p. 8). Thus, despite rising unemployment, spending on active labour market policies is now falling – pro-cyclically (cf. figure). Once more the practice of financing unemployment benefit and active labour market policies out of the limited, and strictly contribution-financed budget of the Federal Labour Office has proved to be a mechanism which leads, in tight budgetary situations, to competition between the two types of spending, making active labour market policy the object of restrictive fiscalist consideration to a greater extent than other policy areas.

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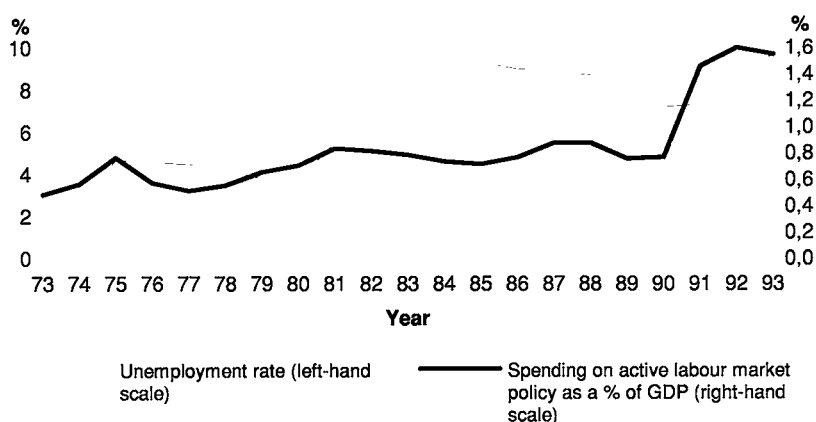
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**Spending on Active Labour Market Policy and the Unemployment Rate, Federal Republic of Germany 1973-93**



# ESSAY

## Mood and Situation

### The Depressed Mood in East and West Germany – Based on Fact or Fiction

No, the mood currently prevailing in Germany, in both the old and the new *Länder* can scarcely be described as optimistic, not to mention euphoric. Indeed, if a number of reports are to be believed, the mood appears in many cases to be worse than the actual situation. In a nutshell, the finding is that there is a discrepancy between “subjective” mood and the “objective” situation; seen by the light of day, there is no material justification for many of the complaints being raised. I would like to illustrate the practical significance of this discrepancy by means of the following example, taken from the “*Berliner Zeitung*”, 12.11.93: Under the title “Some Easterners are better off than they think”, and the sub-title “Average income of many East German households higher than in some districts of West Berlin” was an article, the concluding sentence of which ran as follows: “The mood is worse than the actual situation”. The article reported on a microcensus conducted by the Statistical Office of Berlin which revealed that average monthly net household income in the East Berlin district of Hellersdorf is, at DM 2,650, higher than in the West Berlin districts of Schöneberg (2,600), Neuköln (2,550), Charlottenburg (2,500), Tiergarten (2,450), Wedding (2,350) and Kreuzberg (2,150). In other words the Easterners might moan, but they’re really doing very nicely, thank-you. The lesson drawn was that the depressed mood among those living in the new federal states must be brought back into line, i.e. revised upwards in accordance with the facts.

This illustration reveals a fundamental problem. The various social groups, small and large, in the new Germany are, namely, all but unanimous in diagnosing and propagating a mood-situation discrepancy and the need for “therapy”. They are bitterly divided, on the other hand, when it comes to deciding whose mood requires adjustment to its real situation, which group is in greatest need of an anti-depression therapy: East or West Germany, employers or workers, sellers or customers, those on social benefit or the middle classes, the unemployed or civil servants, political parties or the electorate, the state or its citizens. Reading the newspaper or watching television I am often reminded of a *bon mot* which did the rounds in the former GDR: “The situation is hopeless, but not serious”. Now that the awareness is gradually growing that belts are going to have to be tightened to a greater extent than was generally believed four years ago, representatives of interest groups are taking up position in the public arena, claiming that it is high time that one or more of the other groups pulled in their stomachs, let out some air and went on a crash diet. Lean is in. The result is a double-track strategy which is both exhausting and dangerous: first, social “diet plans” are to be drawn up which are to be made tasty for, and, where possible, prescribed without further ado to, other groups; secondly, one’s own clientele is to be protected against slimming proposals from outside; after all one does not want to lose them. The consequences of this are three-fold:

firstly, the temptation grows to adopt this strategy oneself, so as not to be pushed aside or completely go under – and tough luck for those who are unable or unwilling to follow suit; secondly, this “lean poker” requires ever increasing degrees of subtlety from all participants, as those demanding that others endure hunger pains must declare their willingness to slim down if their credibility and public support are not to be threatened; thirdly, finally, and most seriously, all this leads to a further drop in the subjective mood barometer. Disaffection grows. Motivation sinks. The vicious circle is complete. Not only the legendary man (or woman) on the street grows tired of trying to puzzle out the pros and cons of the interminable programmatic debates and tactical manoeuvring – not to mention getting involved him/herself. In short, the therapy exacerbates the depression, rather than easing it. This provides food for thought., and raises a number of questions. One of these concerns the accuracy of the initial diagnosis: what precisely is meant by the discrepancy between mood and situation?

To start with, the way in which this discrepancy is usually brought up and discussed is often based on a problematic assumption, namely the view that people’s mood and situation should, more or less, coincide: situation good – mood good; situation bad – mood bad. Discrepancies are anomalies. It seems fair to ask whether the reverse is not true, i.e. whether such equivalences are the exception rather than the rule. This is not as strange as it might appear if one remembers that entire periods of recent history – the Great Depression or the 1950s, for instance – are often described or remembered in terms of such a discrepancy between mood and situation. Has it not now become established practice to speak of people’s *élan* or enthusiasm when the mood appears better than the situation, while attesting them neuroses or depression when their mood falls below that supposedly justified by the situation. And if it is indeed the case, and this is neither new nor exceptional, that the “*zeitgeist*” of uplifting periods is reconstructed by means of positive, and that of periods of decline by negative mood-situation differentials, then does this not inevitably pose the question, What do we really mean by “normal” social developments and “usual” mood-situation relationships?

Thinking these questions through, it is but a short step to a further, more fundamental problem. As everyone knows, it is standard practice to attest those complaining of periodic faintness, nausea or headaches a perfectly good state of health for no other reason than that the test and analysis procedures employed did not produce a positive finding, and the patent recipes prescribed as a matter of course did not produce the expected results. Medical diagnoses of this type and the therapy recommended as a result – “Drive the silly thoughts out of your head, then you’ll feel fine” – are now treated with caution and mistrust by many doctors and patients – and with good reason. Social diag-

noses of a similar nature, though, often meet with far fewer reservations. It may well be that, as with the medical profession, appropriate diagnostic methods are simply not available. Nevertheless, or precisely because of this fact, both those examining and those being examined are well advised not to draw the simple conclusion that: "society as a whole OK – members of society objectively OK, but subjectively sickly and ungrateful". Not only does this give a further twist to the spiral of depression, we are surely not in need of further proof to conclude that a social programme of this type – whether scientific or political in nature – is bound to fail sooner or later. After forty years of "actually existing socialism", those living in the new federal states, at least, are all too well aware of this.

One of the difficulties involved in measuring mood-situation relations with any precision is that moods are not due solely – and in some cases not at all – to the concrete situation to which they refer. Whether the sight of the approaching end of a good bottle of wine induces feelings of satisfaction or dissatisfaction depends on a large number of factors; whether the bottle is seen as still half full or already half empty, for instance, how thirsty one is, what other beverages are at hand, who else is helping themselves to wine or whether one generally has the impression that one is not getting one's "fair share". Different people react differently, indeed, in ways which are diametrically opposed – inner peace or open panic – to one and the same fact – here the open wine bottle – depending on the way in which they feel obliged to interpret the situation. The converse case also occurs, namely that different interpretations of a situation lead to one and the same mood. This can be illustrated by means of the example referred to above. In interpreting the income gap between the districts of East and West Berlin, two factors were identified as being responsible: skill levels and double-earner households. Leaving aside other statistical details, such as income variations and household size, I will consider these two factors, based on which two extreme points of view can be constructed. These indicate the moods which can feed on this objective differential. The extreme West German point of view: a blue-collar worker in the district of Wedding, in full-time employment, but the sole bread-winner: "We're handing over the billions, but have got less and less to spare. The end of the story is that after three years of German Unification the Easterners, who never stop moaning, are better off than we are. Enough is enough." The extreme in the East: a public-sector white-collar worker and a chemical engineer whose job-creation scheme is coming to an end. The former: "Basically I'm glad I've got a job that I enjoy and that is fairly secure. But when I see what some bosses in West Germany earn, what they actually do and the privileges they have, then I don't see why we should wait for ever and a day for our wages to be brought in line with those in the West". The latter: "At the moment things are OK, but in my branch the labour market is fully blocked, my degree and occupational experience are worth nothing, and when the job-creation scheme, which is little more than occupational therapy, runs out, then I'll be on the street or selling chips". Thus, while the interpretations differ, the mood is the same.

Obviously, both points of view need to be extended, and account taken of nuances of opinion. In doing so it would seem to me to be important, not to say vital, to face

up from the very outset to three probable and far-reaching conclusions which, at first sight, might appear banal. Firstly, each of these perspectives is rooted in experiences shared by millions of people over years and decades. Each is, for itself, logical and conclusive. They are not erroneous views of life, which can be bent into shape under the force of a few good arguments. Secondly, where these different views come up against each other, day in day out, there arises a sort of zero-sum-game situation – what one side seeks to gain or retain, the other must lose. Thirdly, in such situations, participants are very clearly and substantively aware of what they are losing, but only vaguely conscious, if at all, of what they might stand to gain. And that is a recipe for a bad mood.

Under the current circumstances, seeing things in this way is likely to be due less to the short-sightedness, than to the long-sightedness and perception of the inhabitants of the new Germany. Does not their "bad mood", for which they are so often criticised, reflect a seismographic intuition that the situation in which we all find ourselves is undergoing fundamental and irreversible transition, a transition which will lead to major social restructuring and place a severe strain on the fabric of the new German society? If in their day-to-day life people repeatedly receive confirmation of the view that individual life (and indeed survival) chances are primarily (or even exclusively) linked to the retention and extension of acquired rights and possessions, while at the same time they are increasingly worried that in the course of the current distributional conflicts they are in danger of losing all that they have acquired (or expect to acquire), not just temporarily, but permanently, then it is surely hardly surprising that many people see a bleak future ahead of them, and that their mood is more in accordance with these expectations than their current or past situation.

Merely disqualifying such views as unjustified pessimism and proposing abstract "think positive" philosophies or fiery appeals for moderation may be a approach commonly employed; it is nevertheless inadequate to the problem. Campaigns of this type – this much at least should have become clear during the last four years – will not overcome the depressed mood, neither in East nor in West Germany. It is high time that social moods, and the changes in objective situation to which they give expression, were taken seriously and given due consideration. Not regarding the general direction, but certainly in terms of the concrete steps – and that means those which can be experienced by people in their everyday lives – all those involved in politics, the economy and academic life in the new Germany certainly have their work cut out.

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# INSTRUMENTS

## Wage-cost Subsidies East under §249h of the Labour Promotion Act – A New Instrument on Trial

**A new labour market policy instrument, the “wage-cost subsidy East” under §249h of the Labour Promotion Act (LPA), has been available in the new federal states since the start of 1993. The subsidies enable unemployment assistance funds to be used directly for employment-creating projects for the first time, providing support for work in the fields of environmental renewal, social services and youth aid. Although it contains some innovative ideas, the instrument, often dismissed as merely a form of job-creation programme, is very controversial.**

The programme of wage cost subsidies, due to run until 1997, was introduced when the amended LPA came into force at the start of 1993 (cf. East Germany no. 6, p. 8; no. 3/4, p. 16). In view of Germany's widening budget deficit the aim was to provide the Federal Labour Office with an inexpensive form of support for those whose job-creation schemes (ABM) had expired in the new federal states. As the originally planned title – “Labour Promotion Environment East” – indicates, special emphasis was given to the large-scale environmental projects – known as mega job-creation projects – in which neither the work on the environment had been brought to a conclusion nor permanent jobs created for those taken on under the scheme. As the economic upheaval has also led to the widespread collapse of social institutions, which in the GDR had been largely provided by enterprises, social services and youth aid measures were incorporated as areas entitled to support from the new instrument.

Participants in job-creation programmes whose schemes are about to expire are not the only groups entitled to wage-cost subsidies under the programme. Other beneficiaries are unemployed persons and those short-time workers for whom short time means zero (or close to zero) working hours. Support is only given to part-time employment relations, whereby working hours may not exceed 80% of standard working time, or where wages are no more than 90% of normal collectively agreed rates. For 1993 resources for around 7,000 places were ear-marked in the budget.

### **An innovative labour market policy approach**

As far as the approach is concerned, the new instrument picks up a number of innovative proposals which have been around in the German debate on labour market policy for some time, while at the same time marking a change of direction in the way in which support is provided.

– The wage cost subsidy is based on the principle of financing work rather than unemployment, and of diverting funds from the unemployment assistance scheme to direct employment-creating measures. The level of support is equal to the average level of unemployment assistance in East Germany (including health and pension insurance contributions) and is granted for a maximum of three years (older unemployed persons and the severely disabled are entitled to a maximum of four years). In 1993 the subsidy amounted to a flat rate of DM 1,260 per month or DM 15,120 per year per worker. However, in the ecological field the annual personnel and material costs per worker are estimated to be at least DM 50,000, and in the social services and youth aid at least 35,000. Thus the wage-cost subsidy covers only a relatively small proportion of overall costs (25% to 40%). In contrast to job-creation schemes (ABM), for which the Federal Labour Office and central government meet around 90% of costs, the greater part of the resources required must come from a third party. This can come either from the employer's own resources or from other support schemes run by central, state and local government or the EC.

– This “necessity of co-financing” is intended to bring about a greater degree of interaction between labour market, economic, environmental and social policy. Co-financing will, it is hoped, tie in the regional institutions responsible for economic, environmental and social policy, e.g. the relevant state-level ministries, to the labour promotion scheme, and thus bring about synergy effects.

– An additional difference to traditional job-creation measures is the fact that in the environmental sector private, profit-oriented companies are eligible for the wage-cost subsidies East. The aim here is to bring the subsidised activities closer to the market and thus to support, to a greater extent than possible with existing instruments, the move into self-employment or to regular employment relations. This is a response to the frequently raised criticism of the use of ABM programmes in the new federal states, namely that the strict criteria applied – the jobs created must be in the public interest and may not be profit-oriented – have so far effectively prevented the integration of those institutions implementing the measures – in particular the so-called ABS companies – into the market economy; consequently ABM has not provided a bridge to the regular labour market (cf. East Germany no. 8, pp. 5-7).

### **Wage-cost subsidies in practice**

At the end of 1993 65,388 people were receiving support in the form of wage-cost subsidies under §249h. The Federal Government's aim of creating 70,000 subsidised employment relations in the course of 1993 had thus almost been reached by the end of the year. However, the measure represented only partial compensation for the loss of ABM places: in the course of the year the number of persons benefiting from job-creation under the LPA fell by around 177,000. Adding the job-creation and §249h measures together, 1993 saw a fall in the number of beneficiaries from around 355,000 to about 241,000 (cf. p. 2).

Implementation of the new programme began rather hesitantly at the start of 1993. In addition to a lack



of information and the initially impractical implementation regulations, a major problem proved in practice to be that of obtaining co-financing. The institutions implementing the measures (the "employers") lacked, and in most cases still lack, the necessary resources, and the federal state governments were initially slow in setting up support programmes to complement the new instrument.

It was only in the environmental field, especially in the immense task of cleaning up the ecological legacy of the GDR – re-cultivating environmentally polluted formerly industrial sites or removing commercial buildings of firms that have been liquidated – that complementary financing, and thus the prospect of continuation for many job-creation projects, was provided at an early stage. As ecological damage was considered a barrier to investment, an agreement was reached as early as the autumn of 1992 between central and East German state governments to clean up ecological pollution. This freed potential investors from responsibility for dealing with polluted sites; this task was taken over by central government – in the form of the *Treuhandanstalt* (THA) – and state governments. These in turn commissioned firms, whose employees were supported under §249h, with the task, sharing the costs not covered by the wage-cost subsidy at a ratio of 60 (THA) to 40 (state) – 75 (THA) to 25 (state) for large-scale projects. On the basis of this agreement a large number of job-creation measures whose end was imminent were continued under the new form of support without difficulty. This was facilitated further by agreement between the mining and chemical unions and the *Treuhandanstalt* on special collective agreements for environmental work, which regulated the continued employment under §249h of those who would have been made redundant on expiry of their job-creation schemes. The manner in which co-financing was ensured at an early stage is the prime reason for the dominance of large-scale environmental projects in the chemical and lignite mining industries in the measures receiving support (cf. table 1). An indirect effect of this, in turn, is that the new federal states benefit to very different degrees from the new instrument. Brandenburg and Sachsen-Anhalt receive a disproportionately large

**Table 1: Employees Receiving Wage-Cost Subsidies under §249h LPA, by activity area and gender, end November 1993**

Activity area	Employees		Women as % of total
	absolute	%	
Environmental work	44,441	79.6	27.7
of which: in			
Lignite mining	13,905	24.9	18.3
Chemicals	10,453	18.7	40.0
Steel	2,342	4.2	18.3
Other	17,741	31.8	29.0
Social services	7,481	13.4	79.2
Youth aid	3,890	7.0	58.2
Total	55,812	100	36.7

Source: Figures from the Federal Labour Office; calculations by the editors

**Table 2: Employees Receiving Wage-Cost Subsidies under §249h LPA, by federal state, end November 1993**

Federal state	Employees		For comparison: Share of unemployment in new federal states
	absolute	%	
Mecklenburg-Vorpommern	3,508	6.3	12.9
Brandenburg	11,529	20.7	15.4
Sachsen-Anhalt	16,479	29.5	19.8
Saxony	15,052	27.0	28.1
Thuringia	6,062	10.9	16.9
East Berlin	3,182	5.7	6.8
Total	55,812	100	100

Source: Figures from the Federal Labour Office; calculations by the editors

amount of support, due to the concentration of old industries and their associated environmental damage in these states (cf. table 2).

For §249h measures not covered by the agreement between central and state-level government the main source of financing must be secured on a case-by-case basis. This is particularly true of projects in the social services and youth aid, which depend either on the own resources of the organisation implementing the measure – usually a charity – or additional financing by state or local government. Although all the eastern federal states with the exception of Saxony have now provided appropriate programmes for the new instrument, the shortage of resources is making it difficult, especially in the social services and youth aid, to obtain the co-financing without which no claim can be made for wage-cost subsidies under §249h. This is why only about 20% of the subsidies provided benefit these areas. In view of the fact that the social services are a major source of

employment for women, it is not difficult to see why women still only account for 37% of those receiving these subsidies (cf. table 1). The privileged support offered to traditionally male-dominated activities in the environmental field is why the official aim – to ensure that women benefit from §249h to a degree corresponding to their share of the unemployed – has not been realised.

In order to avoid the short-term support typical of ABM measures, the Federal Labour Office provides wage-cost subsidies under §249h for a period of three years. Federal states are, however, often unable to grant the necessary complementary funding for so long a period, due to the uncertainty surrounding their medium-term budgetary position. Consequently, projects are often limited to one year after all, and participants have to hope for a one-year extension in the next financial year. This uncertainty reduces motivation and makes it difficult to organise work processes effectively.

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### The controversy surrounding the new instrument

The concept underlying §249h is innovative in many respects, opening as it does the "labour market policy ghetto" to some extent, and the new instrument has been termed a "paragraph of hope" in the face of the employment crisis in East Germany. Criticisms have been voiced no less strongly, however. The "wage-cost subsidy East" was quickly stigmatised as a "slim-line ABM programme" or as "dumping ABM". The fact that the subsidy would provide work for only a proportion of those leaving ABM schemes and that the Federal Labour Office would, in contrast to ABM, bear not even half of the cost of implementing measures were points of criticism. Controversy of a more fundamental nature revolves around the stipulations governing pay. The metal-workers' union IG Metall went so far as to announce that it would take the matter before the constitutional court. The requirement for a 10% cut compared with normal wages implies, according to the IG Metall, state pay determination, and unjustified intervention in

the principle of free collective bargaining guaranteed by the German constitution.

Despite its fundamental reservations, the IG Metall has since, like the mining and chemical unions before it, reached special collective agreement regulating employment under §249h, so as not to endanger implementation of the measure altogether. These special agreements, which sanction pay levels below the standards for the branches in question, have created a precedence which will influence the future course of the debate on lower than collectively agreed wage rates in publicly supported employment measures.

### Outlook

A year after its introduction, scepticism is called for in evaluating whether the new instrument really constitutes an innovative alternative to existing job-creation programmes. Criticism has centred on the stipulations on pay and co-financing, the discrimination against women and regional inequality.

Moreover, there is little reason to expect that the instrument can pro-

vide a significant bridge to the primary labour market. The narrow range of areas enjoying support – in order to avoid competitive distortions, support is concentrated in areas which still lack a private supply potential and substantial effective demand – militates against this. As long as activities are excluded which have a chance of establishing a foothold on the market at a later date, there is the real danger that the "wage-cost subsidies East" will remain a surrogate ABM scheme. If it were revised, though, to take account of the criticisms raised, the new instrument might well make an important contribution to the East German transformation process and even offer new labour market policy perspectives for crisis-hit regions in western Germany.

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## TRENDS

### The EC Structural Funds in the New Federal States – Summary and Outlook

**In support of the structural change underway in the East German economy and labour market, the European Community is making substantial financial support available to the new federal states. This support comes from the three structural funds. Between 1991 and 1993 around ECU 3 billion were granted; in the subsequent support phase, which runs from 1994 to 1999, aid totalling just under ECU 14 billion is planned. Besides standard national programmes, in the preceding phase the Funds also promoted innovative labour market policy approaches. The European Social Fund, in particular, enabled preventive in-firm further training projects to be realised, thus closing gaps in German employment promotion law.**

The three Structural Funds are the most important Community-level instruments deployed with the aim of overcoming the inequalities between the different regions of Europe, thus

helping the European Union to attain a greater degree of "economic and social cohesion". In view of the pressure of economic adjustment and its grave social consequences, the new federal

states (including East Berlin) were declared a priority development area (Promotion of the development and structural adjustment of underdeveloped regions) shortly after German Unification. This put the new federal states on a more or less equal footing as regards EC support with the structurally weakest regions of the Community such as the Italian Mezzogiorno, Greece or Portugal. Of the ECU 3 billion made available – relatively quickly and unbureaucratically – during the first support phase from 1991 to 1993, 50% came from the European Regional Development Fund (ERDF), 30% from the European Social Fund (ESF) and 20% were due to projects within the framework of the European Agricultural Fund (EAGGF) (cf. East Germany no. 3/4,

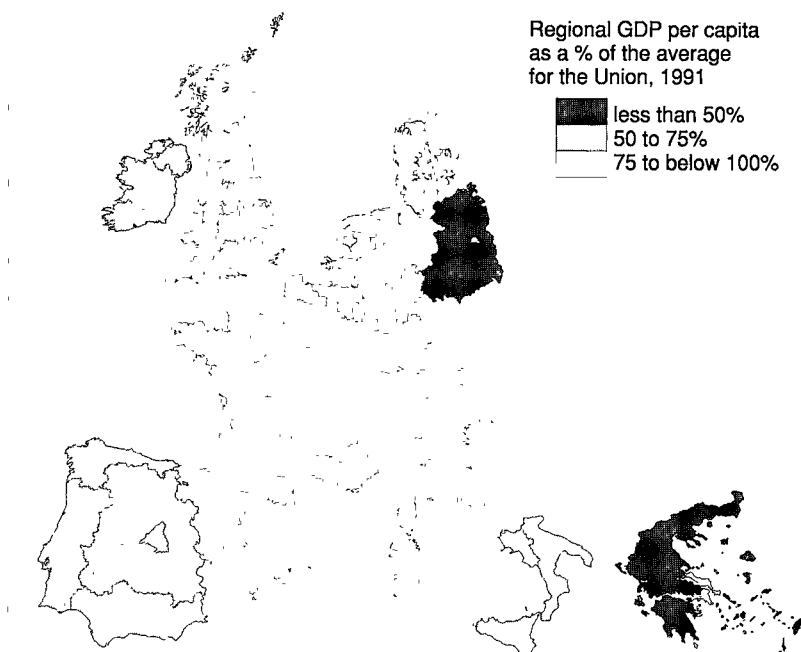
pp. 9-10). A preliminary look back at the past three years shows that the structural funds have all made a contribution, each in a different way, to the transformation process in East Germany.

### **The Regional Fund (ERDF): Supplementing national standard programmes**

The resources provided by the ERDF (ECU 1.5 billion) were largely deployed to (partly) finance and supplement the joint central and state-level government programme to improve regional economic structures in East Germany ("Gemeinschaftsaufgabe Verbesserung der regionalen Wirtschaftsstruktur" – GA). This regional promotion programme, which has been in operation in the old Federal Republic since 1970 and which is planned and financed jointly by central and federal state government, was extended to the new federal states following Unification, initially for five years. It is now a central element of economic support there. The decision to extend the GA as an instrument of economic reconstruction in East Germany was taken not least for reasons of time pressure: it would have taken considerable time to develop economic support instruments specifically tailored to the needs of the new federal states. Time was of the essence not least because of the fact that participation by the EC structural funds in financing support is contingent on the existence of appropriate national programmes. Given the urgency of the problems, the use of tried and tested instruments had the advantage of ensuring the rapid provision of the financial resources available.

The rapid extension of the GA to the new federal states also had its disadvantages, however. So as not to lose time, and not to miss out on possible sources of support, no attempt was made, contrary to funding practice in West Germany, to concentrate regional support for East Germany on individual regions or specific areas, or to differentiate aid conditions between the different East German regions. Critics have taken the view that the GA thus spread its resources too thinly on the so-called watering-can principle. An additional source of criticism has been that by incorporating ERDF resources into the GA the flexibility of EC support was re-

### **Regions whose economic performance is below the European Union average**



Source: EUROSTAT, Regio-databank  
The figures from the various Member States were converted using purchasing power parities.

stricted. In contrast to the ERDF, in the "Gemeinschaftsaufgabe" – which had originally been set up to avoid competitive subsidisation between West German federal states – the conditions and requirements of support are stipulated very precisely; these rigid conditions were thus also applied to the provision of EC funds.

The resources made available by the GA (and thus also by the ERDF) are generally provided in the form of direct investment support for firms and subsidies for infrastructure projects conducive to economic activity. Due to the very slow pace of recovery in the East German economy, fewer firms than expected actually claimed direct investment support over the past three years. Consequently, priority was accorded to improving East German infrastructure, the aim being to facilitate private economic activity. Examples of such projects include opening up industrial and commercial sites, support for industrial and small business centres and improving transport and communications.

### **The Social Fund (ESF): Facilitating preventive labour market policy**

The ESF (ECU 0.9 billion) was used by the new federal states and the Federal Labour Office in order to extend and supplement labour market policy measures, in particular vocational training. In contrast to the ERDF, the ESF served not only to boost standard national programmes, but also compensated for deficits and gaps in national support under the Labour Promotion Act (LPA), thus enabling the new federal states to realise new training concepts based on the idea of preventive labour market policy. In particular, the ESF promoted in-plant further training, a form of training largely excluded from support under the LPA because of the fear of take-away effects. The training measures financed by the ESF are aimed not only at the unemployed but also – indeed especially – at still employed workers who, due to structural change, would be threatened with unemployment in the absence of further training.

ESF funds were provided, at federal state level, for the following preventive measures (examples):

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- adjustment training of core workforces in privatised small and medium-sized firms;
- adjustment training of research and development staff in firms;
- recruitment and start-up help in setting up small and medium-sized firms;
- training measures for newly created businesses. It is in these areas in particular that ESF funding compensated deficits in German support legislation, as support under the LPA aims primarily at wage and salary earners.

Other programmes, funded jointly by the ESF and central and state-level government, enabled young people whose enterprises had been closed to complete their vocational training, either in other firms or in external training centres.

In addition to preventive training measures in individual federal states the Social Fund also supported, through the Federal Labour Office, participants in further training measures under the LPA by providing additional benefits. These included:

- maintenance benefits for individuals who, due to inadequate periods of social insurance contributions, were not entitled to maintenance allowance under the LPA;
- assumption of child-care costs to an amount exceeding the maximum available under the LPA (DM 120 instead of DM 60 per month; in cases of hardship up to DM 250),
- reimbursement of higher costs for travelling between home and training centre;

- raising the work familiarisation allowance to West German levels in cases where a worker entitled to support is transferred to a West German plant.

### Agricultural Fund (EAGGF)

The resources provided by the EAGGF (ECU 0.6 billion) are used to support necessary structural change in rural areas. The main aims here are village renewal and the modernisation of agriculture, fishing, forestry and the food industry. In addition, support has been provided for re-equipping individual agricultural enterprises, restructuring agricultural co-operatives as private firms and one-off projects such as processing or marketing centres (slaughter-houses, wholesale markets etc.).

### New support phase 1994 to 1999

As in the previous phase from 1991 to 1993, the new federal states including East Berlin will enjoy the status of target-1 regions in EC structural assistance. This entitles them to top priority for support, the highest level of resource input, and the greatest degree of freedom in determining target groups, types of measure and regional emphasis. The classification as a priority development area is in accordance with the fact that in terms of economic performance East Germany is lagging roughly as far behind the European Union average as Greece or Portugal (cf. map).

The division of funds – which will total almost ECU 14 billion – is expected to be as follows:

ERDF	ECU 6.8 billion
ESF	ECU 4.1 billion
EAGGF	ECU 2,7 billion
Federal Labour Office	ECU 1.1 billion
Berlin	ECU 0.8 billion
Brandenburg	ECU 2.2 billion
Mecklenburg-Vorpommern	ECU 1.9 billion
Saxony	ECU 3.5 billion
Sachsen-Anhalt	ECU 2.4 billion
Thuringia	ECU 2.0 billion

It is as yet difficult to predict where the emphasis of support will be laid in each case. This is due to the limited progress made in the ongoing application procedure to the EC. The details of the support to be made available are not expected before the spring of 1994.

At the same time, it is unlikely that major changes will be made compared with the initial support phase. The resources provided by the ERDF will probably remain tied to the "Gemeinschaftsaufgabe". The use of ESF resources is also likely to follow past practice, although a more pronounced regional emphasis is expected.

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