

EMPLOYMENT OBSERVATORY

EAST GERMANY

Labour Market Developments and Policies
in the new German Länder

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CONTENTS

Economic and Labour Market Statistics	2
Focus	
The Transformation of East Germany's Corporate Structure	3
Trends	
Longer-term Socio-economic Prognoses for the New <i>Länder</i>	7
Instruments	
Amendments to the Labour Promotion Act	11
Information	12

EDITORIAL

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

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

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

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

Employment in

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



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ECONOMIC AND LABOUR MARKET STATISTICS

	1st half- year 1989	1st half- year 1991	2nd half- year 1991	1st half- year 1992	2nd half- year 1992	1st half- year 1993	2nd half- year 1993	1st half- year 1994	Oct. 1994
Economy									
1. Gross Domestic Product in 1991 prices (billions of DM)	149.6	96.5	109.5	108.7	118.4	110.3	124.7	120.1	
2. Gross value added by sector in 1991 prices (billions of DM)									
2.1 Agriculture and forestry	2.6	0.1	7.0	0.4	7.1	1.0	6.8	0.7	
2.2 Energy and mining	9.5	8.1	7.1	6.7	6.9	6.8	6.8	7.0	
2.3 Manufacturing	45.5	17.8	19.1	18.1	20.6	18.7	22.0	21.1	
2.4 Construction	13.8	11.5	12.7	15.2	16.6	17.7	19.9	21.7	
2.5 Trade and transport	23.2	14.2	15.6	14.6	16.1	16.4	17.3	17.4	
2.6 Services	16.8	21.3	24.6	26.4	27.3	27.5	28.6	29.5	
2.7 Government	21.6	22.8	21.5	21.4	21.3	20.8	20.6	20.4	
3. Expenditure on the Gross National Product in 1991 prices (billions of DM)									
3.1 Private consumption	82.1	84.7	95.0	92.9	104.0	96.0	106.3	100.0	
3.2 Government consumption	39.3	39.1	48.6	43.7	50.0	43.5	49.1	44.3	
3.3 Fixed capital formation	28.5	42.1	50.0	56.0	61.7	62.7	71.6	73.6	
3.4 Exports minus imports	-4.2	-65.9	-78.4	-86.0	-91.9	-90.5	-100.3	-100.6	
Labour market									
4. Working-age population (in thousands)	10721								
4.1 Migrations to West Germany (in thousands)	49	102	148	94	106	78	95		
4.2 Commuters to West Germany (in thousands)		446	541	451	506		607		
5. Total employment (in thousands)	9932	7462	6903	6491	6373	6246	6310	6267	
5.1 Share of female employment (%)	49	46	46	46	46	45	44		
5.2 Employees in <i>Treuhand</i> companies (in thousands)	-	2115	1404	1070	458	296	187	132	
6. Employment by sector (in thousands)									
6.1 Agriculture and forestry	985	469	385	300	266	245	234	218	
6.2 Energy and mining	306	244	209	181	164	145	134	124	
6.3 Manufacturing	3265	2170	1725	1357	1230	1138	1115	1063	
6.4 Construction	846	701	727	797	848	887	957	998	
6.5 Trade and transport	1652	1252	1206	1160	1141	1129	1136	1115	
6.6 Services	962	920	970	1014	1057	1091	1142	1173	
6.7 Government (incl. ABMs)	1750	1514	1450	1442	1416	1359	1337	1320	
7. Employment in labour market measures (in thousands)									
7.1 Employed in job creation measures (ABMs)	-	148	390	402	355	237	177	198	222
7.2 Includes "wage-cost subsidies East" (§ 249h AFG)	-	-	-	-	-	14	63	91	99
7.3 Short-time workers	-	1899	1095	417	233	201	125	105	67
7.4 Full-time equivalent of loss of working hours in case of short-time working	-	1078	694	223	109	89	56	46	33
8. Non-active population in labour market measures (in thousands)									
8.1 In full-time further training measures		170	310	442	434	368	271	234	261
8.2 In early retirement		521	705	806	834	857	778	643	594
9. Total persons in labour market measures (7.1 + 7.3 + 8.1 + 8.2) (in thousands)									
9.1 As % of potential labour force		22	23	21	20	18	15	14	14
10. Total unemployment (in thousands)									
10.1 Unemployed women (in thousands)		482	695	715	704	708	754	784	671
10.2 Unemployed women (%)		59.5	61.6	63.6	63.9	64.4	64.1	65.7	67.1
10.3 Unemployment rate (%)		9.5	11.8	14.2	13.9	15.1	16.2	15.7	14.1
10.4 Male unemployment rate (%)		8.0	8.9	10.0	9.7	10.4	11.2	10.4	8.9
10.5 Female unemployment rate (%)		11.2	14.7	18.9	18.6	20.2	21.5	21.3	19.5
11. Shortfall of "regular" employment (9.+10.) (in thousands)									
11.1 As % of potential labour force		31	34	34	32	30	29	26	23

Sources:

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

Comments:

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

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

The Transformation of East Germany's Corporate Structure

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

Corporate structure: initial situation and developments since 1989

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

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

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

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

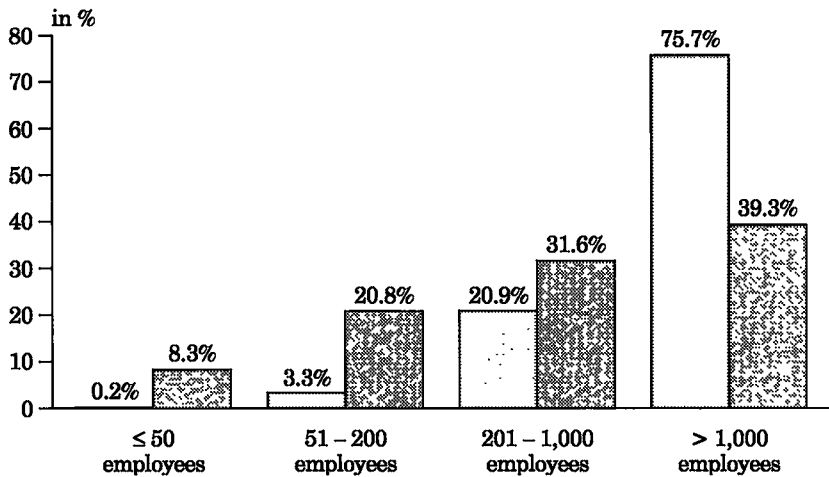
merly state-owned, large-scale companies were split up, privatised, returned to their previous owners, transferred to municipal ownership, or were closed down ("top-down" transformation); these processes were usually accompanied by huge manpower cuts. Secondly, numerous new businesses were set up, generating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

Top-down transformation: privatisation by the *Treuhandanstalt*

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

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

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



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



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

Source: Federal Statistical Office.

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

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

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

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

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

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

“Bottom-up” transformation: new businesses and closures

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

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

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

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

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

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

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

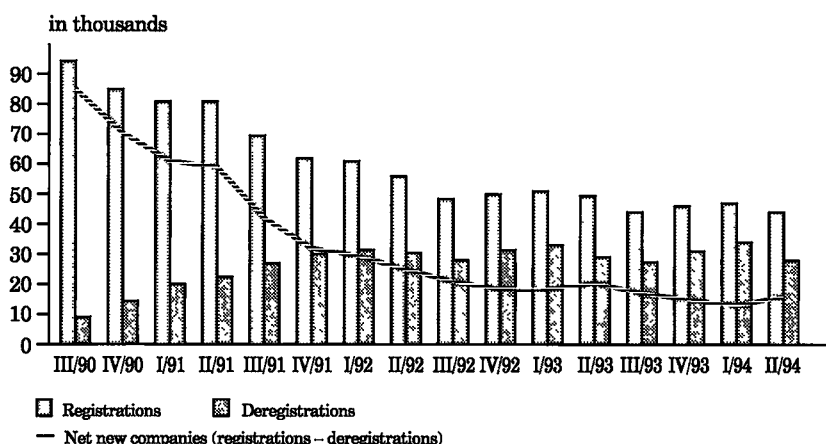
It is estimated that there were approx. 460,000 private enterprises (including agriculture and the liberal professions) in the new federal states in mid-1993. Since only around 10,000 private enterprises emerged from the stock of companies held by the *Treuhandanstalt*, and around 25,000 companies were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

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

Problems facing East German enterprises

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

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



Source: Federal Statistical Office.

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

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

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

Promotion schemes for East German enterprises

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

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

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

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

Results and conclusions

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

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

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

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

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