

O P I N I O N

The Labor Market and Ten Years of German Unification

German reunification, originally hailed as a once-in-a-lifetime gift, now looks more like a Danaens' present to many observers. It was supposed to pull eastern Germany's economic wagon on the journey toward a "blooming landscape" – after an unprepared cold or "jump start". But the wagon got stuck in the mud shortly after the journey began. Even if the level of transfer payments to eastern Germany remains as high as it is today, it would take at least another thirty years to complete the east-west convergence process in such areas as public infrastructure.

It is often concluded that eastern Germany is slow to catch up because it was headed in the wrong economic direction from the outset of unification. But there is no point in blaming politicians alone for all the undesirable developments. Economists must just as well admit to their own errors. The metaphor of a cold or "jump start", alluding to the extemporary transposition of the West German social market economy into the "new Laender", is misleading. After all, a warm-up lap certainly wouldn't have helped the East German "Trabbi" automobile to take the pole position. What

the car really needed was a new engine – and we might as well have given it a whole new body, too.

At the heart of this misunderstanding lies a flawed interpretation of the role of wage costs in explaining the desolate employment situation in eastern Germany. It is simply wrong to attribute the unemployment problem mainly to the high and rapidly rising wages after the new currency was introduced at a one-to-one exchange rate. We must keep in mind that the entire product range of former East Germany had become hard to sell – even in Eastern Europe.

As a consequence, the effective rate of unemployment, which includes both registered and hidden unemployment, still remains at over 30 percent in eastern Germany today. According to a back of the envelope calculation, neglecting all the relevant structural aspects, wages would have to fall by more than 80 percent in order to achieve full employment in the "new Laender". The suggestion to concentrate on the wage factor is therefore far from reality, just like the assumption that the eastern German labor market functions according to neo-liberal textbook economic principles.

The extent to which wages in east and west have converged is often overestimated since a comparison of union wages is easily misleading. In the west, union wages are often much lower than actual wages. In the east, most companies do not bother to participate in collective wage bargaining. Therefore, collectively agreed wages often do not apply, or they are simply ignored. Fringe benefits, such as vacation or Christmas premiums, are still substantially lower in the eastern part of the country. From this perspective, the eastern German labor market is much better than its reputation with regard to creativity and flexibility.

Therefore, the effective wages of east Germans, compared to their compatriots in the west, are not as far apart from productivity as is commonly alleged in the

public debate. But a general comparison of productivity always tends to be deceptive: It only works for sectors with interregional trade of goods, not for areas that are dependent on the public sector or on local purchasing power.

It is safe to assume that the labor market in the east will continue for a long time to play by different rules than the west. Despite high unemployment, the average number of hours worked per potential worker in the "new Laender" is almost at the same level today as in the rest of the country. Another example is the above-average education level, which – in contrast to the west – does not effectively protect workers in the east from losing their jobs.

Nonetheless, active labor market policy in its current form has no future. Regardless of its function as a social stabilizer, it has failed economically (with the exception of a few individual programs for further education). The political quarrel about this kind of policy will undoubtedly remain until we manage to establish an independent scientific evaluation of labor market policies as it has long been common practice in other countries.

Notwithstanding the progress made, overemployment in the public sector and an underdeveloped service sector still reflect the structural deficits of the eastern German economy. Rapid economic transformation has unleashed the potential for a modern service economy meeting the challenges of the information age. But this potential has not been fully realized. The lack of export orientation is yet another enormous structural deficit. EU eastward enlargement, which is already looming on the horizon, may be a promising opportunity to do some catching up. Nothing will be gained, however, without a consistent improvement of public infrastructure. This will remain an important task for support from the federal government.

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