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The Travails of Unification

East Germany's Economic Transition since 1989

Charles S. Maier*

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Abstract

The former German Democratic Republic underwent a unique post-communist transition because it was absorbed into the wealthy Federal Republic of Germany and has received massive subsidies. Nonetheless, serious difficulties have persisted, including higher unemployment, rapid deindustrialization, and greater political loyalty to the successor parties of the former Communists than in the West. The reasons for these phenomena remain debated, but seem to the legacy of concealed structural weakness in the old GDR, perhaps the one-to-one conversion of East German savings into Deutschmarks, and the commitment to elevate wage levels in the East close to those prevailing in the FRG.

Keywords: currency conversion, deindustrialization, market economy, transition, Treuhand, unemployment

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* Harvard University, Boston, email: csmaier@fas.harvard.edu

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Acronyms

CDU	Christian Democratic Union of Germany
CMEA (Comecon)	Council for Mutual Economic Assistance
FRG	Federal Republic of Germany
GDR	German Democratic Republic
NÖS	New Economic System
Stasi	Ministry for State Security
VVB	*Vereinigung Volkseigenen Betriebe* (council of self-governing state enterprises)
SED	*Sozialistische Einheitspartei Deutschlands* (Socialist Unity Party of Germany, the Communist-led ruling party of the GDR)
SPD	*Sozialdemokratische Partei Deutschlands* (The Social Democratic Party of Germany)

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UNU World Institute for Development Economics Research (UNU-WIDER)
Katajanokanlaituri 6 B, 00160 Helsinki, Finland

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1 Introduction

It might have been thought that, at least in economic terms, no post-1989 transition should have been easier than the East German. An economy that was an industrial powerhouse for the CMEA (Comecon) states fell into the lap of the most powerful west European economy during 1990. It acquired thereby a highly developed legal regime for private property, which other east European economies had to develop from a more rudimentary base. Within a couple of years, perhaps the most highly developed and detailed regime of social welfare and protection in the west was extended to its own citizens.[1] And yet the former GDR (German Democratic Republic) had and has had continuing difficulties and even today seems to lag behind West German standards. I write ‘seems to lag’, because the most recent assessment proposes that the results are really stronger than usually depicted.[2] Nonetheless, as of 2008, before the current crisis really hit, the Eastern German unemployment rate was 13.1 per cent as compared with 6.4 per cent in the west. Although the East German population is approximately 20 per cent of Germany’s as a whole, labour market expedients were needed far more in the East. One-third of those workers in job retraining, and one-half of those in various short-term job-creation schemes, which the unemployed had to accept to retain long-term benefits, were in the East. And even the most optimistic assessment must take into effect that the stabilization of living conditions involved the continuing emigration of Germans, especially younger ones, from East to West. Politically the transition proved relatively easy, although right-radical outbursts against immigrant workers sullied civic life for several years. Economically the transition proved far more difficult than believed at the outset. Any serious inquiry must explain this disappointment.

As with most phenomena in economic history, several explanations can and have been proposed. Indeed, the outcome might be thought of as over-determined. Alleged factors have included the East’s long-standing failure to match the productivity growth of the West German economy; the currency settlement at the time of unification; the possibly misconceived policies of the agency given control of the GDR’s state enterprises, the Treuhandanstalt, and even the lack of entrepreneurial vigour among the East German populace. Let us consider these in turn.

The stark fact is that the GDR economy had a lower productivity growth than the Federal Republic at the end of the 1940s, and never caught up, although per capita growth probably outpaced the Federal Republic during the 1970s when so many western economies suffered prolonged stagflation.[3] However, GDR total factor productivity fell behind again sharply in the 1980s. As of 1987, value added per person employed in East German manufacturing seems to have been 30.5 per cent of the West German level and 21.4 per cent of the United States level (Van Ark 1995: 89). Overall productivity in manufacturing at least continues to lag in the East, and it does so across firm sizes and

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1 For a recent account of this process, see Ritter (2007).

2 See Pacqué (2009). Because his is the latest synthesis, I have relied on Pacqué for much of the statistical comparisons cited. The East-West comparison of retraining and work-creation employed comes from page 119. I use West German and East German (or western Germany and eastern Germany) to refer to the former territories of the FRG and GDR, respectively.

3 See Ritschl’s overview (1995/2: 11-46), which provides ranges of estimates for key parameters, from the implausibly high official statistics of the GDR to pessimistic values and what he deems the most plausible mid-level figures. See also van Ark (1995: 75-100).

age of firms as well. Even a comparison of firms with equivalent knowledge assets (patents) confirms a productivity gap. The only factor that lowers the differential is ownership by a West German company. Becoming a subsidiary makes East German firms shape up, or perhaps the East German firms that have performed better are the ones to have attracted West German purchasers (Czarnitzky 2005: 211-31). Recent investigations have suggested that the federal government may have even subsidized too much innovation among the small and medium East German manufacturing firms for their own good (Czarnitzky and Kraft 2006). Whereas in the West, R&D expenditures (as a percentage of sales) had a linear positive impact on credit ratings and thus expectations of future firm performance, this relationship did not hold in the East. Rather R&D, provided in large measure by government subsidies, was thought to overburden a firm's prospects. The harder you try, in effect, the less profitable you are expected to be! Still, it cannot be the utilization of available R&D that has contributed to the overall gloom. While all these factors have been present, I think it makes most sense to attribute the lagging economic results to what might be described as the failed recontextualization of East German economic life. In effect, the former GDR (the new *Bundesländer*) was assigned an economic role that had little purpose and no real market demand. Whatever strengths its economy did offer—networks of productive capacity within the frameworks of state-owned *Kombinate*—may have been effectively dismembered by the strategy of selling industrial components individually.

2 Economic difficulties of the GDR

Let us consider more closely the difficulties or challenges that afflicted the East German state, the German Democratic Republic, before its collapse in 1989-90. Gustav Stolper and Nettl outlined early on the difficulties afflicting the period of Soviet occupation and the 1950s, which ended with considerable loss of labour-age population to the west (Buchheim 1995a, 1995b). Erection of the wall in 1961 staunched this flow, and the 1960s began with an effort to institute reforms known as the *new economic system* (NÖS). These gave primacy to investment goods, encouraged, in line with Walter Ulbricht's enthusiasm, cybernetics and the technological enthusiasm that motivated many capitalist states of the period (recall Harold Wilson's invocation of the 'white heat of technology'). As Kopstein (1997: 111-8) points out, the rhetoric of technocracy exceeded its real effects, and by the late 1960s 'retreat from technocracy' was already underway.[4] Like the other economies of the Eastern bloc, the GDR also experimented with a partial introduction of market criteria by which firms could retain profits and would supposedly bear the real costs of losses within the framework of a national plan.[5] The ministries of industry were displaced by a *Vereinigung Volkseigenen Betriebe* (VVB, or a council of self-governing state enterprises). But as was the case with Czech reforms associated with Otto Sik or with so-called *khozrashchet* in the Soviet Union (individual firm accounting of profits and loss sometimes associated with the tepid pro-market views of Evsei Lieberman in the Soviet Union), the GDR experiment revealed that a partial dismantling of central planning was very difficult. Independent firms tended to bid against each other, and provoked unanticipated shortages and bottlenecks

4 For a general survey of the 1950s and 1960s, see Hoffmann (2003).

5 Steiner (2004) outlines the evolution of the GDR economy across its history and provides a detailed bibliography of the monographic literature.

and often disappointing results. The new approach also seemed to stimulate unacceptable demands for political liberalization, such as characterized the Prague Spring and thus was further discredited.

In place of the new economic system, the GDR leadership thus introduced at the VIIth Party Congress of the SED in 1971 the supposed ‘unity of economy and society’, a policy mix associated with the growing influence of Günter Mittag. The unity of economy and society meant an effort to combine economic growth with a relatively high degree of social welfare spending and satisfaction of consumer needs. It was in line with the policies Edward Gierek adopted in Poland after the explosion of worker dissatisfaction in 1970 and the tendencies toward ‘goulash communism’, associated with the later phases of Janos Kadar’s administration in Hungary. Ritschl, certainly a clear-sighted critic of the planned economy, admits that vis-à-vis the difficulties in the West, the GDR enjoyed relative success, which accompanied its growing political recognition both by the Brandt government in the West and the international community (Ritschl 1995: 32).

Such policies, however, were unsustainable without subsidies or credits from abroad, that is from either the Soviet Union or more plausibly from the non-socialist western economies. The Soviet Union’s per capita income was no higher than its satellites, but it could provide oil and other raw materials at a price below world-market levels. Oil price subsidies made a difference after the OPEC countries tripled the price of oil they charged western countries in early l974. East Germany could buy Soviet oil, refine it further, and sell it at a mark-up to the west. Inexpensive oil also provided the basis for a major chemical industry, as did the earlier development of synthetic oil that had been expanded preparing for and fighting Second World War. But by the 1980s the Soviets started raising their oil prices to world-market levels, and in 1985 the Gorbachev administration asked further for payment in convertible currencies. This made the cost of consumer socialism in Poland and the GDR even more dependent on the credits provided by West Germany. Since the new ‘Ostpolitik’ of the SPD-FDP governments in the Federal Republic specifically sought to moderate East German communist policies by conciliation (*Wandel durch Annäherung*), economic assistance and credits formed part of the package. This would lead to substantial indebtedness on the part of the East German economy, especially since the Christian Democratic governments after l982 essentially continued the policies, indeed with Franz Josef Strauss’s efforts at personal diplomacy extending even greater assistance in the late 1980s.

Indebtedness to the west, moreover, played an accentuated role given the policies of the CMEA as a whole. By the 1980s CMEA trade and exchange was taking place within a complex pattern of bargaining. In theory the CMEA was designed to facilitate an Eastern trade zone and an interdependence that would make for the enhanced efficiency of the socialist world and minimize dependency on the west. But in fact western dependency had only grown, and in each bargaining session, the game became to try and detach one’s economy from the reciprocal obligations inside the Comecon. The East European countries wanted as many western goods as possible, which meant they wanted to minimize their obligations to produce for the Eastern bloc and to find customers in the west. It was easy enough to sell folkloric items such as Russian Matrushka dolls, or Polish carpets and hams to the west, but these of course comprised trivial items in the balance of accounts. Tourism was underdeveloped since personal service occupations hardly existed to western standards. By dint of sharp discounting some industrial goods could be sold in the west—in my country village in Rhode Island a local farmer had purchased a tractor from Belarus!—and to the East Germans, but what the GDR did relatively well was produce industrial goods for the Soviet Union. Its major specializations, heavy industry, machine tools, and chemicals were oriented toward the CMEA markets, where they played an important role. But the CMEA was being pried apart as a zone of economic exchange: each of its European components was being left to make its own arrangements with the west. And what East Germany could offer no longer had a role for western producers or markets. What East Germany produced, moreover, brought with it particular ecological vulnerabilities, since the country's major domestic fuel was lignite or brown-coal, a particularly sooty fuel with two-sevenths the thermal output of equivalent weights of hard coal. Moreover, as part of the CMEA as a whole, the GDR lagged in such technological sectors as copiers and computers, and indeed post-industrial services and consumer items in general. Since the Federal Republic was also a machine tool producer, the East Germans did not have a ready market for their machine tools in the west. Essentially the East Germans became the industrial machine tool producer for the socialist world, and depended on credits and outright subsidies and personal remittances from West German relatives for western consumer goods. These they distributed first through inter-shops for western currency and then in *exquisit* and *delikat* stores at premium prices, a system that created a network of privilege which naturally undermined the socialist ideology that the regime propagated (Zatlin 2007; Landsman 2005). East Germany was vulnerable to the continuing flow of credits from the west and, above all, from West Germany. In the event of reunification, these were not really likely to halt (and, of course, they did not—having amounted by 2009 to over a trillion Euros), but the dependency meant that the vanishing state was in no position to suggest alternatives to the economic reorganization that was decreed after 1990.

Structurally the system was revised in 1979 to group suppliers and producers into so-called *Kombinate*, which meant large aggregated production units with their own internal logic—a close approximation of vertically integrated firms. As of 1986 there were 132 centrally managed *Kombinate* with an average of 25,000 employees each and another 90 some district Kombinate with 2,000 employees each. The *Kombinate* models integrated East German engineering expertise, and productivity arrived at certain efficiencies, but often at the cost of developing regionally vigorous economies. As in other socialist countries, management of these enterprises involved pre-emptive purchase of raw materials and continued negotiation with state planners and workers.[6] Although such modifications of central planning can be viewed as undermining economic performance, they also constituted the social learning of East German enterprise, and it was these networks and links that were rudely ruptured by the great sell-off of constituent firm units from 1990 to 1994.

The country had woefully neglected infrastructure in housing and buildings. The 'unity of economy and society' meant that consumer goods might be sought alongside the production of exports to the CMEA or the west, if possible. Investment in the physical plant of GDR cities was sacrificed. What is more, during the 1980s the regime devoted much of its scarce resources for urban development to projects in the capital. As a stake in the cold war, Berlin—Hauptstadt der DDR received the lion's share of urban development funds. The competitive preening for the fifth centennial of Luther's birth in 1987 provided only a final episode.

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6 For examples of *Kombinate* transactions with their workforce, see Wilczek (2004).

Still, within the overall structure set by these political constraints, the East German economy still satisfied a modicum of welfare. A consumer had to wait a year or more and pay a far larger price in terms of his worktime for an inferior automobile; housing was dilapidated and run down, but within their little republic they made do with a certain shabby coziness. As of 1980 the per capita income of East Germany (based on purchasing power equivalents) was 45 per cent of the average in the wealthy FRG, France, Sweden, Belgium, Holland, and Switzerland.[7] The next wealthiest socialist economy, Czechoslovakia, achieved 36. With the fall of the Wall on November 9, however, a new perspective opened up: the possibility of individual entry into a far richer state. In retrospect one can see a basic inconsistency developing in the East German population: the vision of a higher standard of living, and the preservation of all the social guarantees they associated with their own socialist state. Kohl's Ten Point Programme for progressive merger, presented to the Bundestag on 25 November, was a masterly stroke that spoke of progress towards confederative structures without foreclosing what these might be or openly disturbing French and British concern about rapid political unification.

3 Unequal equals

German unification was formalized through two treaties: the State Treaty of 18 May 1990 between the two German states which created a 'currency, economic and social union' (*Währungs = Wirtschaft = und Sozialunion*), and came into effect on 1 July. The second Unification Treaty (negotiated in the 'two plus four' process) provided for constitutional adhesion of the East German federal states (Länder) to the existing Federal Republic by virtue of Article 23 of its basic law. It effectively substituted for a formal peace treaty concluding the Second World War, defined the boundaries of the new united Germany and was ratified by the European nations who had adhered to the CEE that had signed the Helsinki Accords in the mid 1970s. It came into effect on 3 October 1990.[8]

The path to this dual settlement was both delicate and turbulent, but largely foreordained by the weakness of East German authorities during the period of merger. Inside East Germany during the winter of 1990, two authorities contended—the Modrow government of 'national responsibility', and the non-official 'round table'. The five months between the replacement of Erich Honecker in October 1989 and the East German parliamentary (Volkskammer) elections of March 18, which returned an overwhelming CDU majority, was a period of dissipating illusions. The Modrow government's backsliding about dissolving the Ministry for State Security (Stasi) led to angry public demonstrations in mid-January 1990. The clumsy move and the bitter protests made clear the political fragility of the GDR government and undercut any possibility that it might confront the West German negotiators as an equal partner. The official government was still playing with concepts of a transition to a market economy with a large state role (although how one made this transition was not really addressed), while the Round Table picked up on the ideas of the national trusteeship. On 1 February

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7 See Kopstein (1997: 198) and Janos (1994: 4).

8 For a comprehensive treatment of all the legal and constitutional issues connected with unification, Quint (1997).

1990 the Modrow government—its authority rapidly waning and finding no real support at the time of the premier's Moscow visit at the end of January—announced its own plan for a federation of the two Germanies: *Deutschland einig Vaterland*, and broadened its party base beyond the SED and the block parties a few days later. It also requested 10 to 15 billion credits from Bonn, which were refused in mid-February. By this time, Bonn had little interest in any bailout, although it also had to guard against a total rapid collapse in the East. Three hundred and fifty thousand East Germans had already moved West in the last quarter of 1989 and the budget deficit was growing rapidly. The first (and last) free multiparty Volkskammer elections of 18 March 1990 changed the unification situation with the dramatic victory of the East German CDU led by lawyer (and violist) Lothar de Maizière. Essentially the new government saw its task as preparing the most rapid and frictionless union possible. Although the committee to ponder a new East German constitution hoped to create the basis of a state that would be democratized but retain its autonomy for negotiations, the new Volkskammer rejected these projects and pushed through instead an administrative restructuring that recreated six new (or renewed) German *Länder* that would be able to merge into the federal structure of the West German Basic Law according to the provisions of Article 26.

Two issues emerged as critical for the impending economic unification. One was structural: how to continue or dispose of the GDR's collective property. Still, in this period a whole bunch of economic reform proposals emerged that shared the notion that somehow there was a middle or 'third way' between the old planned economy and what was feared to be a ruthless competitive capitalism. The other was how to value GDR monetary assets and ongoing wages, prices and earnings in the transition to a single currency. These were crucially interrelated, for whatever conversion factor was chosen would determine the burden of wages and debts that the GDR's industry would be burdened with. Among the concepts, most of which remained rather nebulous, the idea that Wolfgang Ullman's *Freie Forschungsgemeinschaft* (later Kollegium) within the movement *Demokratie Jetzt* advanced had the most success. It envisaged a trusteeship institution or holding company (*Treuhandanstalt*) that would take over the state property of the GDR and provide a substantial asset with which to confront the West (Seibel 2005; Kemmler 1994; Fischer and Schröter 1993).For a brief while the Treuhand was one of the largest property owners of the world and employed four million workers. It took over 8,000 units, reorganized them for sale into 12,350, sold about 8,400, liquidated 3,700 and transferred the remaining hard-to-dispose-of firms into a successor agency (Nativel 2004: 50-1). But what its properties were worth and how they might be utilized were the key issues. Early estimates of the socialist patrimony's value were based on assessments of physical property and took little account that the whole demand structure was transformed with unification.

The Treuhand would have a tremendous task; it had to find buyers for the nationalized industries of the East who were willing to take on the tasks of rehabilitating their acquisitions. The agency itself did not take on the task of working through the old debts, but according to the terms of the currency union worked out in the spring, assigned these a value in deutschmarks at half their east-mark value. Retaining this burden of debt on Treuhand properties meant that the sums purchasers offered were correspondingly lower than might have been expected. (In effect East German properties came with a burden somewhat akin to the 'toxic assets' that vastly reduced the repurchase value of Lehman Brothers or Bear Stearns and other United States financial firms in the fall of 2008—a recent capitalist example of the need for vast write-downs of value. Whereas the American Treasury stepped in quickly to keep some of these assets afloat, the Federal Republic would find itself required to sustain transfers over the next decade.) Western purchasers expected allowance to be made for the investments needed, above all when environmental cleanup had to follow. Prospective purchasers could also calculate that employee compensations levels in the East were also likely to rise, as indeed they did from under a third to half the real wages of the West between January 1990 and October 1991, as the West German based labour unions extracted large pay increases from the Treuhand. The impact of Treuhand sales on the ownership of former GDR property is hard to determine. Ninety per cent of the buyers were West German firms who wanted essentially to set up ‘extended work benches’, or factory subsidiaries in the East, with access to markets in East Central Europe, but retain control in the West. On the other hand, the same source reports that three-quarters of East German businesses have East German owners (Nativel 2004: 51).

Treuhand problems became visible once political unification was complete. More attention during the negotiation process was focused on the setting of the exchange rate of the two German currencies at the ratio of 1:1, at a time the East German currency had an international exchange value of perhaps one-quarter or one-fifth the West German deutschmark, although its purchasing parity within the GDR was significantly higher. Overarching the entire settlement was the promise that the Deutschmark was to become the new currency of united Germany, that ongoing obligations in the East such as wages and pensions, rents and interest payments would be valued at a parity of 1:1. The basic idea of a currency union was floated by the SPD parliamentarian Ingrid Matthäus-Maier in early 1990, and the Kohl government largely took the idea over in an announcement on 7th February. This decision, which was politically motivated, and for which many good reasons can be given, supposedly made the wage costs of GDR industries unsustainable. In addition, West German unions, which largely took over the wage bargaining in the East, pressed for a rapid convergence of East German pay scales, which far exceeded the convergence of labour productivity rates. Although the Council of Economic Advisers (*Sachverständigenrat*) warned publicly against the implications of the 1:1 currency union two days after the Chancellor made it his own, the Scientific Council (*Wissenschaftlicher Beirat*) of the Economics Ministry gave precedence early on to preventing rapid mass migration westward. Partially softening the Scientific Council’s plan to evaluate existing GDR liabilities and assets at 1:2 and future income streams at 1:1, the new Currency and Economic Union provided that personal savings accounts or company balances in GDR marks would be converted at par up to a total of DM 2,000 and at 1:2 for amounts higher than the 2000 (or up to DM 4000 for senior citizens). In terms of the monetary claims the Federal Republic was adding to its money supply, and the reserves required to cover them, the Federal government did not pose a exceptional strain on currency stability. But where the ‘mark equals mark’ conversion would have graver consequences was in the continuing burden of pay scales. The Bundesbank monthly report of July 1990 (*Die Währungsunion mit der deutschen Demokratischen Republik*) estimated that East German productivity was only 40 per cent of FRG levels. Nonetheless West German unions insisted that wages in the East converge on Western levels. There was a good political argument for this policy. Aside from concerns about massive population transfers, the ideology of unification assumed that the new Germany was to share social burdens and provide equal opportunities. This premise was important in keeping both major West German political parties behind the terms of unification. Nonetheless, the resulting hike in East German real wage costs put new firms under tremendous pressure (see Ritschl 1995: 39-41).

4 Economic landscapes: blossoming or bleeding—*blühend oder blutend*?

By 1992-93 even Chancellor Kohl, who had spoken blithely of 'blossoming landscapes' was compelled to recognize that the economic situation was grave. The mid-1990s probably represented the worst years of the transition. Different estimates, which are hard to reconcile, suggest that 70 per cent of its employees would lose their jobs, or that two and a half million workers lost industry jobs during the years of Treuhand transition, approximately 60 per cent of those who had been employed in the industrial sector. From 1990 to 1991, East German industry cut back work time (*Kurzarbeit*) for 900,000 employees. The unemployment rolls hit a million (after many hundreds of thousands had already moved West), and after 1992, early retirement at age 55 went into effect for perhaps 800,000; job retraining would occupy another 400,000: in effect a massive underemployment. All in all, unemployment reached 15 per cent and the total of unemployed, early retired, employed in state created jobs, or in retraining, totalled perhaps a third of the potentially employable, a total comparable to the great depression of the 1930s.[9] Federal Labour Office statistics show unemployment rising to a million by mid 1991 and then continuing between 1.2 and 1.5 million through the 1990s. By 1993 agriculture and forestry had fallen to one-fourth its 1989 size (ten per cent of the active population), and industrial employment to one-third (of the almost half the labour force it comprised originally) (Ritter 2007: 122-6). A rise in construction employment of 50 per cent and of services by 40 per cent (although of a reduced overall work force) partially offset the losses. But the gains included youth entering the labour market while the losses counted a high proportion of the middle-aged, 50 and older. Women in particular proved vulnerable to unemployment. The GDR had brought most women into the work force, although it did not place them in high-status positions. Nonetheless, nurseries and day-care were extensively available. With unification, the employment pattern reverted toward the West German pattern with fewer women working, and child care facilities more fragmentary.

Only massive transfers made this bloodletting of jobs bearable. Unemployment support, standardized along West German lines, provided about two-thirds of the most recent net pay for a limited period and thereafter about half the salary, at least until the so-called Hartz IV reforms of 2004 tightened benefits. The West German old-age pension insurance system, based on accrued contributions over the years of employment, was also extended to the East in August 1991. The result was to make East German pensions on average 15 per cent higher than Western pensions, in part because GDR workers had experienced virtually no unemployment and far more continuous women's employment. Pensions constituted about 18 per cent of East German aggregate income, but only 9-11 per cent in the West. Moreover, it can be estimated that of the East German pensions about €21 billion are derived from West German fiscal sources. This amounted to about 7.4 per cent of the East German GDP (using this term for that portion of national output generated in the East)—perhaps two-thirds of today's yearly net transfers. Despite these large sums, individual pension entitlements remained less in the East than the West (57 per cent in 1992 rising to 88 per cent since 2002).

9 Pacqué (2009: 61) for the Treuhand figure; pages 116-7 for the aggregates. For 2008 the corresponding totals were 13 per cent unemployed, and 16 per cent 'underemployed', still massive, but half of the early 1990s.

Insofar as productive activity helped to ameliorate the depressed conditions in the East, it was the construction industry that provided a major motor, at least at first. Whereas construction contributed about 5 per cent of the West German GDP, it amounted to about 12 per cent of East German GDP in 1991 and rose to about 17 per cent in 1995—but then fell steadily through 2006. The result of all this building and urban renewal was that whereas the housing stock of East German cities was renewed, and the shabby buildings spruced up, the number of empty residences reached 13 per cent by 1998, twice as high as in the West. As of 2006 it was still 12.6 per cent (vs. the West's 6.8 per cent). Housing prices had fallen 15 to 20 per cent, and office space from 30 to 40 per cent between l995 and 2005 (Pacqué 2009: 103-5). Of those employed in this sector, 600,000 had lost their jobs, perhaps for a second time. But they left behind urban neighbourhoods that were restored and attractive. Yet this author can testify to the somewhat spectral appearance of beautifully restored city centres (as, for instance, in Gorlitz), with relatively few commercial tenants and space claimed by public agencies.

The challenges of the world market did not hit Eastern Germany alone. The mid-1990s compelled a reconsideration of the costs of the German *Sozialstaat* in general as the impact of globalization really began to strike home. The extensive German social insurance system rested on high costs that employers had to cover, such that the overall cost of hiring a worker with all the 'fringe benefits' might amount to twice that of his or her wage. But while the hourly or weekly costs of labour (per worker) remained high on an international scale of comparison, labour was sufficiently productive that the cost per unit of output remained globally competitive. This reflected both the extensive capital equipment that West German labour could work with, as well as a high degree of social investment in training skilled workers. German goods thus retained a reputation for superior quality that also allegedly preserved their market share. Unions and works councils bargained closely with employer associations and provided high-quality labour in return for wage and social guarantees. This social compact, combined with an extensive network of apprenticeship training, constituted what had been admired as *Modell Deutschland* or the German model in the 1980s and 1990s. By the end of the last century, however, this cosy equilibrium came to be seen by critics as too costly and inflexible as emerging markets provided strong competition. The enviable apprenticeship system produced lifetime workers with high qualifications in diverse branches of industry, but not a labour force that might be moved with alacrity to new sectors. The United States system of turning out mass products with less investment in employee skills seemed to be yielding a higher rate of employment and job creation in a more internationally competitive milieu. With respect to eastern Germany in particular, recent investigations, as noted above, have suggested that the federal government may have even subsidized too much innovation among small and medium East German manufacturing firms for their own good. The whole notion of Germany as a territory on which German products were produced, investment took place and the economy was territorially based (*Standort Deutschland*) came into question.

'Reform', as might be expected, would have to come at the expense of this humane but stodgy labour partnership, and as usual at the cost of labour union concessions. Given the strength of unions and the Social Democratic Party, resistance from the Left was to be anticipated but resistance derived, too, from the socially-minded wing of the CDU under Norbert Blum, who was strikingly successful in winning continued social payments for the East. By the late 1990s one talked of the *Reformstau* in Germany—the blocked reforms or the 'gridlock' that Americans refer to.

Nonetheless, with the present century a different sort of German labour market started to emerge—in part because the growing number of immigrant workers offered a more disposable labour force. By the early years of the first decade, the long-term unemployment insurance was cut back (Hartz IV), and layoffs became more possible. German constitutional court decisions made strikes riskier not only for the union delegates represented in a given factory, but also for those representing the wider industrial sector that included the factory, who could be assigned the financial costs of factory closures, if the owners responded to a strike by a lock-out. The upshot, as it tended to be in many economies, would be a segmentation of the labour force. Migrants and low-wage workers increasingly formed the 'disposable' sector that could be expanded or contracted, while the core skilled workers, who formed the core of the SPD, remained relatively protected.

Looking back at the experience of German labour as a whole during the two decades since 1989, the East German work force might be deemed to have served as the avant-garde of the newly insecure. They experienced early on and with greater severity the pressures on employment and welfare that would overtake the united country as a whole. Given this overall transition, East German production found it difficult to catch up. In effect, the new Bundesländer were too protected to serve as a site for outsourcing from the West, the way Slovak and Hungarian factories might serve, but neither were they so efficient as easily to become part of the productive German core, which still ran along the Rhine river from Baden Wurttemberg north toward a restructured Ruhr and with a new centre of gravity in Bavaria. Ultimately the safety net of the West German economic system may have contributed to the East Germans' prolonged laggardness. West German firms seeking to outsource industrial assembly, for instance, did not find it profitable to settle down in East German factories, which had become as expensive as their own. It made more sense to establish their suppliers in Hungary or Slovakia, which they could rapidly reach by rail and road and whose wage costs were lower. East Germany was too costly to become a land of Maquiladoras. On the other hand, it has remained a low wage area by German comparison. In 2007, 460,000 East German workers were eligible for supplementary wage support, while in the West, with five times the population, the number was 760,000.[10]

5 Conclusion

The concept of transition exerts a curious perspective. It suggests a beginning point and an end point, which can look relatively benign. It tends to make the observer deemphasize the pain of the process, because ultimately the pain diminishes. Those forced out of the labour market at age 55 in 1995 would have reached normal retirement age by 2005. University professors—to take the sector I know personally—whose faculties were shut down in the early 1990s would have long since become emeriti. A new generation comes to adulthood, and while some remain long-term unemployed or short-term workers with little stability, many find their niche in the new social profile. But to assess the impact on the East German transition we must keep in mind the distress of the years in between. They left a lot of bitterness and disillusion. They contributed to the ongoing support for the heirs of the old Communist Party or SED,

10 Pacqué (2009), citing Bundesagentur für Arbeit, *Arbeitsmarkt 2007*, pages 141-3.

renamed the Party of Democratic Socialism and now merged with the left of the old SPD as *die Linke*. In East Berlin a certain culture of socialist regret or *Ostalgie*, persisted. And even more harmful, the distress augmented a new 'skins' culture of intolerance on the Right.

East Germans had taken their political future in their hands in the fall of l989. They could be proud of having finally contributed to the downfall of the regime that walled them in. But unlike the other countries of eastern Europe, they did not have the same responsibility for their economic future. They had landed in the lap of their wealthy compatriots, who, they felt, often treated them with contempt. Were they not being treated as a colonial land where the Westerners were taking over the leading positions in the universities, the public administration, the reconstructed firms? Was not their own tradition and achievement being consigned to oblivion? Street names were changed; university faculties were shut down; industries were pried apart; jobs were lost. The euphoria of getting rid of the Wall and the Stasi quickly dissipated. Many East Germans, far more than those directly impacted, shared a feeling that they had been badly treated, that they thought they would enter a united Germany as one of two national units, but in fact had been marginalized and indeed colonized by what American southerners after 1865 called 'carpetbaggers', who had in this case travelled East to take over their administration, their economic units, their university professorships, and their judgeships.

East Germans sometimes developed a schizophrenic view of what they went through. On the one hand, they suggested that their former state had exerted a degree of totalitarian surveillance through the Stasi that was as evil as the Third Reich. On the other hand, they spoke warmly of the cosy collective mentality that they had enjoyed, their associative life, the absence of an 'elbow' society, and they threw a warm veil of sentiment over the old days. Their more ambitious young people, however, understood that they now enjoyed opportunities and freedoms their parents had never had during the two generations of state socialism. The grounds for mutual reproach were strong. Westerners felt that unification was costly—a 'solidarity tax' that Chancellor Kohl finally imposed to cover some of the costs was finally legislated in l993 as the impact of the transition became clear. But westerners sometimes forgot that they had benefitted from the Marshall Plan and American assistance while the East Germans had seen much of their plants shipped east by the Soviets.[11] And had one asked West Germans before l989 what they might have paid to secure unification, most would have pledged a significant amount.

Two comparisons may help us understand the transition. One was offered by sceptics from the early 1990s on (although this writer initially resisted it), and that was the idea of the former GDR as a sort of German *Mezzogiorno* without a mafia, as former Chancellor Helmut Scmidt termed the territory—that is, a region afflicted with long-term low productivity, no matter how much investment was provided and achieving comparable living standard only by virtue of continuous subsidies. There are some

11 Ritschl (1995: 20-22) argues that the discrepancy between Soviet and western treatment of their respective zones in the late 1940s made little difference, since West Germany had to absorb a greater number of displaced countrymen expelled from Czechoslovakia or the territories occupied by Poles after 1945 as well as those migrating westward. On the other hand, it can be argued that the downward wage pressure exerted by the new arrivals actually served West German recovery well.

similarities—primarily the fact that in both the Italian south and the German east, income levels have been raised while innovation lags. Despite certain vigorous enclaves around Dresden and Leipzig and Jena, such a bleak assessment can be defended. The Italian south, despite hopeful signs and half a century of continuous investment projects and transfers, still lags behind the north, as does the former GDR. Autonomous vigour is hard to sustain. Nonetheless, there are important differences that limit the value of the comparison. The 'backwardness' of the Italian south dates back centuries; it was a land of barons living at the rim of one distant state after another (Greek, Roman, Arab, Angevin, Spanish, Bourbon, Piedmontese) and also a land of under-capitalized estates in an arid climate. The *meridionalisti* of the nineteenth century diagnosed difficulties that had taken root long before. The industrial regions of East Germany, in contrast, were traditionally a region of vigorous mid-size and diverse industries and had a long history of development (see Herrigel 1996). But whether in the chemical sector or the textile sector they are hit hard by globalization.

It is clear that when one examines such 'backward' regions (or conversely such regional success stories, say, as Baden Württemberg or, outside Germany, parts of northern Italy or Flanders, or Catalonia, or Silicon Valley, and, of course, now, parts of southern Asia), aggregate national economic indices do not provide enough explanatory power. Somehow the regional *Gestalt*—its culture and geographical embeddedness, the resourcefulness of its local government as well as entrepreneurs, and the mentalities that a regional consciousness inculcates—needs to be brought into play. Where these produce a commitment to regional innovation and cooperation across classes, centres of development can make the transition from one technological basis to another with striking success. Where local elites remain distrustful of state power, jealous of class prerogatives, and heedless of education, we have regions of long-term disappointment and stagnation. That does not mean that such apparently long-term laggardness cannot change. The American south seemed doomed to remain a backward region after 1865 but advanced dynamically from the 1960s onward; Ireland forged ahead in the 1980s and 1990s; Flanders prospered while Wallonia lagged. The key to such advance is not necessarily extraction of minerals or fossil fuels; it is the potential to create high value added through social capital and a well-educated workforce. The replanted Zeiss concern in Jena promised some local success in the 1990s, and the Dresden region was generating a regional base for computers and software development. But such development is fragile, and it is never clear in advance what combination of factors encourages these rapid changes.

The other comparison, oddly enough, is provided by the current or recent financial crisis. What that demonstrated was the insubstantial nature of 'worth' or value. Under capitalism, but even more under socialism, the illusion of intrinsic asset values persisted. But value arises only from the intersection of demand with supply. The rapid collapse of derivatives in 2008 revealed that values could be fictitious. The truth is that such fictitiousness can apply to hardware and real machines and buildings as well as to paper assets. No matter what the cost of producing a good, it has no value if no one wants it. East Germans and others believed that their factories, which had a demand within the structures of the socialist economic order, the CMEA, had far less of one within the frameworks of international capitalism. In classical terms, the market clearing price of the assets and what they might produce was lower than the imposed costs of labour or environmental clean-up. Like an old car, which might still serve well in a third world milieu, the GDR assets had value only as salvage and cannibalized parts inside the Western economy.

East Germans are said to have faced a dual transition: one to capitalism, the second to the post-industrial economy that had taken hold in the non-socialist world, while they remained in their collectivist CMEA cocoon. Ultimately, the East Germans had to undergo the transition from an old industrial society to a post-industrial society in a far more compressed time period than other sections of western Europe. The Ruhr was de-industrialized over a long generation.. Perhaps the north of Britain revealed the most similar difficulties: job losses and the shutting down of industry, but again over a longer period. The coal and iron that had testified to industrial vigour in Europe through the 1950s became its liability from the 1960s on. So, too, for the 'rust belt' in the United States. Sheltered under state socialism, its 'soft budget' policies, and its Marxist idealization of a heroic proletariat, these industries had persisted in the East without their governments reckoning the opportunity costs of preserving them, once they had achieved their function of industrializing formerly agrarian societies, such as Poland, Romania, or Slovakia.

If one looks at eastern Europe, the results are revealing. As of 2007 labour productivity in East Germany was about 77 per cent of West Germany, whereas in the Czech Republic it was only 33 per cent. And in the Czech Republic the contribution of industry to the GDP was 33 per cent whereas in united Germany it was 23 per cent and in the East, 20 per cent. In general, industrial production clung to its earlier role in east central Europe more than in East Germany where the country had been radically de-industrialized. This came at a cost: industrial wages in Western Germany as of 2006 were about €3,270 per month, in Eastern Germany they were €2370, and in the Czech Republic about €670. Taking the Czech-German comparisons again, East German per capita GDP in 2007 was 72 per cent of united Germany, and the Czech Republic was 42 per cent (Pacqué 2009: 201-5). Still, the east European societies could enjoy the sensation of being autonomous actors and determining their own future. They had not undergone the same degree of unemployment. Only Russia in the 1990s had a more catastrophic depression, uncushioned by the transfers from the west that the East Germans could draw on. Nonetheless, the East Germans often felt demoralized by the rapidity of the changes and the fact that their living standards depended on subsidies and transfers.

The legacy of state socialism in general was to retard the processes of so-called post-industrial development that transformed the west between the 1960s and the 1990s. Did this have to be the case? The Soviet Union, after all, had developed an aerospace sector that rivalled that of the west. Why could it not have forged an informatics and electronic sectors that kept apace? It had the mathematicians. Certainly the closed economic zone of the socialist bloc also limited innovation. Without market price signals the costs of persisting in aging industrial sectors could not really be measured. (Conversely, the absence of market signals sometimes allowed or encouraged costly efforts at technological emulation that consumed far more resources than in the west or Japan. East German planners did press to develop a modern computer chip industry. They were proud of their 256-bit processor and perhaps gained valuable technological skills in producing it. But from the criterion of international production, it came too slowly and too late, as did such similar ventures as the Walkman they finally manufactured in the late 1980s).[12] But I think that the answer is ultimately a political one. The heroic images of socialism derived from nineteenth-century industrial society. Read George Orwell on

12 See Ritschl (1995) and Maier (1997).

the coal miners of Wigan Pier, and one can see the industrial romanticism that motivated even a non-communist English left intellectual. Communism remained wedded to this image of the heroic proletarian, and in the case of the Soviet Union's Communist Party, or the Italian Resistance tradition, the image of heroic labour was augmented by the military heroism of the Second World War. The ideology of the future became frozen in a vision of the past. The 1960s revealed the forces that would corrode this world view, whether manifested by the Beatles or later by the Xerox machine, and, by the 1980s, the Walkman. The goods that the Eastern bloc celebrated and the strengths it sought to perpetuate, whether in Eisenhüttenstadt or Nowa Huta, would be increasingly provided by producers in Asia, who would also turn out the jeans and the shoes, and the T-shirts and the consumer electronics that East Germans craved. Where there were exceptions—highly specialized construction material or optics—there was a future. But it is a painful process to arrive at the future. It was painful in the West for afflicted regions for a generation, and it would be proportionally even more painful when packed into a decade. Moreover, the world the East Germans had contracted to join was not the one they found. Bärbel Bohley, a dissident leader, had said, 'We wanted justice and got the *Rechtsstaat*'. The East German population had similarly wanted welfare capitalism, but got what they saw as neo-liberalism. In fact they got a lot of welfare as well. It was not necessarily a bad deal, but they found it a disquieting one.

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