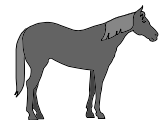


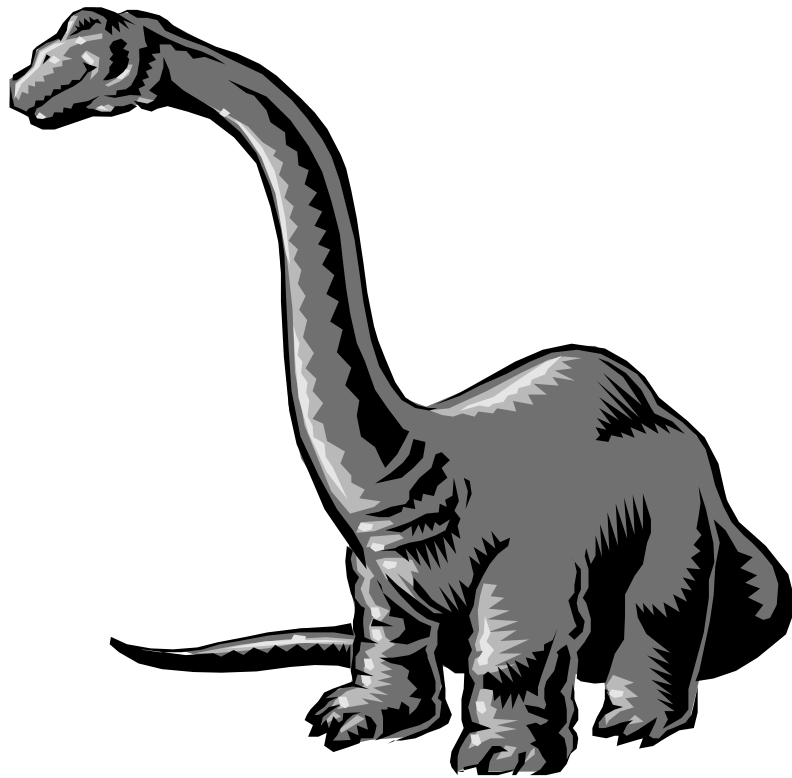
A Trojan Horse? Implications of Exit Clauses in the New German States

Prof. Michael C. Burda
Humboldt-Universität zu Berlin
Rome, 3 March 1999

The Trojan Horse?

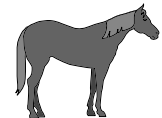


Eastern German Industry in 1990



- Irrationally large enterprises with outdated plant and equipment...
- ...and without modern management know-how...
- ...and without friends in high places...

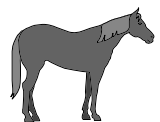
The Trojan Horse?



The Leveraged Buy-Out of Eastern Germany, 1990-94

- Cost
- Incentives
- Labor v. Capital
- Subsidies

The Trojan Horse?

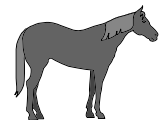


The Bargain



- West German *capital*
- West German *labor*
- neither the government nor the East Germans were represented!

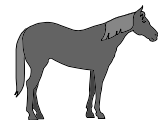
The Trojan Horse?



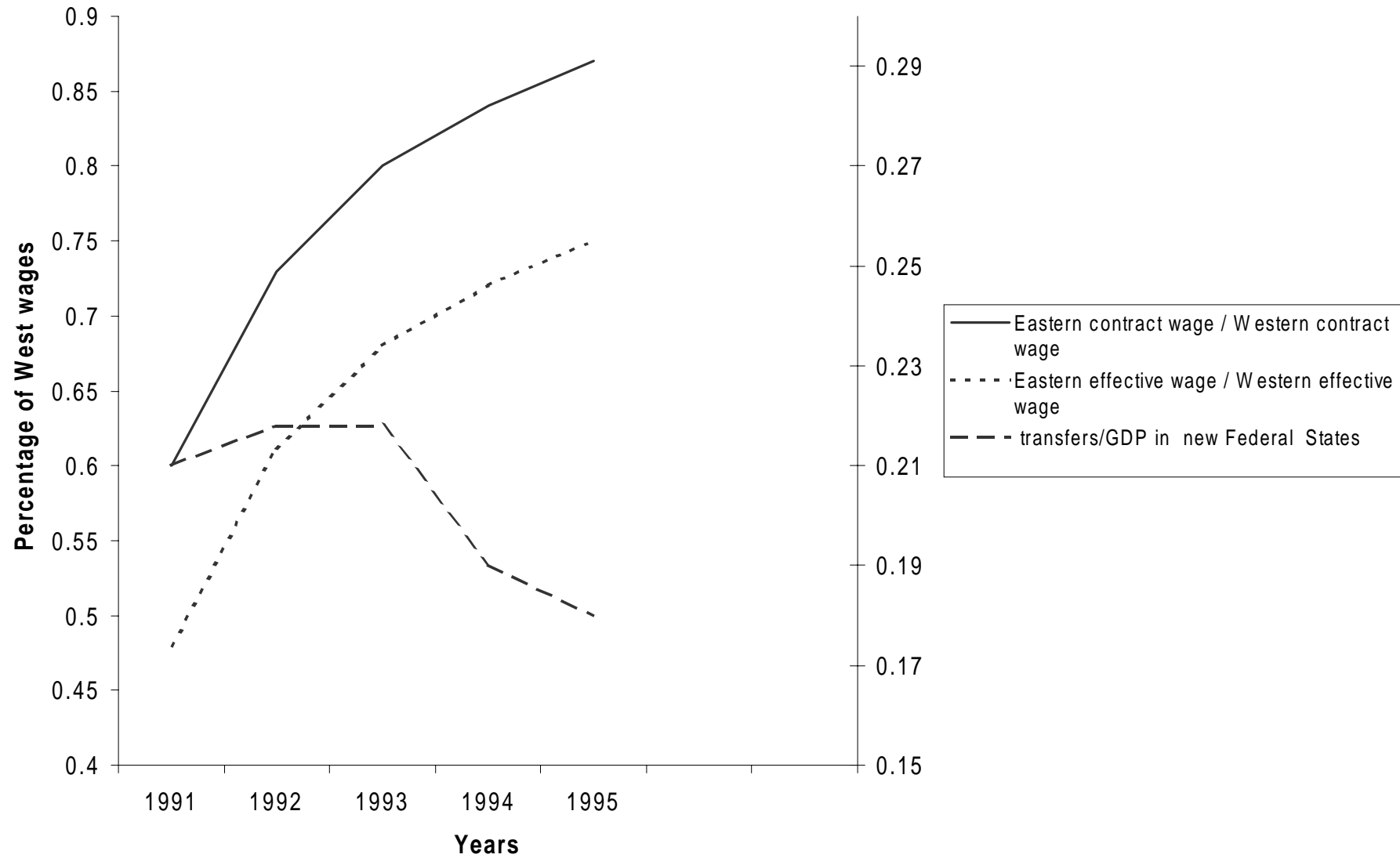
Eastern Wages after German Monetary Union

<i>Year</i>	<i>Gross Weekly Earnings (DM)</i>	<i>As fraction of western equivalent</i>	<i>Real Product wages (1991=100)</i>	<i>Real consumption wages (1991=100)</i>
1991	425	0.5	100	100
1992	571	0.65	131	118
1993	644	0.71	145	121
1994	683	0.72	152	124
1995	726	0.74	160	129
1996	722	0.72	157	125
1997	767	0.76	163	130

The Trojan Horse?

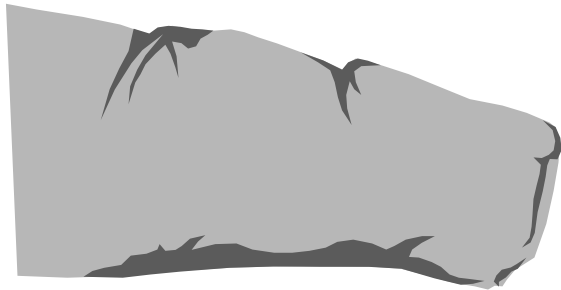


Transfers versus New Federal States and Wage Convergence



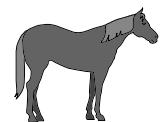
The Trojan Horse?

The Outcome



- Initial East German union membership boom..
- ...followed by massive unemployment..
- ...followed by a marked decline in membership in labor unions and...
- ...*in employer's associations..*

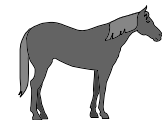
The Trojan Horse?



DGB-Membership in the Eastern States, 1991-1996

	Membership (000s)			Union density (%)		
	1991	1993	1996	1991	1993	1995
<i>Berlin & Brandenburg</i>	1085	910	684	38.0	43.8	36.6
<i>Saxony</i>	1342	836	602	59.0	52.1	42.0
<i>Saxony-Anhalt</i>	727	471	348	52.8	52.2	41.4
<i>Thuringia</i>	613	404	285	50.2	50.8	38.5
<i>Mecklenburg-West Pommerania</i>	439	283	227	48.3	49.5	36.7
<i>Total</i>	4158	2906	2145	50.6 ^{a)}	48.8	39.0
<i>Memo item: West Germany</i>	7643	7383	6828	32.3	32.5	31.4

The Trojan Horse?

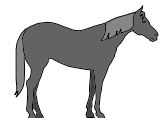


Wages Paid in Eastern German Industry, 1995

	Percent of enterprises paying:		
	union contract wage	less than contract	more than contract
<i>Status</i>			
private enterprises	61	6	33
enterprises under trusteeship of "Treuhand"-successor agencies	75	6	19

Source: DIW-Wochenbericht, No. 27-28/1995, p. 482.

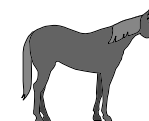
The Trojan Horse?



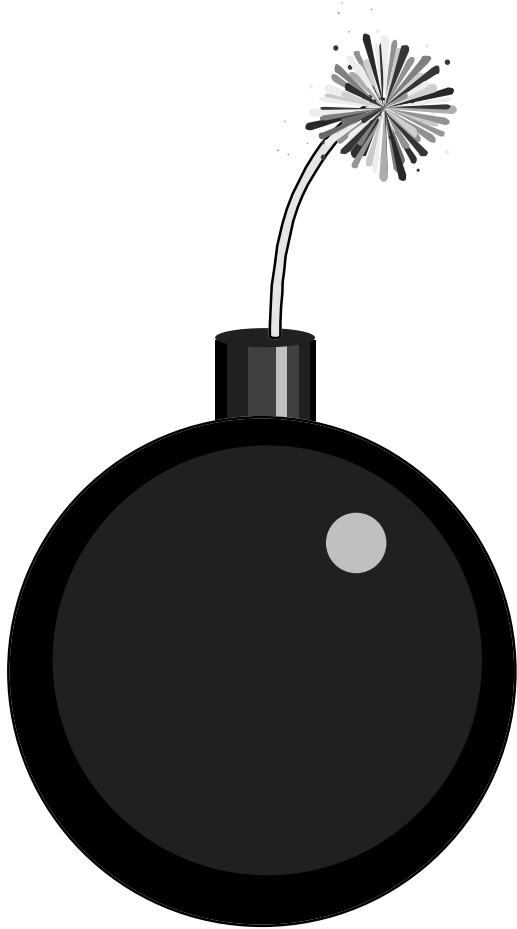
**Membership of eastern German Firms in Employer's Associations
by payment of their employees, 1995**

Percent of Eastern firms paying...	All enterprises	Firms which...		
		are members in an employer's association and ...		are not member of an employers association
		...want to remain so	...are considering quitting	
...contract wages	61	86	82	52
...significantly above contract wages	6	9	6	6
...generally below contract wages	33	5	12	42

The Trojan Horse?

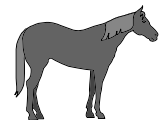


An Explosive Situation?



- Latest metalworker wage contract in Baden-Württemberg: 3.6 (4.2%) annual nominal increase
- A pilot agreement?
- Less fortunate regions will pay the price
- Is the exit clause a possible solution?

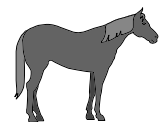
The Trojan Horse?



Pros and Cons of the Exit Clause

- For:
 - allows for flexible reaction of wages to economic circumstances
 - preserves jobs in fragile east German economy
 - increases competition in labor and product markets
- Against:
 - violates principle of „equal pay for equal work“
 - undermines authority of labor unions *and* employees associations
 - increases competition in labor and product markets

The Trojan Horse?

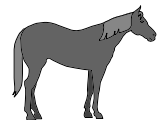


What to do now?

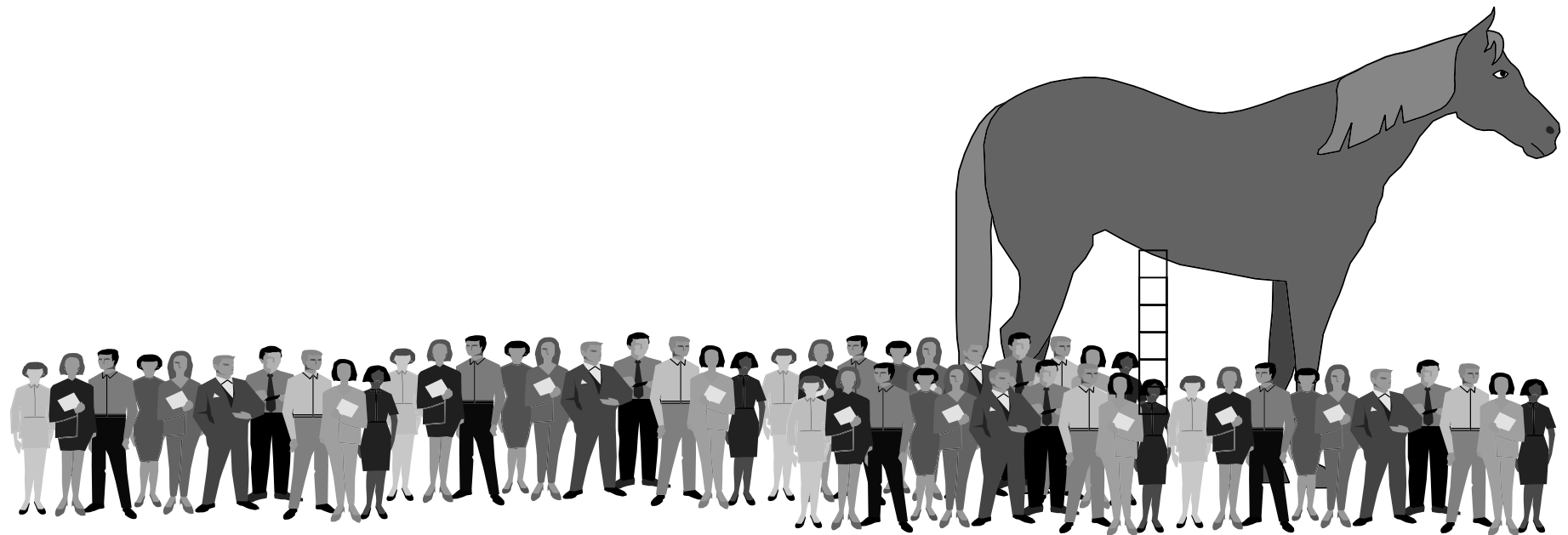


- "Flexibility spillovers" from East to West Germany are inevitable
- explains the aggressive mood of DGB, IG-Metall after new agreement
- how to keep the Trojan horse in its stable?

The Trojan Horse?



Reform the German collective bargaining system very soon!



The Trojan Horse?

