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**Agents of Active Labor Market Policy:
Companies for Employment, Training and Structural Development
in Eastern Germany**

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ETS companies: basic facts and figures

Between 1991 and 1993, nearly 400 Companies for Employment, Training and Structural Development (ETS) were founded within the boundaries of the former German Democratic Republic. About two thirds of these ETS were started between April and December, 1991. This was the period when the ground for active labor market policy in Eastern Germany was laid and when the financial conditions were most favorable for starting an ETS.

ETS companies are non-profit organizations of private law, mostly in the form of a limited liability company. ETS were set up for the primary purpose of acting as temporary employers for participants in direct job creation programs. For short periods, also workers on short-time schemes were transferred from formerly socialist enterprises now under *Treuhand* administration to ETS (see Emmerich in this volume for an explanation of the instruments of active labor market policy). The mission of ETS is to organize public employment projects in such a way that the work performed will foster structural development and the creation of new permanent jobs.

ETS combine employment with training on the job, and they offer counselling to their clients about full-time re-training opportunities. In 1993, about 30% of the ETS' participants in direct job creation received some formal training which accompanied subsidized employment. Full-time training courses, however, are not delivered by ETS themselves, in most cases, but by specialized training organizations. Subsidized employment, training and structural development are the three objectives which make up the name "ETS" (in German: *Arbeitsförderung, Beschäftigung und Strukturentwicklung* = ABS).

Whereas organizations similar to ETS play only a marginal role in West German labor market policy, ETS became increasingly important in Eastern Germany. In the spring of 1994, ETS with almost 115,000 participants were responsible for almost half of direct job creation in Eastern Germany. The individual ETS employed between a handful up to several thousand persons. At the end of 1993, the average ETS had around 350 employees. More than 95% of this employment was based on labor market policy subsidies of various kinds and sources. Only 2% of the ETS workforce earned their own income through gainful activities in the market, but another 4% had already spun off the ETS founding new commercial enterprises.

Because employment in direct job creation projects is only temporary, annual labor

turnover rates in ETS are as high as 70%. Of those who left ETS until the end of 1993, 20% quit their subsidized jobs voluntarily in favor of new regular jobs even before their fixed-term labor contracts with the ETS expired. This rate of mobilization for regular employment is about the same for ETS and for other East German agents of direct job creation, such as public administrations and charitable organizations. In Western Germany, mobilization rates out of direct job creation projects were considerably lower. In a period when everything was turned upside down in Eastern Germany, not only unemployment was escalating but also the flows on the labor market were unusually rapid. In November, 1993, only 29% of the East German working population were still, and without interruption, employed in the same establishment as four years before. In this process of vast employment shifts, participants of active labor market projects had considerably better chances to find new regular employment than unemployed persons seeking a new job.

The decline of production, privatization and the need for far-reaching manpower adjustments

For East German industry, the monetary union of July, 1990, resulted in an immediate loss of domestic, Western and Eastern markets. Production plummeted to about 30% of the 1989 level. Employment followed this path with some time-lag. Between 1989 and 1993, dependent employment decreased by 40%, with only marginal compensation through an increase of self-employment.

By Western efficiency standards, East German companies had been severely overstaffed. Productivity in the East was estimated at about one third to one quarter of the Western level. The capital stock was more than twice as old as West Germany's. Discounting the technical productivity lag resulting from the superannuation of equipment and infrastructure, the rate of "hidden unemployment" specific to the socialist system was estimated at 15%. These were jobs no longer necessary in a market economy. The decline of production resulting from the monetary union and the exposure to world market competition severely aggravated the manpower surplus which already existed. As a result, industrial employment was reduced to roughly one third. This, however, was not an automatic process brought about by anonymous market forces. It was a result of the German privatization policy.

The late GDR governments had placed the legacy of the socialist economy in the hands of the *Treuhand* Agency which became responsible for 40% of East German jobs, including industry entirely. After the German unification in October, 1990, the *Treuhand* became an agency of the Federal Treasury. Three quarters of East Germany's total job destruction took place in the sector of the economy for which the *Treuhand* was responsible. Discounting jobs destroyed or externalized either before the *Treuhand* became operational or after units had been privatized, the *Treuhand* was immediately involved in the elimination of 1.75 million jobs, 45% of the total East German job loss.

It might be asked why one federal agency, the *Treuhand*, disposed of workers for whom another federal agency, the Federal Employment Services, became responsible as a result. From the perspective of a former Soviet country, such a

question seems to suggest itself even more. Would it not have been better to retain workers within the old enterprises, subsidizing their wages while the enterprises were restructured? Even American economists, not to be suspected of socialist nostalgia, proposed wage subsidies to ease the transition. But the *Treuhand* and the Federal Government saw rapid privatization as the principal way of restructuring. Innovation, investment decisions and the conquest of new markets were left to the future proprietor. It seems hardly conceivable, indeed, how a centralized authority responsible for 13,000 enterprises could have spurred dynamism and innovation within them. Given the starting conditions of an uncompetitive economy, the monetary union with open markets, and centralized governance of enterprises, the strategy of finding patrons for them as quickly as possible seemed to be without alternative. The question arises, then, how an enterprise which has lost most of its markets, whose capital assets are of minimal value and which is overstaffed can attract a buyer. One answer found by the *Treuhand* were symbolic prices, often topped by investment grants which made the total price a negative one: a generous dowry for the groom who would wed the ugly bride. But even this would not have been sufficient if the bride had too many children which had to be fed. In order to understand the significance of overstaffing, we have to take a brief look into German labor law.

Mass dismissals and the take-over of enterprises

Through the German unification, West German labor law became applicable in Eastern Germany. Under German law, employment is protected but dismissals are possible under certain conditions and following certain procedures. Mass dismissals due to the loss of markets or the closure of production lines require:

- the observance of notice periods during which workers are still entitled to their pay even if there is no work (however, the financial burden on the company may be alleviated by introducing short-time working, even with "zero" hours);
- negotiations with the works council and the agreement on a social plan which regulates severance payments;
- selection of the workers to be dismissed among all workers within the same job category, applying criteria of social adequacy (primarily age, length of employment, number of children); this selection may become subject to revision if workers appeal to a labor court against their dismissal.

To sum up, mass dismissals are time-consuming and costly, and they bear considerable procedural risks. Since older and handicapped workers enjoy more protection than younger and able workers, mass dismissals tend to change the structure of the workforce for the worse, putting the recovery of the enterprise in jeopardy. Another important element of German labor law is that any buyer of an enterprise automatically succeeds in the labor contracts that are in effect at the moment of transaction. A private investor taking over an overstaffed enterprise would have faced the burdens and risks associated with mass dismissals which he would have to execute after the take-over. It is logical, then, that such enterprises were not attractive to investors. After the thin stratum of "cream" companies had been sold, further privatization was impossible without previously reducing the companies' payrolls to numbers compatible with their medium-term viability. The downsizing of workforces and the managing of closures where privatization was regarded hopeless

turned out to be just as important a task of the *Treuhand* as privatization as such.

ETS companies played an important part in helping *Treuhand* enterprises to separate from surplus labor in a socially accepted way, with minimal conflict, with few legal contests, and within relatively short periods of time. Using a term of personnel management, ETS became agents of outplacement. In order to explain how ETS could do this without any financial means of their own, we will have to take a look at labor market policy as it was enacted in Eastern Germany starting in 1990 and intensified from 1991.

Cushioning the job loss: The proactive intervention of labor market policy

Whereas, in a net comparison, 3.9 million jobs were eliminated between 1990 and 1993, registered unemployment in 1993 averaged 1.15 million or less than one third of the job loss. In other words, for two thirds of the net total of redundancies, solutions other than registered unemployment were offered or successfully sought by individuals. The most important individual way out is working in the West: At the end of 1993, net migration and commuting added up to slightly above one million of the former East German labor force. All the other major alternatives to unemployment were related to labor market policy.

- Almost one million left the labor market through an early retirement program which allowed entries until the end of 1992.
- A peak of more than two million persons (equivalent to a full-time volume of 1.1 million) worked short-time in spring, 1991. Short-time - often at zero hours - was used to dam up underemployment and to slow down its transformation into unemployment. It was also used to buy time until active labor market policy projects could be organized or until individuals had reached their age of eligibility for early retirement.
- Up to 450,000 persons participated in programs of further training and retraining, not counting training for those still formally employed but put on short-time.
- Up to 400,000 persons were temporarily employed on fixed-term contracts in programs of direct job creation.
- At the end of 1994, the total volume of relief through labor market policy instruments was still slightly above registered unemployment.
- Until November, 1993, almost half of the East German working population had at least once participated in a labor market program, whereas "only" one third had experienced periods of unemployment.

As these figures illustrate, active labor market programs offered alternatives to unemployment at large scales, and even those who became unemployed could hope to be included in such a program later. Bolstered up with financial transfers from the West, East German labor market policy was given a markedly active profile (for distinction of "active" and "passive" measures, see Emmerich). In 1991, when underemployment was still to a large extent contained within the firms by means of subsidizing short-time, participation in job creation and training rose faster than unemployment. Active labor market policy in the East was implemented in a proactive manner aimed at getting the jump on the rise of unemployment. Namely direct job creation assumed the form of a public employment program designed to curb the

level of unemployment. The East German ratio of job creation participants per 100 persons remaining unemployed ran above 30 from September 1991 to the end of 1992, whereas the West German peak record had been a ratio of 6 in 1979, a year of relatively low unemployment. Temporarily, job creation became the principal means of job placement: In 1991, 63% of the job placements by employment offices were placements in subsidized jobs created by the Federal Employment Services themselves through job creation programs; in 1992, this number was still 45%.

In order to implement programs of direct job creation, someone must be willing to act as an employer of the participants, to design a project that meets the criteria of eligibility for subsidy and to file an application with the employment office. Since one important criterion, the "public interest" in the works performed, excludes private commercial interests, private enterprises usually have neither a motive nor much of a chance to be agents of direct job creation. In West Germany, these agents were local authorities, the churches, charitable organizations and non-profit initiatives of all sorts, but rarely private companies. In East Germany, too, public authorities used job creation programs extensively. In 1991, the starting period of active labor market policy, it was even tacitly accepted that cities and counties used direct job creation as a means to fulfill new legal obligations which were imposed on them by the new political system but for which the financial means were lacking. This "crowding-out" of regular jobs by direct job creation is normally curbed by the criterion that jobs subsidized through these programs must be additional to legal obligations. But even with unusually generous conditions, the traditional types of direct job creation agents were not able to implement the programs at the scale and speed which, in 1991, was desired to curb the rise of unemployment. The sector of intermediate non-profit organizations based on civil self-organization in charities, social work, environmental protection etc. was lacking almost completely in East Germany. The churches had been marginalized under the socialist system and were not prepared to assume a role in labor market policy. There was a void to be filled.

In the early stage of implementing job creation in Eastern Germany, the Federal Employment Agency generously accepted that *Treuhand* companies themselves, regarded as public rather than private, would use direct job creation as a wage subsidy for work outside of production. Participants would dismantle abandoned machinery, remove industrial waste and demolish derelict buildings. This solution relieved the companies of labor costs and enhanced the value of their real estate but did not solve the *Treuhand's* main problem: How to get redundant workers permanently off the payrolls. Rather than using direct job creation as a wage subsidy within the *Treuhand* establishments, there was the need to use these programs as a means of outplacement. In order to do this, a separate legal entity was needed to implement the measures and to act as a temporary substitute employer for the participants. Albeit external, such an outplacement agency should co-operate closely with the respective *Treuhand* firm. ETS companies were the solution that became to be widely accepted in this situation.

ETS companies as agents between *Treuhand* policy, employee interests and labor market policy

ETS can be seen as a new type of institution in which, for a certain period of time,

different interests converged:

- (1) The *Treuhand* needed substitute employers to facilitate outplacement from its enterprises. In order to make workers accept direct job creation schemes as a substitute for their old job, seamless transitions without any interval of unemployment had to be organized. Only ETS companies set up and operating in close connection with *Treuhand* firms could guarantee this. As a by-product of increasing significance, the *Treuhand* came to benefit from the work performed by ETS on its sites.
- (2) What appeared as outplacement from the side of the firm served as a proactive intervention into the process of redundancy from the side of labor market policy. The Federal Employment Services were willing to have their instruments utilized in such a way and soon came to support ETS which were able to organize this at large scales. This was seen as the most effective way to curb the rise of unemployment at its source.
- (3) Works councils of *Treuhand* companies had little room of maneuver when negotiating about mass dismissals and social plans. Through *Treuhand* guidelines, there was a very low ceiling on severance payments. But pushing to set up an ETS company was an option they could pursue. In cases of closures, this was the last thing they could do for their constituency. Besides, some works councils survived for some time as works councils of the newly-found ETS; in other cases, works council members became managers of the ETS.
- (4) The national trade unions clearly appreciated the economic situation of East German firms. They did not want to subsidize employment through excessive wage restraint because this would have disrupted the system of collective bargaining in Germany as a whole. Neither did they want to lead militant struggles of defense against dismissals which would turn out to be inevitable. Therefore, they actively supported the setting up of ETS companies as an alternative. Furthermore, the trade unions keenly advocated structural development through ETS companies. They put great emphasis on the "S" which gave hope for new jobs to be created. A by-product of ETS important for trade unions was the fact that it was far easier to retain membership in ETS than among unemployed persons.
- (5) The governments of the five new federal states into which the former GDR was divided had to assume political responsibility for processes they could hardly influence. Since they could not stop the destruction of jobs in *Treuhand* firms and since policies aimed at the creation of new regular jobs have only effects in the long term, they were interested in attracting a maximum of temporary jobs subsidized under direct job creation schemes. In order to facilitate this, they stabilized ETS through complementary financing for projects and management overheads. They also set up and financed intermediate organizations which are responsible for the administration of labor market programs, the counselling of ETS and other agents of labor market policy, the training of the permanent staff of such agents, and the dissemination of information through periodic bulletins.

Negotiated outplacement by direct job creation: legal aspects and financial contributions

The conditions of transition from employment in a *Treuhand* company into temporary employment in an ETS were negotiated locally within the framework set by the *Treuhand* on one side, the Federal Employment Services on the other. Therefore,

the details of the agreements differed over space and time. The following account explains some key elements which were used in different combinations. These elements will illustrate the basic logic set into operation by ETS companies.

Employees marked for dismissal by a *Treuhand* firm were offered a temporary contract with an ETS. In most cases, the main financial basis for this temporary employment relationship was a direct job creation grant which allowed for one year of employment, sometimes two years. In some cases, the basis was short-time "working" at zero hours, with the perspective of entering a direct job creation project or a training course later on. The offer of substitute employment was often tied to certain conditions and obligations which workers had to accept if they wanted to enter an ETS. One of these conditions might be that they voluntarily severed their old labor contract, thus renouncing the possibility of legally contesting their dismissal. An additional condition might be that they would leave the *Treuhand* firm sooner than their period of notice, thus saving personnel costs which the *Treuhand* enterprise would then assign to the ETS as a financial start-up. A third condition often used was that workers leaving a *Treuhand* firm for an ETS would not collect their severance payments immediately. These funds provisioned by the firm under the social plan were kept under trusteeship as long as the ETS saved the claimants from becoming unemployed. In the meantime, the ETS was entitled to the interest payments achieved by investing the funds for the social plan on the money market. The original stock sum was preserved for the claimant to be received when she or he left the ETS. (It should be borne in mind that inflation rates are low in Germany). In a few cases, also the substance of severance payments was partially consumed to fill gaps in the financing of substitute employment.

In addition to these trilateral deals between a *Treuhand* firm, employees to be dismissed and an ETS, bilateral cooperation contracts were established between the ETS and the respective *Treuhand* firm. The firms provided the founding capital for ETS and financed management and consultancy costs. They guaranteed certain services such as accountancy, and they let rooms, buildings, land and equipment for use free of charge or at moderate rates. When financing of direct job creation projects became less generous on the part of the Federal Employment Services, the *Treuhand* assumed responsibility for the remaining costs if a project concerned the environmental restitution of *Treuhand* property. Complementary *Treuhand* financing covered material costs, the leasing rates for machinery, the subcontracting of special jobs to commercial firms (blasting buildings to be torn down, for example) and labor costs not covered by grants from the Federal Employment Services.

The opening of ETS for persons already unemployed and the shared responsibility for ETS

Whereas the majority (55%) of ETS originated from *Treuhand* enterprises, 30% were founded by municipal authorities or counties and another 15% through private initiatives. On average, the *Treuhand*-related ETS were larger; they employed 75% of the total ETS workforce at the end of 1993. Not all of these participants, however, came directly from the *Treuhand* enterprises from which the ETS originated. As far as possible, ETS integrated persons already unemployed. In late 1993, only 40% of ETS employees came directly from *Treuhand* firms, and this ratio has diminished

since the *Treuhand* finished its job at the end of 1994. Increasingly, the character of ETS changed. Having started as agents of outplacement from *Treuhand* firms, they became agents of active labor market policy in general.

In order to start an ETS a limited liability company must be founded. This legally requires a minimum capital of 50,000 German Marks which may be held by one natural or legal person or may be divided into several shares. A sum of 50,000 Marks is less than the annual labor cost for only two persons. Founding capital, therefore, was not a problem of magnitude but because of the legal and political responsibility associated with the role of a shareholder. The *Treuhand*, in the case of firm-related ETS, was willing to provide the founding capital as a loan but prohibited its firms from becoming shareholders. Consequently, others had to take responsibility for the setting up of ETS. The following list illustrates the incidence of ETS shareholders from different categories at the end of 1993:

- municipal authorities 59%
- counties 43%
- private enterprises 27%
- individuals 22%
- trade unions 19%
- private associations 18%
- and many other categories, but:
- *Treuhand* firms 4%.

80% of ETS had more than one shareholder; on average, they had 5.5 shareholders from 2.7 different categories. ETS have become a means by which public, private and institutional actors share responsibility for labor market and structural policy in their respective region. Although the majority of ETS originated from industrial enterprises, public authorities are the most important category of shareholders.

Sources of financial flows into ETS

Instruments of active labor market policy implemented by the Federal Employment Services remained the most important source of finance for ETS. For the most part, these instruments consist of *per capita* wage subsidies. Complementary labor market programs of the new federal states of East Germany rank second. These programs include wage subsidies for certain groups not entitled to the programs of the Federal Employment Services as well as personnel cost of the small professional and permanent staff of ETS. Many of these state programs are co-financed by the European Social Fund which is especially important for the cost of training in conjunction with employment on a job creation scheme. The third rank is occupied by the *Treuhand*, followed by regional authorities. Interest on severance payment funds came last and will have lost significance altogether as outplacement from *Treuhand* firms came to a standstill.

ETS and structural development

Contrasting with the West German tradition of direct job creation, job creation projects in East Germany are mostly of an investive nature. This applies even more distinctly to projects performed by ETS. At the end of 1993, subsidized jobs in ETS were distributed over different categories as follows:

- 41% dismantling of machinery, demolition of buildings, environmental restitution of industrial, mining and military sites
- 34% environmental amelioration, landscape gardening, maintenance of forests and parks
- 9% creation and maintenance of infrastructure and services with relevance for recreation, tourism and cultural activities
- 3% data collection, planning and projecting for regional and urban development

- 2% development of new products and technologies
- 4% restoration of dwellings and historic buildings
- 2% recycling of products and materials
- 1% general services (e.g. kitchens, laboratories, counselling)
- 3% social services
- 1% social production: repairs and products for the poor.

The first four categories which add up to 87% of the jobs are directly related with the potential of a region to attract investment. In a densely populated and industrialized country like Germany, the recycling of industrial sites is of crucial importance. Instead of leaving abandoned sites in ruins and covering the landscape with new industrial structures, the old and often contaminated locations should be restored and redeveloped. ETS were in an ideal position to do this. They combined abandoned workers, abandoned industrial areas, abandoned equipment and public finance to create a base on which something new might grow.

It is too early yet to say to what extent these investments into the infrastructure and into the improvement of locational factors will bear fruit. The economic recovery of Eastern Germany will require decades. After the collapse of the centralized economic and political system of the GDR, the development of new regional networks is considered to be of crucial importance. Such networks can be divided into two types: (1) economic networks of enterprises which act as contractors for one another and which, ideally, will come to form a mutually supportive "production cluster" within a given region or "industrial district"; (2) policy networks of public authorities of different levels, employers' organizations, trade unions, and agencies created especially for the implementation of structural and labor market policies. Ideally, such a policy network should be held together not only by common interests but by a "concept for regional development" - i.e. a shared vision of a desirable and attainable future for the respective region and of a number of operational steps which, in a market economy, will certainly not guarantee this future but which are commonly believed to point in the right direction.

ETS with their links to the "old" economy, with their emphasis on preparing abandoned industrial sites for new usage, with their endeavor to open up new prospects of permanent employment for their employees, and with their ties both to private and to public actors were in an ideal position to take part in the evolution of new regional networks. Their potential for "structural development", one of their three missions, was partly tied up in a paradox, however. When ETS were thriving, with generous financial conditions, a relatively qualified and motivated workforce taken over directly from *Treuhand* firms, and with new ideas and motivations not yet

fettered by the repeated experience of bureaucratic restraints, the local public authorities were barely functioning. Beyond the basic and indispensable administrative functions, policy networks had not yet emerged. The economy was still in the process of decline, and hardly any one had any realistic appraisal of the regional potential for a new development. Now as the structures of local politics have somewhat consolidated, and as some regions display trends of economic recovery, ETS have to assume responsibility for the long-term unemployed and have to operate under much more restrictive financial conditions. As it becomes clearer what they could possibly do in terms of regional development, they are less able to actually do it.