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## The threat of migration - can it be contained? Lesson for Korea from German unification?

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# Kieler Arbeitspapiere

# Kiel Working Papers

Kiel Working Paper No. 898

**The Threat of Migration – Can It Be Contained? ’**  
**Lesson for Korea from German Unification?**

by

Rüdiger Soltwedel



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## **Abstract**

This paper deals with the question of how the pressure of migration resulting from the unification of a rich and a poor country can be mitigated. The example of Germany is presented with a view toward potential lessons for a future Korean unification.

*Keywords: Migration, wage policy*

*JEL Classification: J4, J6, R2, R5*

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## I. Introduction<sup>1</sup>

One can hardly assess properly the political decisions with respect to immigration in the early 1990s without taking into account the widespread anxiety about a migration deluge in the climate of the general migration-phobia in Europe at large and in Germany as the most conspicuous case in point. Soon after the wall came down in early November 1989 and after the dramatic geopolitical landslide changes that the breakdown of the iron-curtain entailed, the threat of migration did not only appear as a nightmare to the Germans but also to Europe at large, after the Italian port of Bari was besieged by Albanian ships with ten thousands of refugees, after asylum applications soared throughout Europe at large and in Germany in particular.<sup>2</sup>

Given rather defensive attitude of European countries towards immigration throughout the 1980s, the refugee door had become an increasingly important entry gate into the EC from the outside. The asylum systems throughout Europe got under strain from the constant growth in the numbers of people seeking asylum the number of asylum-seekers rose from 14,000 in 1973 to 71,000 in 1983 and to 575,000 in 1991. The rising tide of the number of asylants were perceived of being a severe drain on taxpayers' money. The estimated costs of processing the asylum applications and providing care to the applicants amount to about US\$ 7 billion in Europe in 1991.<sup>3</sup>

In the Germany there was a general „the boat-is-full attitude“ towards the immigration of foreigners in the political arena and in society at as well as the anxiety about dramatic inflows from East Germans. Even those who used to have a perception of immigration as being a positive-sum game would have acknowledged that too much of a good thing at a time may finally turn it into a bad. It was a kind of common sense that a sudden “migration of nations” would probably exceed the absorptive capacity of the member countries of the EC, with Germany being the country under dual immigration pressure.

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<sup>1</sup> This contribution draws heavily on Paqué, Soltwedel et al. (1993) and Soltwedel (1993).

<sup>2</sup> In the first months of 1998, Italian ports again served as entry ports to Europe for ships packed with Kurdish refugees from Turkey who were heading mainly for Germany, too.

<sup>3</sup> For details see Widgren (1993).

Apparently, to many people in South Korea mass immigration from the north is likewise more of a threat than a blessing. And against the background of the size of the North Korean population,<sup>4</sup> the traumatic decline in economic activity in North Korea and the tremendous differential in per-capita-income between the two Koreas – which is by far bigger than the differential between East and West Germany – widespread anxiety about a deluge of migration seems warranted.

My paper is organized as follows: Some theoretical considerations on the driving forces of migration are presented in Section II. I will briefly sketch out the German perspective of immigration policy in Section III. Section IV explains that the threat of migration after unification prepared the ground for a wage explosion in East Germany. Section V will – against this background – report on the pattern of east-west migration in Germany. Section VI tries to draw cautious tentative conclusions whether the threat of migration be contained in a unified Korea.

## II. Some theoretical considerations

The migration calculus takes not only the starting conditions (standard of living differentials) and the cost of migration into account but likewise the expected future development over time.<sup>5</sup> Hence even a severe differential in real per capita income may be consistent with the decision to stay on when the expectation is justified that (i) the standard of living in the home country is improving and (ii) catching up with the destination country. The costs of migration may increase with rising labor market difficulties in the destination country. However, models in the tradition of the Harris-Todaro type explaining rural urban migration hint at the positive present value of queuing in the slums around the urban areas. There are mainly two reasons for that: (i) the probability of getting a job (in the official or black economy) may be quite high despite a relatively high average rate of unemployment, if turnover is high. (ii) Being

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<sup>4</sup> Whereas the North Korean population is about half the size of the South Korean population, East Germany was just sixteen per cent of the West German population.

<sup>5</sup> For an analysis of the microeconomic calculus in migration see Stark (1991). For a short description of an analytical framework for international migration see Siebert (1993).

poor in the environment where the rich live is in general more convenient (not least because of the higher level in the provision of public goods) that staying in the cluster of masses of the poor.' Hence the expectation about the probability of convergence in real income and about the timepath of convergence are crucial for the decision-making process whether to stay on or move.

Basic trade theory suggests that trade can help in this respect: let the goods migrate instead of people.<sup>6</sup> The well-known story is that countries tend to export commodities that use intensively the factors in which they are well endowed, while they tend to import commodities that use intensively the factors in which they are poorly endowed. Just consider the case that transactions costs are drastically reduced by, say, generic innovations in the transportation technology or by moving from autarchy or protection to more freedom in the trade regime: prices of traded commodities tend to equalize. Countries will now export more of the goods that exploit their favorable factor endowment. The demand for the abundant and cheap factor booms, while that for the scarce and expensive factor slumps. Thus, commodity price equalization tends to produce factor-price equalization, although theory is ambiguous about how much. E.g. Hatton and Williamson (1994) show that commodity price equalization played a significant role in contributing to real wage convergence up to 1985, and in muting the divergence effects of superior American industrialization thereafter.

In an analysis of the interrelations between the transformation processes in Central and Eastern Europe and emigration from these countries, Krueger (1994) hints at the experiences of other middle-income countries and sees the possibility for the transformation countries to raise their per-capita incomes by 5-7 percent per annum over the next decade, if they adopt outer-oriented policies. A prerequisite for such an outcome is, of course, that Western European countries open their markets to exports of these countries and enhance their investments in these countries.<sup>7</sup>

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<sup>6</sup> For the following see Hatton and Williamson (1994).

<sup>7</sup> See Krueger (1994). Wyplosz adds, in the same volume, that adequate reforms carried out in the sending countries will foster capital accumulation, offering the prospects of better conditions with markedly rising incomes. This would contribute to the slowdown of migration (Wyplosz 1994: 173-191).



### III. The German perception of „non-immigration policy“<sup>8</sup>

Despite official denials, West Germany has been an immigration country ever since the beginning of the 1950s and even in a historical perspective. The relative size of the inflow of migrants is comparable to the immigration into the United States at the beginning of this century. Altogether about 26 million people moved to West Germany from 1950 to 1989.<sup>9</sup> The leitmotiv of German guestworker policy, the rotation principle, which means economically that foreign workers figure as a “buffer stock” to alleviate temporary labour shortages, has proven to be a mirage, in particular since the (Europe-wide) recruitment stop for non-EC labour in 1973: guestworkers have come to stay. In 1987, about 60 per cent of the foreign population was already living in West Germany for more than ten years. This is a kind of paradox: the largest part of the “guestworker population” is staying in a close to permanent immigration situation in a non-immigration country where the *jus sanguinis* does in general not allow them to become German even if they married a native German citizen; furthermore, naturalization is very costly.

Immigration into Germany has in the 1980s been fed from four sources (Table 1): (i) inflow from the former GDR (“Übersiedler”); (ii) inflow of ethnic Germans from the former socialist countries (“Aussiedler”); (iii) asylum seekers<sup>10</sup>; and (iv) conventional immigrants (e.g. in the course of family reunification; on the basis of work permits; from EC countries).<sup>11</sup> In 1989, there

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<sup>8</sup> For a stylized description and assessment of immigration policies in Germany and other industrialized countries see Zimmenmann (1994: 227-258).

<sup>9</sup> *Ibid.*: 249.

<sup>10</sup> The inflow of foreigners (gross as well as net) has been subject to strong cyclical fluctuations, in line with the pattern of the German business cycle. There has been a surge of asylum applications — from 57,000 in 1987 to 438,000 in 1992. For these applications, the approval rate declined substantially from an already low 11 per cent in 1987 further down to 6 per cent in 1991. Many of those who have not been granted asylum according to the German asylum law cannot be returned because of the 1951 Geneva UN Convention and on humanitarian or other grounds; this has been the case for about 57 per cent of disapproved applicants in 1989. Returning disapproved asylum applicants to their home countries is a cumbersome process, not least because it requires acceptance of these countries. Only about 3 per cent of asylum seekers are actually returned. In 1991, roughly one million refugees was staying in Germany.

<sup>11</sup> In the longer run, the “*homines migrantes*” will mainly come from Turkey, a country which has traditionally close links to Germany. The Turkish labour potential, measured as

was a net flow of immigration of roughly one million people (1.6 per cent of total population in West Germany), in 1990 of about 900,000. Two thirds of the net immigration flows in 1989 and 1990 — being ethnic Germans — were entitled to receive a German passport. The number of the “Aussiedler” declined considerably from about 400,000 (1990) to 220,000 (1991). This decline was mainly due to a more cumbersome queuing procedure and special efforts to give the ethnic Germans an incentive to stay in the countries where lived so far. To be sure, most of the “Aussiedler” are as alien to Germany as the immigrating non-German population, with hardly any command of the German language and no up-to-date knowledge about the country and the society itself. To a large extent, the “Aussiedler” are also regarded as foreigners by the incumbent German population, and not welcomed with more enthusiasm than non-Germans.

The surge of asylum seekers is perceived as a severe matter of concern for the public at large, in particular because the processing of applications and providing accommodation is costly: the federal government estimates that these costs amounted to DM 6.4 billion for the federal, state and municipal purse in 1991 — as compared, for example, with a public budget on development aid of DM 9.3 billion in 1989. Per asylum applicant the costs add up to about 15,000 DM annually.<sup>12</sup>

Not only Germany but Europe as a whole will be unable to effectively control the entry of low-skilled and illegal immigrants. Hence, the informal sector will expand, with more competition between immigrants leading to an enhanced labour market segmentation, but also to a more de-facto deregulation of labour markets. Nevertheless, even in those cases where immigrants will be living on the fringe, they will be regarded as being better off than if they had stayed at

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the size of the population in the 15–64 age bracket, is rising from 34 million in 1991 to 42 million people in 2000 (United Nation 1991).

<sup>12</sup> *Bundesministerium des Innern* (1992). Since July 1991, asylum seekers are entitled to work, but only under some quite restrictive conditions such as the lack of an adequate German or EC citizen to fill the particular vacancy in question, and a highly constrained regional mobility. After changing the constitutional provision for the acceptance of asylants into a by far more restrictive policy stance (countries are separated according to their „safeness“ with regard to the risks of an asylant to be prosecuted, tortured or even run a deadly risk if being returned in 1994, the inflow of asylants declined dramatically. Nowadays there is hardly a substantial asylant problem that is exiting to the general public or to the public coffers.

home, which will sustain the momentum of immigration.

At present, the empirical assessment about the effects of migration is still rather controversial, with opponents dominating the political arena and the general public discussion; it seems to be mainstream thinking that immigrants take more from the public purse than they add to it. However, recent research shows that foreigners have been an asset for the German public coffers not only in the last four decades, but also in the most recent past, although the positive contribution of immigration might diminish in the future as the labour force participation rate of foreigners is now close to the one of Germans, and their average unemployment rate even higher; but they still have a lower average income than Germans and — most important of all — they have a “better” age structure with a higher share of young people, which helps to widen future financial bottlenecks of the social security system.

As to further pros, immigration has helped easing labour market tensions and foreign workers tend to foster the upward mobility of the native work force. Hardly anybody in 1948 Germany did believe that it would be possible to quickly integrate about 10 million refugees. Furthermore hardly anybody in the early 1980s did believe that macroeconomic wage moderation for a couple of years helped supply about 1.4 million new jobs that allowed the relatively smooth integration of a great number of immigrants from Central and Eastern Europe. In addition, revealed preferences of consumers indicate their appreciation for the increased variety in the supply of services (e.g. in catering), and the somewhat more colourful cultural environment.

As to cons, it is maintained that migrants take jobs away from native workers;<sup>13</sup> that there is anti-social behaviour by immigrants, such as welfare dependency or crime, unwillingness to integrate; tensions in housing markets would be harnessed; bottlenecks in urban infrastructure worsen; educational standards might suffer; the stability of the labour market in general and wages in particular is endangered. Strain on the public purse that discourages appealing hand-outs to native citizens spurs envy, exclusion and marginalization of refugees in particular and foreigners in general. Immigration is largely perceived as a negative-sum game and, hence, further immigration seems to be

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<sup>13</sup> Pischke and Velling (1997) show that there is little evidence for displacement effects due to immigration.

unsustainable.<sup>14</sup> On that basis, there was widespread acceptance that the liberal asylum provisions in the Basic Law of Germany was made more restrictive in the mid of the 1990s, that the queuing procedure for ethnic Germans were made more cumbersome and that financial assistance was provided for neighbouring countries in the east (Poland, Hungary, Czech Republic) to improve border controls. Hence, to some extent the threat of migration would be dampened by legal and administrative means.

#### **IV. Unification and the Threat of Migration: The Recipe for Wage Explosion**

The German Government has not undertaken any effort at all to (physically or legally) prevent East Germans from migrating to West Germany. To prevent people from migrating to the west, the government had to credibly commit itself to an economic policy that stabilized the expectation of a swiftly rising real income. Hence, the West German government decided to heavily invest into the public infrastructure in the new federal states. The political argument was to avoid an economic devastation of East Germany. Economically, the investment into public infrastructure was justified because the overall economic returns (public and private value added) to investment presumably have been and are significantly higher than in the West given the desperately bad condition of infrastructure capital in the former GDR. However, the productivity effects would be felt only over the medium term. These of investment could hardly meet the zeal of the East German populations for a quick catching-up process in

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<sup>14</sup> It is important to note, however, that in many instances the perceived costs of immigration are not directly caused — though possibly accentuated — by immigration itself. Many of the time-honoured and broadly accepted domestic policies in these areas are by themselves largely inefficient or even ineffective. In any event, they represent a major drain on taxpayers' money, and would deserve a profound reconsideration anyway. Immigration pressures may give additional reason to rethink housing policies, instead of taking recourse to closing the borders for the inflow of people: a deregulation of the housing market which may spur a regional deconcentration of economic activity would likewise be a complementary policy response which could be advocated on its own merits. And it is highly questionable whether every part of labour market regulation and the pay structure is appropriate and sustainable anyway. In all these instances, potential migration could be just another incentive for pursuing the appropriate kind of economic policies.

real income, i.e. in wages. Hence this put the heat on wage policy as a means to cushion the incentives to migrate.

Compared to the endowment with physical capital, East Germany was labor rich. According to theory, East Germany was to offer a labor cost advantage in order to catch up rapidly with West Germany and other countries, in order to avoid unemployment and to attract outside private capital. However, relative factor prices did not comply with the economic rationale; the consequence was a skyrocketing increase in unit labor costs and concomitant unemployment. Wage explosion became the core of the German unification problems.

There was a severe principal-agent problem in wage policy in the last months of the existence of the GDR, in fact, there were no principals at all. This was partly due to the break down of the old political system; on the company level, wage increases were not resisted, as the director generals wished to attain the support of the work force under the new political conditions. Hence, the companies had a soft budget constraint; the government as the factual owner of the companies had to come up for all companies losses, but could not control the companies. With its guarantee to convert wages at a rate of 1:1 the government of West Germany at least had nourished the illusion, that wage increases would have no consequences, and this the more so as, according to the unification treaty, the Federal West German government was to become the owner of the state owned companies in East Germany. In the average of the second quarter of 1990, monthly wages and salaries per employee were 20 p.c. higher than in the fourth quarter of 1989 and 26 p.c. than in the third.<sup>15</sup>

Immediately after the introduction of the DM, collective wage bargaining rounds took place in East Germany without solving the principal-agent problem. In the bargaining rounds, East German employers (in the sense of employers of privately owned companies) did not exist; instead the director generals of the old industrial combines of the (previous) GDR played this role.<sup>16</sup> Very often, representatives of West German employers associations took the part of the

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<sup>15</sup> Schatz and Schmidt (1992: 374).

<sup>16</sup> As a matter of fact, the combines had come under administration of the Treuhandanstalt, a holding of publicly owned companies (see below). The Treuhandanstalt, however, was not the owner of the companies and could not take the employers part in the bargaining rounds.

employers in the bargaining rounds in East Germany.<sup>17</sup> These employers did not represent the later owners of the companies which were to be privatized nor the owners of companies which would be newly established; they did not have to bear the economic consequences from the bargaining agreements. The trade unions, dominated by West German trade union leaders, followed in East Germany the same strategy of „equal pay for equal labor“ as they used to do in West Germany, neglecting productivity differences between regions, branches, and firms, for the sake of the rapid adjustment of East German wages to the West German level.<sup>18</sup>

The trade unions achieved wage increases for the second half of 1990 of between 25 % and 60 % from the level at which wages had been converted from Mark East to DM on the first of July.<sup>19</sup> In the remainder of the year, contracts for 1991 were bargained, generally providing an increase of wages in East Germany to from 55 % to 60 % of the West German wage level, and further rapid adjustments to the Western level in the subsequent years.<sup>20</sup> Wages and wage increases completely decoupled from productivity and productivity increases. Industrial decline in East Germany was harnessed (table 3) and unemployment exploded together with the explosion of wages (table 4). Since 1989, employment in East Germany has been reduced by 35 p.c.. However, compared to West Germany (and other industrialized countries) labor force participation rates have been extremely high in East Germany, above all the rate of women (table 5). The introduction of the West German collective bargaining system with its „cozy corporatism“ (Paqué) turned out to be extremely harmful for East Germany and for unified Germany as a whole.

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<sup>17</sup> It has often been discussed whether the representatives from the West German employers associations have not been reluctant to resist the rapid wage increases in the East because actual and potential competition for companies in West Germany was reduced.

<sup>18</sup> For a comparison of the detrimental role of trade unions in Southern Italy and in East Germany see Boltho, Carlin and Scaramozzino (1997).

<sup>19</sup> One argument put forward to justify the wage increases was that otherwise people would migrate to West Germany. However, the increase in unemployment which was enforced by the wage increases in turn was reason to migrate to West Germany. Evidence from West Germany exhibits in addition, that despite significant wage differences people do not migrate often as long as they have a job in their home region.

<sup>20</sup> See: Geschäftsbericht der Deutschen Bundesbank für das Jahr 1990 (Annual report of the Deutsche Bundesbank for the Year 1990: 23).

The transfer of West Germany's welfare state provisions and social insurance systems intensified moral hazard in wage policy. It was the West German tax payer and those contributing to the social insurance system who had to bear the brunt of the economic costs of the wage increases: (i) Most of East German companies became the property of the German government, which had to cover company losses. (ii) With no capital stock based on previous contributions from East Germans to tap on the increase of unemployment in East Germany translated into West German contributors paying for unemployment benefits in East Germany. Hence, there was no effective brake against moral hazard in collective bargaining. Furthermore, there was a broadly based political approval for a very rapid equalization of wages between the west and the east despite the vast (and increasingly obvious) labor productivity differential. In any case, under the given institutional conditions and the incentives they implied it was the West German tax payer or and those from West Germany contributing to the social insurance system who had to come up for the wage increases and for the costs resulting from them. Thus, the trade unions in East Germany did not need to care much for the consequences of the wage cost explosion. In essence, East Germany turned out to be a high cost location with unit labor costs exceeding the level of West Germany considerably, even seven years after unification (table 2).

The tremendous appreciation in the sequel of the introduction of the D-Mark provided the final blow to the manufacturing sector's competitiveness. Production fell rapidly in the later course of the first half of 1990 and continued to do so in the second. Within one year following the economic, social and monetary union in 1990, in East Germany industrial production dropped to one third of its 1989 volume, and GDP by one quarter<sup>21</sup>. A massive deindustrialization took place which, in terms of intensity, was unique among the transformation countries in Central and Eastern Europe. Hence, East Germany's manufacturing sector had to be rebuilt mostly from scratch.<sup>22</sup>

The federal governments policy with regard to getting East Germany's economy off the ground officially rested on two pillars: (i) The improvement of the infrastructure in East Germany by federal programs; e. g., in the years 1991

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<sup>21</sup> Schatz and Schmidt, op. cit.: 374.

<sup>22</sup> Gerling and Schmidt (1997).

to 1996 roughly 125 Bill. DM or 11 p.c. of all gross transfers to East Germany have been spent on improving roads, highways, the inland shipping system or the railway system. (ii) The compensation of disadvantages for companies in East Germany compared to companies in West Germany because of the poor infrastructure endowment (and other heritage from socialism, e.g. environmental pollution).

Early in 1991 in view of the general decline in the new federal states the Federal government decided to grant massive support to the revitalization of the East German economy. Initially, the basic approach was against subsidies for the maintenance of the old companies and old industries and in favor of restructuring and of establishing new companies and industries. However, restructuring turned out to do just this: modernize old factories and industries at a high cost often under the pressure of politicians in the new federal state, the trade unions and the work force. The programs aiming at building up of the economy have been supplemented by comprehensive financial transfers for labor market policy purposes and for general social policy purposes.<sup>23</sup> According to the federal government's own calculations gross public sector payments as well as net payments have peaked in 1993, when they hit the record level of 215 Bill. DM and 172 Bill. DM respectively or 7.5 p.c. and 6.0 p.c. of the west German GDP.<sup>24</sup> According to the budget plans the transfers to East Germany were 200 Bill. DM gross and 144 Bill. DM net in 1996. In the years 1991 to 1996 together the payments have made up for 1.175 Bill. DM gross and 905 Bill. DM net. Most observers would agree that the larger amount of transfers was not for public infrastructure investment or to induce private investment.

The East German economy is, at the late 1990s, still far away from developing growth dynamics of its own, and the increase of the living standard of the population has rested to a large degree on the public transfers from West Germany. This becomes particularly clear from the observation that final domestic demand (or use of resources) exceeds GDP significantly. Internal

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<sup>23</sup> Various estimates on the net transfers to East Germany mainly differ because of the counting of transfers. E.g., it could be argued that certain payments of the federal government for the construction of roads should not be treated as transfers as such payments to west German federal states are not counted as transfer either.

<sup>24</sup> Bundesministerium für Wirtschaft (1996; mimeo).



production of East Germany made up for only 63 p.c. of internal final demand, and the share of private consumption in GDP was 74 p.c. (compared to roughly 50 p.c. in West Germany)<sup>25</sup>. The gap between domestic demand and domestic production is still being closed by public transfers to East Germany and by private capital flows.

To give momentum to economic growth and to reduce the difference in productivity against West Germany investment must expand significantly faster. Investment by private companies has been comprehensive in East Germany; the share of private investment in east German GDP can be estimated to have risen from 36 p.c. in 1991 to 44 p.c. in 1995.<sup>26</sup> As a matter of fact, due to private and public investment the capital stock in East Germany has increased markedly, though still lagging substantially behind (per capita) capital endowment in West Germany. More private investment requires that its profitability is improved. Numerous company polls in East Germany have revealed that too high and too fast rising wages are the most important obstacle to competitiveness and to profitability<sup>27</sup>. E.g. 61 p.c. of a very large number of companies which have answered the questionnaire for the most recent report of three German economic research institutes rank wage costs to be the outstanding problem<sup>28</sup>. They are the most important impediment for the reduction of unemployment in the new federal states, too.

Times and again the government has been urged to pay wage subsidies to companies in East Germany in order to reduce the labor costs for them and to contribute thereby to the reduction of unemployment<sup>29</sup>. Such subsidies, however, would mean that failures of the employers associations and the trade unions are sanctioned *ex post*, and they could even induce further wage

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<sup>25</sup> Because of increasing statistical difficulties, which could not be overcome, in the national accounts statistics separate figures for East and for West Germany on the expenditure side are not published beginning 1995.

<sup>26</sup> Deutsches Institut für Wirtschaftsforschung, Berlin, Institut für Weltwirtschaft an der University Kiel; Institut für Wirtschaftsforschung Halle, *op. cit.*: table A11.

<sup>27</sup> See on this issue also: Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung (Counsel of Economic Advisers) (1991: 196 - 200; 1996: 184).

<sup>28</sup> *ibid.* table A3.

<sup>29</sup> Akerlof, Rose, Yellen and Hessenius (1991).

increases<sup>30</sup>.

In recent years, though, more and more firms in East German manufacturing realize that they would face immediate bankruptcy if they would obey to the collective agreements. They are trying to get out of the cost enhancing collective bargaining system.<sup>31</sup> Many East German employers agree with their work force on lower wages, longer working hours and others. In autumn 1996, 42 p.c. of companies paid wages below contract wages compared to 33 p.c. in 1995<sup>32</sup>. In particular, the smaller and the newly established private enterprises escape the collective bargaining agreements in this way. In as far as the companies are members of employers associations and the workers members of trade unions, agreeing on the company level on pay below the wages settled in the bargaining agreements is illegal. However, neither the trade unions nor the employers associations or the government dare to insist on the bargaining contracts; for, in many cases, the result would be immediate bankruptcy of most of the companies concerned.

## V. The pattern of east-west migration in Germany

Because all East Germans had the constitutional right to receive full citizenship upon arrival in West Germany anxiety of mass migration that would add to the already high immigration from other sources was prevalent. The GDR citizens did know about the wealth gap between the east and the west from watching TV, from direct testimony from pensioners who were entitled to travel to the

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<sup>30</sup> In order to prevent further aggressive wage increases, wage subsidies would have to be conditioned. The open question, however is, whether the government has sanctions, which can be applied in case that the conditions are hurted, and whether the government applies the sanctions.

<sup>31</sup> It is important to note that since the mid-1990s, manufacturing firms in East Germany are increasingly escaping the rigid legal norms of collective bargaining, e.g. by simply ignoring collective agreements and agreeing on firm-specific terms with the works council. Whereas such a behavior in the 1980s has called forth vigorous protest from unions and legal action, nowadays there seems to be a tacit agreement for toleration, indicating that the collective bargaining system as such is under serious pressure also in West Germany. For details see Soltwedel (1997).

<sup>32</sup> Deutsches Institut für Wirtschaftsforschung, Berlin, Institut für Weltwirtschaft an der University Kiel, Institut für Wirtschaftsforschung Halle (1997: 11).

west, yet now it was possible to have a look of their own. And the leitmotiv was: „Kommt die D-Mark nicht nach hier, fahren wir zu ihr“.<sup>33</sup> Initially, about 60 000 people left the GDR in a hurry. In 1989 as well as in 1990, East Germany lost about 5 per cent of its population (table 6).

However, after it became a certainty that unification would come and that swift improvement of living conditions could be expected, the political motive, i.e. the anxiety that the door would be open only for a short period of time, net-migration decreased markedly. Furthermore, living standards of the East German population have improved significantly since unification (table 2). Net wages and salaries per employee, to which it is often referred to as a measure for improvement, have risen from 55 p.c. of the west German level in 1991 to 85 p.c. in 1996.<sup>34</sup>

Outmigration from as well as immigration to East Germany seem to have stabilized since the mid-1990s at a low level. Five arguments may explain these developments.

*First*, after the removal of the borders many emigrated from East Germany to West Germany because of the chance that was given to them for which they may have been looking for long, whether for political or for economic reasons.

*Second*, because of the „big bang“ with a „rich brother“ east Germans received transfers from West Germany which meant in general, that they were significantly better off then before in absolute terms and relative to west Germans, keeping them from moving to the west.

*Third*, west Germans migrated to East Germany either to seize new

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<sup>33</sup> „If the D-Mark does not come to us, we'll go where it is“. See Watrin (1998). The gist of the *zeitgeist* is revealed by a cartoon on the frontpage of the International Herald Tribune in the week after the wall was torn down in Berlin: The cartoon displayed the head of Mr. Krentz, the successor to Mr. Honecker as Secretary General of the Socialist Party of the German Democratic Republic, behind him masses and masses of people queuing up until the horizon, with Mr. Krentz saying: „We'll bury you“.

<sup>34</sup> Net wages and salaries relative to the level in West Germany have increased significantly faster than gross wages and salaries due e.g. to the lower absolute wages in combination with the progressively of the tax system or to legally determined lower contributions to the social security system. At the same time, per capita GDP, which is the most meaningful indication, while also rising rapidly in comparison with the level in the west, has improved less because of the strong decline in employment: As this decline results to a large degree from wage and salary increases, GDP per capita presumably would be higher with lower wages and salaries, but more employment in turn.

opportunities which had opened up for private persons there or to built up administrations (sent by the western governments and administrations, though on a voluntary basis for the officers).

*Fourth*, east Germans may have been disappointed and returned to East Germany<sup>35</sup>.

*Fifth*, with the continued relatively poor performance of the West German economy since the recession in 1993 and the increase of unemployment, east Germans may have been prevented from migrating to the west. For what reason ever, apparently the expectation was wrong that East Germany would suffer a continued loss of population due to (net) migration to West Germany because of higher living standards there.

## **VI. The Threat of Migration - Can It Be Contained in Unified Korea?**

The question whether the threat of migration can be retained in the case of Korea is dependent upon time in the first place: If there would be a collapse of the political regime in North Korea, unification could come over night, as was the case in Germany. In such a scenario the threat of a migration deluge may have some probability, although it is open to doubt whether the North Korean citizens have the appropriate knowledge ( or expectation or merely hope) of the tremendous wealth gap.

However, if there would be time for convening with the north on something that could come close to the European single common market program, with monetary policy in the north being firmly anchored via, e.g. a currency board system, to the Won, a binding self-commitment to structural reforms could help bringing the beneficial effects about trade theory is talking about.

From this it follows that the credibility of the reform process and its efficacy for improving systemically the institutions of the social and economic order is a necessary condition for trying to contain the threat of migration. What could South Korea do to increase this credibility? To better be able to answer this

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<sup>35</sup> This is a mere speculation, as figures do not exist which would allow to discriminate between previously east Germans and west Germans among the migrants to East Germany.

question we should consider what type of consequences South Korea would have to face if the reform process would give impetus to the reconstruction process in North Korea and, hopefully, to a process of self-sustaining growth. Income converge could result even without migration of people with „migration“ of products, hence increasing division of labor by the Heckscher-Ohlin process of specialization and the resulting trade pattern. South Korea would in this case witness intensified competition via trade in Heckscher-Ohlin products, i.e. labor intensive goods. To render credibility to the reform process South Korea should refrain from protectionist reactions to the heightened competitive pressures. In particular it should refrain from impairing the competitiveness of North Korean producers by raising the competitors costs e.g. by a relatively high appreciation due to a high rate of conversion when introducing the Won into North Korea, or by urging for a quick convergence of wages despite broad productivity differentials or by subsidizing labor-intensive production in South Korea.

Credibility that reforms in North Korea will stimulate the take-off of the economy can thus be reassured by South Korea if the heightened pressure for structural change in South Korea is accepted and that the institutional framework within South Korea is changed to give incentive to speeding up the process of structural adjustment. Hence, in order to discourage the migration of people, the „migration“ of goods must be accepted and the resulting effects that increased trade has on the South Korean economy.

Furthermore, South Korea will also witness the „migration“ of capital: If a consistent pattern of reform measures is implemented in North Korea and factor-prices correspond to the relative scarcities, the number of profitable investment possibilities will increase. Just assume risk away and – for the sake of argument – accept the premise of credibility, capital will flow into North Korea, thereby raising the real rate of interest also for South Korea. In order to cope with the heightened real rate of interest investment possibilities in South Korea must prove to meet the heightened profitability requirement. From this it follows that profitability of investment must increase in South Korea. How could this be secured? The standard answer is „by speeding up structural change, by getting rid of x-inefficiencies through stronger exposure to competition, by increasing the flexibility of the economy through structural

(institutional) reforms.

The threat of migration can only be contained if the adjustment pressure on the South Korean economy, which will inevitably increase because of integration, is accepted and responded to appropriately. Since unification will change the relative factor prices also in South Korea: the relative price of labor will decline and, correspondingly, the cost of capital will increase.

Structural adjustment takes time. For that reason the initial migration pressure may in fact induce factual migration because of the lacking credibility that the future will really bring improvement. Since structural adjustment for actually making headway requires appropriate guidance from a clear incentive structure, South Korea may want to reassure investors and potential migrants alike by consequently and consistently putting their institutional and legal framework under scrutiny and by the self-commitment improve the capacity to adjust by structural reform. The South Korean government may want to consider that the OECD peer pressure review process provides a good opportunity to benefit from the experiences in structural reform in other member countries.

A step toward avoiding rural-urban migration is to nurture the perspective of doing a living on their own land. Land reform and efficient credit institutions for building up the agricultural system are likewise important. To this end it might be helpful to give incentive for specialized banking institutions such as the Raiffaisen-banks in Germany that did a lot to develop farming. In order to realize scale economics it might be useful to establish cooperatives of owner-entrepreneurs.

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### Tables

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Table 1 — Migration across German<sup>a</sup> Borders 1980–1996 (1000)

	Immigration						Outmigration			Net immigration			Population	
	gross inflows						total	Germans	foreigners	total	Germans	foreigners	total	foreigners <sup>b</sup>
	total	Germans			foreigners									
		total	Aussiedler	Übersiedler	total	asylum seekers								
1980	753.4	122.0	52.1	12.0	631.4	107.8	441.5	55.7	385.8	311.9	66.3	245.6	61538	4313
1981	625.1	124.0	69.5	14.5	501.1	49.4	472.7	57.2	415.5	152.4	66.8	85.6	61663	4459
1982	420.8	99.1	48.2	12.8	321.7	37.4	496.1	62.9	433.3	-75.4	36.2	-111.6	61596	4444
1983	372.0	98.8	37.9	10.7	273.3	19.7	489.2	64.2	424.9	-117.1	34.5	-151.7	61383	4291
1984	457.1	126.0	36.5	38.7	331.1	35.3	608.2	63.2	545.1	-151.1	62.8	-213.9	61126	4027
1985	512.1	113.9	39.0	26.3	398.2	73.8	428.7	62.0	366.7	83.4	51.9	31.5	60975	4010
1986	598.5	120.1	42.8	26.2	478.3	99.7	410.1	62.3	347.8	188.4	57.8	130.6	61010	4124
1987	617.0	144.4	78.5	19.0	472.6	57.4	401.3	67.2	334.1	215.8	77.2	138.5	61077	4146
1988	903.9	255.8	202.7	39.8	648.1	103.1	421.9	62.9	359.0	481.9	192.9	289.1	61450	4489
1989	1522.2	754.6	377.1	343.9	767.6	121.3	545.0	106.9	438.1	977.2	647.8	329.5	62063	4846
1990	1651.6	812.7	397.1	238.4 <sup>c</sup>	838.9	193.1	610.6	143.4	467.2	1041.0	669.2	371.8	63254	5343
1991	1199.0	273.6	222.0	-	925.3	256.1	596.5	98.9	497.5	602.5	174.7	427.8	79984	5882
1992	1502.2	290.9	230.6	-	1211.3	438.2	720.1	105.2	615.0	782.1	185.7	596.4	80594	6496
1993	1277.4	287.6	218.9	-	989.8	322.6	815.3	104.7	710.7	462.1	182.9	279.2	81179	6878
1994	1082.6	305.0	222.6	-	777.5	127.2	767.6	138.3	629.3	315.0	166.8	148.2	81422	6991
1995	1096.0	303.3	217.9	-	792.7	127.9	698.1	130.7	567.4	397.9	172.7	225.3	81661	7174
1996	959.7	251.7	177.8	-	708.0	116.4	677.5	118.4	559.1	282.2	133.3	148.9	81896	7314

<sup>a</sup>1980–1990 West Germany, thereafter including the former GDR. — <sup>b</sup>Own estimates. — <sup>c</sup>Until June 1990. — na = not available.

Source: Statistisches Bundesamt: Fachserie 1: Gebiet und Bevölkerung, Reihe 1: Bevölkerung und Erwerbstätigkeit. Stuttgart, various issues; Statistisches Jahrbuch. Stuttgart, various issues; Statistisches Bundesamt, Wirtschaft und Statistik, Nr. 12, Dezember 1997.



Table 2 - East Germany and West Germany in Comparison 1991-1996

	1991	1992	1993	1994	1995	1996
GDP at 1991 prices, p.c. change against previous year						
- East Germany	x	7.8	9.3	9.6	5.3	2.0
- West Germany	5.1	1.8	-2.0	2.1	1.5	1.3
East Germany in p.c. of West Germany						
GDP per capita, at current prices	31	39	48	52	55	57
Net wage and salary income per employee	55	67	76	79	82	84
Wage costs <sup>a</sup>	47	61	68	70	72	73
- of which Producing Sector <sup>b</sup>	42	58	62	66	67	67
Labour Productivity <sup>c</sup>	32	45	55	58	60	61
- of which Producing Sector <sup>b</sup>	29	43	55	60	62	64
Unit Labour Costs <sup>d</sup>	146	135	124	122	121	119
- of which Producing Sector <sup>b</sup>	147	133	114	110	108	105
Capitalstock at 1991 prices <sup>e</sup>						
- per capita (1.000 DM)						
- East Germany	76	82	88	95	98	-
- West Germany	199	203	206	209	210	-
- East Germany in p.c. of West Germany						
- per capita	38	40	43	45	47	-
- Of which						
- non-housing	49	51	53	56	58	-
- machinery a. equipment	29	34	39	44	46	-
- per employed person	38	45	48	48	49	-
Average capital productivity <sup>f</sup>						
- East Germany	0.257	0.257	0.260	0.264	0.272	-
- West Germany	0.345	0.340	0.325	0.326	0.326	-
Profitability of fixed capital <sup>g</sup> (p.c.)						
- East Germany						
- West Germany	-2.2	-1.3	0.3	0.8	1.2	-
	6.2	5.7	5.0	5.4	5.7	-

<sup>a</sup> Gross labour income per employee. — <sup>b</sup> Manufacturing, Energy, Watersupplies, Mining, Construction. — <sup>c</sup> Gross value added at current prices per employed person. — <sup>d</sup> Gross labour income per employee divided by gross value added per employed person. — <sup>e</sup> Gross fixed capital, annual average. — <sup>f</sup> Gross domestic product at 1991 prices divided by non-housing capitalstock. — <sup>g</sup> Gross entrepreneurial and property income as a percentage of net fixed capital at repurchasing prices.

Source: Statistisches Bundesamt, Fachserie 18, Volkswirtschaftliche Gesamtrechnungen, Reihe 1.3, Konten und Standardtabellen. - Alfred Boss et. al., Aufschwung in Deutschland: Mehr Schub von der Inlandsnachfrage. Die Weltwirtschaft 1996, Heft 4.

Table 4 – Open and Disguised Unemployment in East Germany 1990–1996 (1000 persons)

		Unemployment		Short Time Workers	Public Work Programs	Public Training Programs <sup>b</sup>	Early Retirement Schemes	Commuter (net)
			% <sup>a</sup>					
1990	I	13	n.a.	-	0	0	-	- 14
	II	83	n.a.	-	0	0	-	- 28
	III	309	n.a.	1295	0	0	-	- 101
	IV	556	6.3	1736	12	24	-	- 175
1991	I	756	8.6	1926	41	59	-	- 222
	II	835	9.5	1962	101	108	506 <sup>c</sup>	- 278
	III	1023	11.6	1464	234	157	640	- 308
	IV	1037	11.8	1113	357	201	640	- 352
1992		1170	14.8	370	388	422	518	- 338
1993		1149	15.8	181	237	345	639	- 325
1994		1142	16.0	97	192	241	524	- 325
1995		1047	14.9	71	206	243	341	- 340
1996		1169	16.7	71	191	229	186	-332

<sup>a</sup> Unemployed as a percentage of dependant civilian labor force. — <sup>b</sup> Only full-time. — <sup>c</sup> Until March 31, 1991, 0,382 Mill. persons had retired under an early retirement scheme.

Source: Statistisches Bundesamt, Zur wirtschaftlichen und sozialen Lage in den neuen Bundesländern. Vierteljahrszeitschrift. Dezember 1994. Wiesbaden, 1994. - Bundesanstalt für Arbeit, Amtliche Nachrichten der Bundesanstalt für Arbeit. - IAB. Aktuelle Daten vom Arbeitsmarkt.

Table 3 -- Employment in East Germany by Industry 1989-1996 (1.000 Persons)

	1989	1990	1991	1992	1993	1994	1995	1996
Agriculture	976	781	454	282	233	227	225	215
Energy, Watersupplies, Mining	350	337	233	176	142	119	110	194
Manufacturing	3.408	2.979	2.049	1.306	1.110	1.050	1.035	1.003
Construction	628	628	705	800	919	1.038	1.092	1.052
Wholesale and Retail Trade, Transport, Communication <sup>a</sup>	1.513	1.405	1.241	1.146	1.129	1.135	1.124	1.101
Service Enterprises <sup>b</sup>	619	684	932	1.011	1.111	1.223	1.309	1.358
General Government Services	2.040	1.887	1.504	1.426	1.322	1.249	1.199	1.158
Private Households and Private Non-Profit Institutions	215	120	203	240	253	289	311	313
<b>Total</b>	<b>9.747</b>	<b>8.820</b>	<b>7.321</b>	<b>6.387</b>	<b>6.219</b>	<b>6.330</b>	<b>6.405</b>	<b>6.294</b>
- of which self-employed <sup>c</sup>	187	252	371	418	462	501	524	540

<sup>a</sup> Including Hotels, Restaurants. — <sup>b</sup> Credit institutions, Insurance companies, Other services. —  
<sup>c</sup> Including unpaid family workers.

Source: Statistisches Bundesamt, Zur wirtschaftlichen und sozialen Lage in den neuen Bundesländern. Vierteljahreszeitschrift, Dezember 1994, Wiesbaden, 1994. Statistisches Bundesamt, Fachserie 18: Volkswirtschaftliche Gesamtrechnungen, Reihe 1.3: Konten und Standardtabellen. Hauptbericht 1996.

Table 5 — Labor Force Participation Rates 1989<sup>a</sup>, 1991<sup>b</sup>, 1995<sup>b</sup>, 1996<sup>b</sup> (p.c.)

		Former German Democratic Republic	Federal Republic of Germany	
			East	West
			Germany	
Men	1996	x	79.3	80.5
	1995	x	79.7	81.3
	1991	x	86.0	82.2
Women	1996	x	73.3	59.7
	1995	x	73.9	59.9
	1991	x	77.2	58.4
	1989	81.6	x	-

<sup>a</sup> September 9., age 15-60. — <sup>b</sup> April, age 15-65.

Source: Statistisches Bundesamt. Zur wirtschaftlichen und sozialen Lage in den neuen Ländern. Sonderausgabe, Dezember 1992; Statistisches Bundesamt, Fachserie 1, Bevölkerung und Erwerbstätigkeit. Reihe 4.1.1 Stand und Entwicklung der Erwerbstätigkeit (Ergebnisse des Mikrozensus), 1995 und 1996.

Table 6 - Migration between the New and the Old Federal States 1991-1997

		Brandenburg	Mecklenburg-Vorpommern	Sachsen	Sachsen-Anhalt	Thüringen	Berlin (Ost)	New Federal States
1989	Net-Migration							-383 261
	Per 1000 Inhabitants							-23.3
1990	Net-Migration							-359 126
	Per 1000 Inhabitants							-22.4
1991	Immigration	11 644	8 223	21 606	12 505	13 857	12 452	80 267
	Emigration	40 136	32 460	72 546	47 664	41 696	15 241	249 743
	Net-Migration	-28 492	-24 237	-50 940	-35 159	-27 839	-2 789	-169 476
	Per 1000 Inhabitants	-11.1	-12.7	-10.8	-12.3	-10.7	-2.2	-10.7
1992	Immigration	15 194	12 296	28 345	15 255	20 222	20 084	111 345
	Emigration	37 321	26 137	52 607	33 755	31 364	17 903	199 170
	Net-Migration	-22 127	-13 841	-24 262	-18 500	-11 142	2 181	-87 825
	Per 1000 Inhabitants	-8.7	-7.4	-5.2	-6.6	-4.4	1.7	-5.6
1993	Immigration	19 555	13 400	27 946	17 730	17 370	23 109	119 100
	Emigration	30 758	23 093	41 698	27 919	25 988	22 850	172 386
	Net-Migration	-11 203	-9 693	-13 752	-10 189	-8 618	259	-53 286
	Per 1000 Inhabitants	-4.4	-5.2	-3.0	-3.7	-3.4	0.2	-3.4
1994	Immigration	25 803	14 333	30 358	19 156	18 212	27 924	135 774
	Emigration	25 857	20 946	38 022	28 094	24 583	25 529	163 034
	Net-Migration	-54	-6 613	-7 664	-8 938	-6 371	2 395	-27 260
	Per 1000 Inhabitants	-0.0	-3.6	-1.7	-3.2	-2.5	1.8	-1.8
1995	Immigration	28 521	16 046	31 404	19 973	17 608	29 511	143 063
	Emigration	27 599	20 858	37 533	28 162	25 402	28 782	168 336
	Net-Migration	922	-4 812	-6 129	-8 189	-7 794	729	-25 273
	Per 1000 Inhabitants	0.4	-2.6	-1.3	-3.0	-3.1	0.6	-1.6
1996	Immigration	31 827	18 828	30 541	20 983	17 158	32 636	151 973
	Emigration	28 676	20 115	36 563	26 445	24 094	30 106	166 007
	Net-Migration	3 151	-1 287	-6 022	-5 462	-6 936	2 530	-14 034
	Per 1000 Inhabitants	1.2	-0.7	-1.3	-2.0	-2.8	1.9	-0.9
1997	Immigration	15 766	8 532	14 241	8 356	7 882	17 785	72 562
1.Sem.	Emigration	14 272	9 031	15 024	11 370	9 935	14 864	74 496
	Net-Migration	1 494	-499	-783	-3 014	-2 053	2 921	-1 934
	Per 1000 Inhabitants	0.6	-0.3	-0.2	-1.1	-0.8	2.3	-0.1

Source: Federal Statistical Office of Germany, „Zur wirtschaftlichen und sozialen Lage in den neuen Bundesländern“, 6/97.

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