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**Article**

## Creaking Labour Markets: Migrating into Unemployment?

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## GEORG MILBRADT

Minister-President of the Free State of Saxony

Ladies and gentlemen,

I come from Saxony, the German state with the longest border with the new EU countries, 454 kms with the Czech Republic, 112 kms with Poland. For us in Saxony, enlargement is a chance, a chance for more jobs and more growth. But not for everybody and not in the short run. The chance for growth and, above all, new jobs is combined with a major challenge, as Germany, in particular, will not be able to avoid fundamental reforms in the existing employment and social security systems. Developments in many Western European countries have shown that growth is a necessary but not sufficient condition for the creation of new jobs. Official unemployment rates in the 25 EU states vary between just under 3 percent in the Netherlands and in Luxembourg and nearly 20 percent in Poland. Those Member States that have largely deregulated their labour markets in the past, like the Netherlands and the UK, have significantly lower unemployment rates than others. The new Europe is not a homogenous area, much less homogenous than the United States. Lack of homogeneity is no problem if there is enough flexibility. But here lies the problem. Continuing structural unemployment can be attributed, above all, to an inefficiently functioning labour market. We have experienced this in particular in east Germany where, in the past few years, unemployment has remained above 18 percent despite a large amount of public funds received from western Germany and the EU.

We are, for example, putting strain on the job markets with our high level of social security benefits that is unparalleled in any other country. In early 1990, we in Germany failed to realise that in order to conduct the process of transformation that would have an impact on employment levels, it is not enough to promote investment to stimulate growth. In east Germany, this policy has led to a situation where large parts of the manufacturing industry are now highly productive but very capital intensive,

owing to the high labour costs and capital subsidies. In other sectors of the economy, productivity is lower and average labour costs too high to be competitive. One of the biggest mistakes in unification was to transfer western institutional structures one-to-one to the east, structures that were already outdated in highly developed west Germany.

I believe that after EU enlargement we may have the same problems on the European level. In Germany we pay people for not working rather than for working. We grant ourselves the luxury of giving away benefits instead of wages, benefits that in effect amount to a minimum wage. These are wages that weaker east German companies cannot pay. In east Germany we need more flexible arrangements in order to stay competitive, especially in view of EU eastern enlargement and the flexibility existing in the accession states. To a large extent, companies expand not into east Germany but into Eastern Europe. A good example of this is the Porsche Cayenne, the final assembly of which is done in Leipzig, Saxony, whereas most of the value added process takes place in Bratislava, where labour costs are 20 percent of those in Saxony. The fact that the final stages of production take place in Leipzig has to do with marketing, not with costs. They do not account for much value added, however, and provide little employment in Saxony. Because the problem is not confined to the Porsche Cayenne alone, we need other solutions, especially in the low-wage sector that will enable us to withstand the foreseeable competition as regards labour costs.

I do not believe that there will be a general lowering of wages, except for longer weekly working hours at the same wages, but there will have to be a greater variation in pay rates, particularly for jobs requiring low qualifications. I do not fear migration of workers, but I fear migration of jobs. Let me clarify this by offering you a few figures. Under the present system, a married man on social welfare with two children receives benefits equivalent to a gross income of €10 per hour. Under these circumstances it would not make economic sense for people with low qualifications to take on a job that provides a lower rate



of pay than this. Over 40 percent of the unemployed in Saxony are already long-term unemployed, most of whom no longer have adequate job qualifications. We must find solutions to this dilemma.

Experience in eastern Germany has shown that what we normally do under the label of labour market policy, namely conducting job creation schemes in the so-called second labour market, has proved ineffective in bringing the unemployed back into regular work. Such schemes can actually only be described as parts of social welfare policy. Saxony is prepared to take a different approach. Based on the Ifo model of activating social assistance, we propose to subsidise work in the low-wage sector, so that someone who accepts a job at low pay compared to his value added can receive a higher income than he would from social security benefits. In general, we want to try our own solutions in Saxony, because our problems are different from those in western Germany. But I am not only an economist but also a politician, and I know that carrying out reforms, even if only as model schemes, is bound to meet with resistance. Interest groups insist on perpetuating rigid labour markets because they offer individual advantages. There is wide-spread scepticism and fear regarding the effect of the price mechanism on the labour market, especially on the part of those who have jobs. The public, especially in eastern Germany, believes in the state and in regulation more than in the market and its forces. In addition, the public primarily notices the direct effects of reforms like the removal of protection against dismissal or the reduction of benefits rather than the indirect medium-term effects of higher employment. So I am well aware of the fact that it will be difficult to put into practice what, from the point of view of an economist, is the right thing to do.

What we need is a reorganisation of the welfare state. We cannot abolish it. We have to put our emphasis more on the allocation side, on productivity, flexibility, research, technological and scientific progress, than on distribution.

If we alter our policy and accept the challenges, we can gain from the situation we are in. What we need is a real discussion of the future; we must compare a future with reforms with a future without reforms rather than comparing the future with the present or even the past.

Thank you very much.