

**TOWSON UNIVERSITY
COLLEGE OF GRADUATE STUDIES AND RESEARCH**

**A TWENTY-YEAR ASSESSMENT OF THE ECONOMIC DEVELOPMENT OF
THE FORMER GERMAN DEMOCRATIC REPUBLIC**

by

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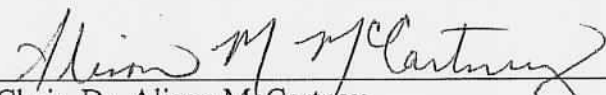
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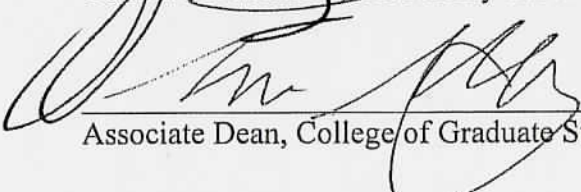
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ABSTRACT

A TWENTY-YEAR ASSESSMENT OF THE ECONOMIC DEVELOPMENT OF THE FORMER GERMAN DEMOCRATIC REPUBLIC

Brandy Jo Sykes

Unification of East and West Germany into the Federal Republic of Germany was a tremendous undertaking and should be examined to understand the economic ramifications. Chancellor Helmut Kohl's economic policies made during the German unification, due to political pressures, resulted in the underdevelopment of the former communist satellite state, the German Democratic Republic (GDR), for over twenty years. Chancellor Kohl's successors, Chancellor Gerhard Schröder and Angela Merkel, initiated several domestic reforms in conjunction with the European Union's Structural Funds' programs to increase the economic development within the five new eastern Länder. The combination of domestic reforms and EU development aid are proving to be beneficial to the development of the former GDR. These recent successful efforts can give eastern Germans hope that with more time the legacy of past economic decisions will disappear and they can meet their full economic potential.

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Introduction

Germany has existed since 1871, a very short amount of time in comparison to other European states. During Germany's short existence it embarked on two bloody World Wars, experienced one of the worst hyper-inflationary periods in the world, lost the majority of its territory, divided into two very different countries, and reunited after forty years of separation. The history and politics behind Germany's fascinating past is thought provoking and worthy of further study.

The German Democratic Republic (GDR), the failed communist satellite state created by the Soviet Union, is almost forgotten, twenty years later, but the region's struggle to reunite with the West is an ongoing challenge. The country of East Germany became the five eastern Länder of the wealthiest European state, the Federal Republic of Germany, which had been known as West Germany. Many people are under the impression that East Germany was lucky in its ability to unify with the prosperous Federal Republic instead of going through "Shock Therapy" and extreme austerity measures on its own like the other transitioning Eastern Bloc countries. However, a second look and further study shows that East Germany may not have been so lucky after all.

In 1989, the GDR was the most economically developed country in the Eastern Bloc. When the Berlin Wall came down and the country subsequently acceded to one of the most developed countries in the world, many thought that East Germany would quickly develop and achieve prosperity at the level of the Federal Republic of Germany (FRG). East Germany also benefitted from inheriting the democratic governing system and judicial system of the FRG, which enabled the country to transition into a liberal

democracy more smoothly than other former Eastern Bloc countries that had to create these structures. Given the assumed fortunes of the unification, why are the eastern Länder still far behind the western Länder in economic development?

The primary reason that the former East German state has struggled to develop is the legacy of unification economic policies, which created endemic institutional problems within the FRG. The economic ramifications of unification policies enacted under Chancellor Helmut Kohl to hasten unification led to excessive long-term unemployment, astronomical wages, and high debt levels within the five new eastern Länder. In contrast, the EU has enacted policies to slowly correct the economic problems plaguing East Germany over the past twenty years, while Kohl's successors, Chancellor Schröder and Chancellor Merkel began reforming the German welfare system.

When thinking of the GDR and its state of development several questions arise. How developed was the GDR by 1989? Why, after twenty years of being unified with the Federal Republic's successful social market economy, is eastern Germany still underdeveloped? How did the unification policies of Chancellor Helmut Kohl affect the eastern Länder's development? Did Chancellor Gerhard Schröder's attempts at welfare reform improve their situation? Chancellor Angela Merkel is the first former East German Chancellor, but has she made any positive impacts on the development of eastern Germany? Finally, did East Germany's automatic membership into the European Union (EU) via accession benefit it? How have the EU Structural Funds benefitted eastern development?

To answer these questions and support the primary argument, the organization of this thesis will consist of five chapters. After a brief literature review, the first chapter

focuses on the development and economic history of the GDR up to 1989. This chapter is designed to put context to the enormity of the unification process. This background chapter is followed by an explanation of Chancellor Kohl's unification policies. Within this chapter the problems with developing the eastern Länder are explored. The fourth chapter begins with Chancellor Schröder's welfare reforms as a means to relieve debt and tax pressure from working Germans and encourage those long-term unemployed easterners to begin working. Chancellor Merkel's impact on eastern development thus far is also discussed within this chapter. She is of particular interest as the first Chancellor from the GDR. Finally, the EU's Structural Funds under its regional cohesion objectives within East Germany are examined to show that despite the EU's economic troubles, the EU is actually helping to revive the former GDR and has brought more success to the region than the chancellor who championed its quick inclusion in the FRG.

Literature Review

There is a debate over Chancellor Kohl's decision to use Article 23 versus Article 146 of the German Basic Law for unification. Peter Quint (1997) provides a thorough debate about the reasons for and against using both of these provisions in the Basic Law. He asserts that Article 146 was originally intended for the unification of East and West Germany via the formation of a new constitution agreed upon through debates from both sides. Quint believes that Article 146 had advantages because writing a new constitution would have created more of a joint effort to bring the two countries together rather than the GDR being absorbed into the existing FRG structures. Furthermore, by combining the views of both countries it could have ultimately reduced the bitter feelings in the eastern regions due to the problems of unification. Finally, in his opinion Article 146 would have

added a sense of legitimacy to the unified state since both countries would have agreed and the entire population would have had to vote for the adoption of a new constitution.¹

Quint then goes on to discuss Article 23, which was ultimately used as the method of unification. Quint points out that the Article was intended for small areas to join the Federal Republic and its established institutions. The conservatives of the Federal Republic supported the Article 23 path because it was the safer route to ensure political and economic stability throughout the unification period rather than having to wait for a new draft of the constitution. The opposition to Article 23 came from the SPD, those politicians in the West that wanted the unification to be a slow process of constitutional reform, and people who viewed the use of Article 23 as another Anschluß. But Article 23 was supported by the ruling CDU/CSU and the GDR in the March 1990 elections.²

Konrad Jarausch (1994) believes that Kohl's decision to use Article 23 was valid because of his and the Federal Republic's political victory. Being the stronger state economically and politically gave Kohl the inherent legitimacy to unify quickly without changing the Basic Law or compromising with the GDR especially since the eastern population demanded a quick unification via the March 1990 elections and an equivalent standard of living as the West.³

Regarding Chancellor Kohl's unification policies against wage equalization after unification to West German levels: Hans-Werner Sinn (2002) and Anthony B. Atkinson (2000) all believe that the wage policy that was negotiated between the policy makers of

¹ Peter Quint, *The Imperfect Union: the Constitution Structures of German Unification* (New Jersey: Princeton University Press, 1997), 50.

² Quint, 50-51.

³ Konrad Jarausch, *The Rush to German Unity* (New York: Oxford University Press, 1994), 179-182.

the FRG and the GDR unions was detrimental to labor competition and took away the East German Länder's labor comparative advantage.⁴ Wolfgang Franz and Viktor Steiner (2000) believe that the wage negotiations were detrimental to east German development after the unification.⁵ They also assert that the FRG did not fully understand the wage structure of the GDR. The FRG believed that because of the socialist system everyone was paid the same wages, however, that was not the case. In the GDR people holding higher degrees were paid more than vocational and unskilled people. Finally, the wage policy has decreased the value of human capital and labor-intensive production in the former GDR, resulting in increased unemployment. The authors state that the supporters of the wage policy during the transition were the politicians, eastern labor unions, and the eastern German population.⁶ On the other hand, scholars supporting Kohl's wage policy, such as Thomas Lange and Geoff (1998), argue that the wage increase actually helped economic development by preventing lower technology industries from continuing, which would have led to longer-term underdevelopment and would have reduced the amount of outdated and unnecessary industries within the region.⁷

Chancellor Gerhard Schröder was elected in 1998. He remained in office until 2005. During that time he began a series of welfare reforms to bring down the federal deficit. After unification the FRG's federal deficit and the costs associated with the

⁴ Hans-Werner Sinn, "Germany's Economic Unification: An Assessment After Ten Years." *Review of International Economics* 10, no. 1 (2002): 113.128; Anthony B. Atkinson, "The Changing Distributions of Income: Evidence and Explanations," *German economic Review* 1, no. 1 (2000): 3-18.

⁵ Wolfgang Franz and Viktor Steiner, "Wages in the East German Transition Process: Facts and Explanations," *German Economic Review* 1, no. 3 (2000).

⁶ Franz, 241-242, 264-265.

⁷ Thomas Lange and Geoff Pugh, *The Economic of Unification: An Introduction* (Northampton: Edward Elgar Publishers, 1998)

welfare system were debilitating for the economy and a drag on eastern development. Wolfgang Streeck (2009), Giuliano Bonoli (2007), Bruno Palier (2007), Christine Trampusch (2005), Achim Kemmerling (2006), and Oliver Bruttel (2006) all agree that Schröder's welfare reforms failed and did not solve the problems of Germany's domestic economic policy.⁸ The authors also agree that the welfare system needs reform to be less contribution based and more restrictive to encourage people to return to the labor force. As for Schröder's successor, Angela Merkel, her term in office continues so analysis of her impacts on development would be premature.

There is limited scholarly research currently available that goes through the evolution of German domestic economic development within the eastern Länder and the challenges faced by the German welfare state. Manfred Schmidt and Gerhard A. Ritter are publishing *The Rise of Fall of a Socialist Welfare State: The German Democratic Republic (1949-1990) and German Unification (1989-2004)* at the end of 2011 and *From the Bonn to the Berlin Republic: Germany at the Twentieth Anniversary of Unification* edited by Jeffrey Anderson and Eric Langenbacher published in 2010. These works add to the information recently published on the twenty-year assessments of the unification and eastern development.

⁸ Giuliano Bonoli and Bruno Palier, "When Past Reforms Open New Opportunities: Comparing Old Age Insurance Policies in Bismarckian Welfare Systems," *Social Policy and Administration* 41, no. 6 (2007): 555-573; Wolfgang Streeck and Christine Trampusch, "Economic Reform and the Political Economy of the German Welfare State," working paper for *Max Planck Institute for the Study of Societies* (2005); Wolfgang Streeck, *Re-Forming Capitalism: Institutional Change and the German Political Economy* (New York: Oxford University Press, 2009).

⁸ Achim Kemmerling and Oliver Bruttel, "'New Politics' in German Labour Market Policy? The Implications of the Recent Hartz Reforms for the German Welfare State," *West European Politics* 29, no. 2 (2006): 90-112.

This thesis seeks to provide a 20-year assessment of the economic development of the former GDR and show that the economic policies of Chancellor Kohl during unification inhibited economic development and increased unemployment in the eastern Länder. Schröder inherited the legacy of Kohl's unification policies and attempted to reform the domestic system, but each attempt failed or exacerbated the situation. Chancellor Merkel has so far been the most successful with her policy reforms, and the European Union has provided consistently helpful aid through its regional cohesion programs.

This thesis only focuses on the economic policy aspects of unification. It does not cover the psychological, sociological, or political environment beyond the economic policies of unification. The reasoning behind not concentrating on the above-mentioned aspects is because that type of project is too complex for this venue and would require extensive independent research in eastern Germany such as surveying and interviewing the population, which is beyond the research opportunities currently available to the writer. Further, examining the political debates surrounding these unification policies would be a different project, as the intent of this research design was to combine economics and history into a single project.

Chapter 1: The History of the German Democratic Republic: Post-war to 1989

In 1949, the GDR became a separate state from the Federal Republic of Germany (FRG) and existed until 1990. During that time the East German population suffered under the one of the most totalitarian, Stalinist regime in the Eastern Bloc. In 1961, First Councilor of State, Walter Ulbricht, established the infamous Berlin Wall in the middle of the night to prevent the East German population from fleeing to the FRG. The Wall stood until 9 November 1989 when a miscommunication allowed East Berliners to enter West Berlin for the first time in almost thirty years. Despite being the most developed country in the Eastern Bloc, the communist regime mismanaged the command economy. Its mismanagement caused the economy to flounder by constantly being plagued with consumer goods scarcity, poor quality merchandise and infrastructure, massive hard currency debt (mainly from West Germany), and lack of worker incentives. When unification occurred the West did not fully understand the cost of absorbing a former communist state, at the time considered developed to the level of a third world country, and the East did not understand the hardships of transitioning to a market-based economy.⁹

The Establishment of Two Germanys

Following the end of WWII in Europe, the leaders of the United States (U.S.), United Kingdom (UK), France, and the Soviet Union, met at the Potsdam Conference from July to August 1945. At this conference, the allies discussed how to reconstruct Germany in their occupied zones. The allies agreed to four central themes: denazification, demilitarization, decentralization, and democratization. However, the Soviet Union only

⁹ M. Donald Hancock and Henry Kirsch, *Politics in Germany* (Washington: CQ Press, 2009), 38-52.

demilitarized its zone. The Soviet Union desired reparations from the Germans, much like France after WWI; however, the allies did not want the reparations to have the same devastating results for Germany. The Allies compromised on reparations by deciding that Germany would pay back the Soviet Union from the eastern Soviet-occupied zone.¹⁰

Reparation extraction by the Soviet Union resulted in the loss of eastern German industrial resources. The Soviet occupiers transported industrial materials to the Soviet Union instead of utilizing them for the Soviet occupied zone's reconstruction. The reparations were not as economically devastating as World War I for Germany¹¹, but they did slow East Germany's reconstruction after WWII.¹²

In 1947, the U.S. decided that Western Europe, especially West Germany, needed to rapidly recover because of the growing threat of the Soviet Union. German recovery was critical for the U.S. since Germany was on the front lines of the Cold War. Geographically, it was the closest country in at least partial Western control on the Soviet Union's western borders. President Harry S. Truman and his advisors created the Marshall Plan in 1948 that provided additional economic aid to Western Europe.¹³ The Marshall

¹⁰ Hancock, 35.

¹¹ Many argue the burden of reparations payments at the end of WWI for Germany led to hyperinflation and domestic economic issues as well as the rise of Adolf Hitler and National Socialism within Germany. John Maynard Keynes, *Economic Consequences of Peace* (New York: Harcourt, Brace, and Howe, 1920), 27-112; Constantino, Bresciani-Turroni, *The Economics of Inflation: A Study of Currency Depreciation in Post-War Germany* (North Hampton: John Dickens and Co. Ltd. 1968), 398-404; Steven B. Webb, *Hyperinflation and Stabilization in Weimar Germany* (New York: Oxford University Press, 1989), vi; Karl Hardach, *The Political Economy of Germany in the Twentieth Century* (Berkeley: University of California, 1980), xii, 16-28.

¹² Hancock, 34-35.

¹³ Hancock, 40.

Plan enabled the Western Zones to begin rebuilding and accessing the latest technologies.¹⁴

The fear of growing Soviet domination also led the U.S. to suggest that the three Western zones be combined into one zone. By 1948, the British, French, and U.S. combined their zones and introduced the *Deutschemmark* in both Berlin and Western Germany without Soviet input to the decision. Thus, only two occupied zones remained: a democratic, capitalist zone in the West and a communist zone in the East.¹⁵

The Soviet Union was not pleased with the West for uniting the three zones, particularly in Berlin, because it gave the Western allies a great listening outpost in Soviet territory. Joseph Stalin reacted to the combined zones and the introduction of the *Deutschmark* into West Berlin with the Berlin Blockade in 1948. The Berlin Blockade cut off West Berlin and denied it access to basic necessities from the Western allied supply lines. The U.S. responded by using two previously approved air corridors to fly materials, supplies, and people to and from West Berlin. Stalin believed that the Allies could not possibly keep up the airlift for an extended period of time and that eventually he would be able to claim West Berlin as part of the Eastern territory. Much to Stalin's surprise, the Allies sustained the airlift to West Berlin, and Stalin lifted the Blockade on May 5, 1949.¹⁶

The Blockade demonstrated the dedication of the Western Powers to defend Western Germany and essentially the West from the Soviet Union and Communism. It encouraged allied and Western German leaders to establish the new Federal Republic of

¹⁴ Hancock, 163.

¹⁵ Hancock, 37.

¹⁶ Hancock, 41.

Germany as a Western-style government. Konrad Adenauer, from the center-right Christian Democratic Union (CDU) political party, was elected as Chancellor in 1949 to take on the challenge of creating a strong democratic and capitalist system within West Germany. He began creating a democratic system by ratifying the German Basic Law as the ruling doctrine for the FRG. The new Western state aimed to obtain international recognition as the only legitimate Germany.¹⁷

The German Democratic Republic (GDR) was established on 7 October 1949 based on the Soviet-style one-party government and command economic system. The Social Unity Party (SED) became the only legal political party in the GDR. The party forced the historic Social Democratic Party (SPD) and German Communist Party (PKD) to combine. SED leader Walter Ulbricht became the first leader of the GDR. With the elimination of political pluralism and the “election” of a Stalinist socialist leader, the GDR became a totalitarian Soviet satellite state on the front lines of the Cold War.

Problems with the Command Economic System

Among GDR political leaders, the centrally planned economic system of the GDR was thought to be superior to the social market system of the West. The leadership believed the illusion of far surpassing the Federal Republic of Germany’s productivity and total production values, which eventually created an economic nightmare for the country. The Deputy Chairman of the German Economic Commission, Fritz Selbmann, described the GDR’s planned economic system relative to the Social Market system of West Germany, “We will plan down to the last machine, down to the last production unit of state-owned industry, and then we will see who is stronger – the planned state-owned

¹⁷ Hancock, 41.

industry or the non-planned free market economy.”¹⁸ Fritz Selbmann’s quote highlights the central planning within the GDR typical to a command style economic system; however, the planning did not consider consumer demand. The failure to plan for consumer demands led to some of the flaws within the command economic system – lack of consumer goods, consumer demand tracking mechanisms, and producer incentives.

First Secretary of the SED Walter Ulbricht idolized Joseph Stalin and sought to establish policies similar to the early Stalinist Soviet Union within East Germany. These policies included collectivization, discrimination against artisans, the middle class, farmers, and businessmen, and elimination of private enterprise and entrepreneurship. Collectivization referred to the industrialization of agriculture where the state apparatus forced farmers to join into communal groups to produce for the state.¹⁹

The GDR leadership grossly overestimated the industrial capacity of the country and the cost of implementing these central plans. In 1950, the GDR joined Eastern Bloc’s economic organization, the Council of Mutual Economic Assistance (COMECON). The GDR announced to the group its Five Year Plan for economic production, claiming that the GDR could out-produce the FRG and increase the East German standard of living above Western levels. Unfortunately, the creators of the Five Year Plan underestimated its cost.²⁰

The Five Year Plan strained the economy when it was implemented. The country converted to heavy industry, expanded its military, collectivized agriculture, and eliminated private entrepreneurship. The result was to prioritize heavy industry over

¹⁸ Mike Dennis, *The Rise and Fall of the German Democratic Republic, 1945-1990* (Essex: Pearson Education Limited, 2000).

¹⁹ Dennis, 59-60.

²⁰ Dennis, 60.

consumer products, thus creating a lower standard of living for East Germans. Not only were East Germans living with a scarcity of consumer goods, but they were heavily politically repressed.²¹ The combination of a lower standard of living, consumer goods scarcity created discontent among the population.²²

In March 1953, Joseph Stalin died. His successor, Nikita Khrushchev, began a de-Stalinization campaign throughout the Soviet Union and the Eastern Bloc. De-Stalinization in the GDR took the form of the New Course. The New Course met much resistance from Ulbricht and other hardline Stalinists in the SED. Since the GDR completely depended on the Soviet Union, Ulbricht had to consent to Khrushchev's New Course policies to reduce the amount of political repression, slow rapid industrialization to a realistic pace, and reduce the rapid price increases of agricultural goods.²³

Throughout the mid-to-late 1950s Ulbricht and Khrushchev constantly battled over economic and political differences. Ulbricht refused to implement proper de-Stalinization policies promoted by Khrushchev. Even though Ulbricht did not agree with Khrushchev's political agenda, he was forced to rely on him for economic assistance. Ulbricht's ambitious economic plans were unsustainable given the GDR's lack of raw materials and other vital resources for industrialization.²⁴

Soviet assistance in the form of short-term loans could not remedy the dire economic situation in the GDR. By 1960, the GDR went into an economic depression. The GDR was in tremendous debt to the Soviet Union. East German exports could not compete with the quality of Western products. Imports could not be paid for, thus,

²¹ Dennis, 61.

²² Dennis 61-63.

²³ Dennis, 64.

²⁴ Dennis, 78-80.

foodstuffs, consumer goods, and hard currency to trade with became scarce because the demand was greater than the supply.²⁵

Discontent in the population became a serious issue. Instead of an uprising similar to 1953, the educated, artistic, and business oriented fled the country for West Germany through West Berlin, causing the GDR to suffer from “brain drain.” The out-migration peaked at 3.1 million East Germans fleeing from the country. To stop the population hemorrhage, Ulbricht manipulated Khrushchev into allowing him to construct a barrier between East and West Berlin.²⁶

On Sunday 13 August 1961 the Berlin Wall was constructed with a simple barbed-wire fence. The Wall did not just block Easterners from crossing the Western border on foot or by car, but also by train, subway, and telephone lines. All connections between East and West Germany were broken overnight. It started as a barbed-wire fence and evolved into over a hundred miles of wall with 300 watchtowers. The watchtowers were each manned with gunmen ordered to shoot to kill anyone attempting to cross the border. The day the Berlin Wall went up was known as *Stacheldrahtsonntag* or Barbed-Wire Sunday, and the day that hopes of reunification between the East and West Germany faded.²⁷

The Debt Crisis and Collapse

Ten years after the creation of the Berlin Wall, the man in charge of its installation and security, Erich Honecker, replaced Ulbricht as First Secretary of the SED

²⁵ Dennis, 89.

²⁶ Hope M. Harrison, *Driving the Soviets Up the Wall: Soviet-East German Relations, 1953-1961* (New Jersey: Princeton University Press, 2003), 223.

²⁷ Frederick Taylor, *The Berlin Wall: a World Divided, 1961-1989* (New York: HarperCollins Publishers, 2006), XIX.

and leader of the GDR. He began a campaign to improve the standard of living for East Germans through social welfare benefits, improvements to the housing, increased and better education, and full employment. However, Honecker did not have the proper government funding required for these projects. His domestic development projects combined with international economic decline from the oil crisis led to surmounting national debt for the GDR.

Despite reservations about the cost of the domestic projects by the president of the GDR's state bank, Honecker continued his development plan. The plan involved a housing project goal to build or rebuild 3.3 to 3.5 million housing facilities between 1971 and 1990. The cost of the renovations and rebuilding alone were nearly impossible to pay, especially combined with subsidized housing rules wherein the resident only paid a quarter of the actual value.²⁸

The oil and energy supply crisis of the 1970s compounded the financial problems within the GDR. The country lacked natural resources for its heavy industry, causing the GDR to rely heavily on the Soviet Union for its energy supplies. When the oil cartel, the Organization of the Petroleum Exporting Countries (OPEC), increased its oil prices, the Soviet Union increased its energy prices for all of COMECON and decreased its supply to the GDR.²⁹

As a means of compensating for the costs of domestic reconstruction and the country's energy needs, Honecker turned to the West to get financial assistance. Access to the West was made possible by FRG leader Willi Brandt's *Ostpolitik* that began a political reconciliation process with the Eastern Bloc. The credits the GDR received were

²⁸ Dennis, 154.

²⁹ Dennis, 161.

primarily from West German private banks, which demanded repayment with interest. As a result of delinquency, the GDR went through debt scheduling that increased the interest rates on its debt from 5.6 percent to 13.9 percent. In 1981, the total debt to the West (excluding the FRG) totaled 10.1 billion dollars, and the debt to the FRG alone was 13.7 billion DM.³⁰ To prevent further debt the GDR would have had to lower its living standards by 25-30 percent, which would have been impossible for Honecker if he wanted to remain in power; therefore, Honecker continued to borrow.³¹

In 1985, Mikhail Gorbachev was selected as the head of the communist party in the Soviet Union. He planned to reform the suffering Soviet economy by opening it to the global market, and he began reducing the amount of support for the Eastern Bloc. He wanted to use multilateralism to revive the Soviet economy and created a policy referred to as the “common European home” that was not just Communist or Capitalist.³² Gorbachev increased cooperation with West Germany for economic support in the form of loans from West Germany or business investment. By 1987 Gorbachev let the world know that he did not think that the division of Germany would be permanent. Honecker did not agree and did not participate in any of Gorbachev’s reforms.³³

Growing discontent within East Germany and the growing number of protests led to unification. The citizens of East Germany were unsettled by the amount of corruption in their government, the inability to travel, and their low living standards. As a result, they began peaceful protests in cities in an attempt to achieve changes in travel and

³⁰ Dennis, 162.

³¹ Taylor, 415.

³² Scott Erb, *German Foreign Policy: Navigating a New Era* (Boulder: Lynne Reinner Publishers Inc., 2003), 77-78.

³³ Erb, 85-89.

individual freedom. During East Germany's fortieth anniversary celebration the people that were supposed to be celebrating East Germany began chanting for Gorbachev to change the current situation in East Germany. The East German politicians, with pressure from the Soviet Union, took those protests into consideration and replaced Erich Honecker with Egon Krenz in 1989. Krenz promised reform for East Germany, beginning with lifting the travel restrictions. The lifting of the travel restrictions was the event that sparked the unification process, as people could not be contained once they were allowed access to the West.³⁴

On 9 November 1989 the Berlin Wall opened to allow travel between East and West Berlin. The Wall restrictions were breeched at 11:30 pm allowing East and West Berliners to finally meet and rejoin after 28 years of separation. This day changed the world and impacted Germany for years to come, as unification occurred within the next year.³⁵

When the Wall came down and the rumors of unification began, the East was in a dire economic condition. West Germany gained a country with 13 billion DM of debt to the FRG, 21 percent of its factories over twenty years old, 72 percent of the telephone lines over thirty years old, a deteriorating railway and road system, and a population working at three-quarters below West German productivity levels.³⁶ Also, the lack of consumer goods within the country became apparent when Eastern Germans on average were accustomed to waiting 12 to 17 years for a new vehicle.³⁷ West Germany transferred approximately 1 trillion DM in transfer payments and estimated the

³⁴ Erb, 95-96.

³⁵ Taylor, 421-428.

³⁶ Dennis, 264.

³⁷ Dennis, 149.

development of eastern Germany would cost another 109 billion DM a year.³⁸ The next chapter examines Chancellor Helmut Kohl's unification policies and their economic consequences.

³⁸ Smith, 112.

Chapter 2: Chancellor Helmut Kohl and the Problems with Unification

As chairman of the Christian Democratic Union (CDU), Helmut Kohl became the West German chancellor in 1982. He remained in power until 1998, making him Germany's longest ruling chancellor since Otto von Bismarck. During his era, Kohl initiated extraordinary events in modern history, such as overseeing the unification of Germany, the creation of the European Union, and the agreement to make the Euro a single European Currency. Kohl also solidified Willi Brandt's policy of *Ostpolitik* as well as the Federal Republic of Germany's (FRG) dedication to the United States (U.S.) and its Western Allies. He utilized West Germany's financial success to his advantage when negotiating with the debt-ridden (approximately 123 billion DM) German Democratic Republic (GDR) the high debt levels contributed to the GDR's eventual collapse.³⁹

Despite all of Kohl's accomplishments as a negotiator and leader of West Germany, his economic decisions during the unification of East Germany led to severe economic development issues within the eastern Länder. The consequences of those policies still affect the five new Länder 20 years later. The main detrimental economic policies were equal currency and wages, capital-intensive subsidies, and privatization.

Kohl's decision to use Article 23 of the German Basic Law, which states "For the time being, this Basic Law applies in the territory of the Länder [West Germany]... In other parts of Germany it is to be put into force on their accession,"⁴⁰ for rapid unification maintained economic and political stability for West Germany and satisfied standard of

³⁹ Taylor, 415.

⁴⁰ "Article 23" *Basic Law of the Federal Republic of Germany (1949/ Amendments 1956)* <http://germanhistorydocs.ghi-dc.org>.

living demands of the East German population. However, the pace of unification led to quick economic decisions without analysis of the long-term consequences.⁴¹

Using Article 23 made the FRG's political victory all encompassing and ensured the political stability of the Federal Republic during this period, but this path had unforeseen consequences for east Germans. Since it dissolved and discontinued all GDR institutions, many East Germans found themselves with inadequate education and skills in comparison to their Western counterparts. Lacking a Western standard education seriously increased unemployment and exacerbated the misery of the former East German population during the German version of "Shock Therapy."⁴² The pace of the transformations made some East Germans refer to it as *Anschluß* because after the privatization process only six percent of former East German industries were actually owned by eastern Germans, while western Germans owned 85 percent.⁴³

Economic Policies after 1989

In 1990, the German Democratic Republic was in the process of integrating into the FRG and optimistic that it would become economically solvent after years of international debt and consumer scarcity. However, globalization and the rise of Asia made competing in the international market system more of a challenge than anticipated. Japan, Korea, Southeast Asia, and China had all emerged as economic powerhouses that flooded the global market with inexpensive, high quality goods. East Germany, now disadvantaged, had not only to convert to the FRG's social market economic system, but

⁴¹ Quint, 51-53.

⁴² Patricia Smith, *After the Wall* (Boulder: Westview Press, 1998), 25-26.

⁴³ Smith, 5 and 16-19.

also had to try to compete with its lesser quality and higher-priced products in the global market.⁴⁴

Yet, in 1989, East Germany was the most successful communist country in the Eastern Bloc. It was seen as “lucky ex-communists” because of its relationship with West Germany, one of the strongest and largest economies in the world, unlike its eastern neighbors, which transitioned on their own. Unfortunately, East Germany’s connection to the West and its large financial assistance may not have benefitted the GDR. The economic policies invoked by the FRG failed to address sustaining long-term economic restructuring. Instead, the FRG’s economic policies were designed to accommodate East German standard of living demands and the unexpectedly quick unification.⁴⁵

The Economic and Monetary Union Treaty came into force in May 1990. Kohl believed that a similar “economic miracle” in the FRG after World War II would occur for the east and that the new Länder’s economies would recover within five years. His vision; however, did not come to fruition because of the unforeseen consequences of the economic union that delayed eastern development, caused skyrocketing unemployment, and increased the federal deficit.⁴⁶

After the treaty went into effect, the successful social market system of the Federal Republic became the economic system of the GDR. Various actions had to occur to convert the GDR over to the new and completely opposite economic system, including currency union, privatization, market pricing, and free movement of labor and capital.

⁴⁴ Frederick Taylor, *The Berlin Wall: A World Divided, 1961-1989* (New York: HarperCollins Publishers, 2006), 444.

⁴⁵ Taylor, 444.

⁴⁶ Smith, 109.

The goals of the Federal Republic's economic conversion policies were to integrate quickly and to eliminate any remnants of the old central planning system.⁴⁷

Currency union was the first policy to rapidly convert. On 1 July 1990 the Western *Deutschemark* replaced the Eastern *Ostmark* at an equal exchange rate up to four thousand DMs; after that amount the ratio became 2:1.⁴⁸ The 1:1 ratio of the currencies benefitted the people of East Germany because their currency was worthless in comparison to their Western neighbors. Bundesbank President Karl Otto Pöhl resigned in protest over the generous currency conversion rate that he feared would lead to an economic disaster. Helmut Kohl used the currency union as a political tactic and was less concerned about economic ramifications. East German industry suffered tremendously from the 1:1 conversion because the value of capital fell. Kohl felt that he guaranteed rapid unification by converting the *Ostmark* to the *Deutschemark*.⁴⁹

Kohl also initiated substantial financial assistance to the East German economy after unification in the form of industrial subsidies. Originally, the productivity gap should have been completely closed by 1998 because the amount of capital investment in the east surpassed that of the west. Unfortunately, the productivity of the East German economy did not improve as it was intended with the financial support, and the gap between east and west stopped closing.⁵⁰

There are several factors, which made the slowing of productivity within East Germany unanticipated. First, East German industry was modernized with the most

⁴⁷ Smith, 110.

⁴⁸ Smith, 110.

⁴⁹ Scott Erb, *German Foreign Policy: Navigating a New Era* (Boulder: Lynne Rienner Publishers, Inc., 2003), 101.

⁵⁰ Henning Klodt, "Industrial Policy and the East German Productivity puzzle," *German Economics Review* 1, no. 3 (2000): 315.

advanced technology because the Federal Republic had the opportunity to utilize this option. Second, East German factory labor was more skilled in some cases than West German labor. Finally, the productivity gap was substantially larger than the wage gap because of wage negotiations, which made eastern labor costs nearly equal to western labor costs, despite the lower productivity of eastern workers and the high supply of labor within the eastern Länder. The increase in labor costs decreased eastern Germans' comparative advantage in low-cost, widely available labor causing an exponential increase in unemployment. Despite federal subsidies and transfer payments, new capital, and skilled industrial labor, East Germany could not keep up with the Federal Republic because the subsidies provided the most advanced technology reducing the need for labor, the skilled labor was still less productive than western labor, and the welfare system within Germany at the time provided little incentive to actively participate within the labor market (to be discussed further in chapter three).⁵¹

The one trillion DM in financial transfers and capital subsidies intended to preserve jobs and increase productivity in the former GDR. At first the program seemed to work. By 1992 the former GDR increased its productivity from 25 percent of the FRG in 1990 to 60 percent.⁵² The FRG gave subsidies to capital-intensive industries, which it wanted to preserve in east Germany, particularly chemical and steel manufacturing. Subsidies also went to researching and developing technologies as well as providing capital investment incentives to encourage expansion of West German firms into the East. Helmut Kohl and his policy makers thought that by preserving capital-intensive industries through subsidies they would modernize the eastern Länder and promote job

⁵¹ Klodt, 316-321.

⁵² Klodt, 316.

creation. However, since economists did not make the policy, Kohl's subsidy programs artificially altered supply and demand of capital and labor in the east resulting in a detrimental development decision. Subsidizing capital decreased the price of capital despite the low supply of capital, while other policies increased the price of labor, which had a large supply and low demand.⁵³

Kohl's subsidy decision artificially lowered the price of capital to entice industry investment within the eastern Länder. What happened due to this policy decision was that the cost of a low supply item, capital, went down (contrary to what would be expected in a free market), while the price of a high supply item, labor, went up (again contrary to the what is expected within a free-market). When combined with the wage policy that already exaggerated the price of labor, German economists doubted the success of the capital-incentive industry policy and criticized Kohl for creating a policy that would inherently cause unemployment when unemployment was already rampant⁵⁴ (seven million eastern Germans were employed in 1990, but by 1991 only 5.5 million were employed).⁵⁵

Subsidizing capital-intensive investment is not an appropriate policy for reducing unemployment. Capital is the main means of production, not labor. Economists believed that an alternative policy like reducing the value added tax (VAT) on east German goods or subsidizing labor would reduce unemployment. Reducing the VAT was expected to drop the price of East German goods to thus increase demand. Labor subsidies would drop the price of wages to their real market value giving a comparative advantage, thus

⁵³ Klodt, 321.

⁵⁴ Klodt, 321.

⁵⁵ Franz, 244.

encouraging firms to hire cheaper labor. When the wages dropped the Federal government would provide assistance to the people to bring wages back up to an acceptable standard of living. Economists believed that this policy would increase productivity, increase investment, and decrease unemployment.⁵⁶

Wage policy between East and West Germany is another economic policy that hindered Eastern development. The Eastern worker unions demanded the same wages as their West German counterparts, while Eastern labor productivity and investment stalled. They also wanted quick unity and to immediately receive the living standards of West Germans without thinking about the possibility of high unemployment and austerity measures to reduce the amount of debt incurred during the rebuilding process.⁵⁷

Unemployment was exacerbated by wage negotiations between the eastern and western labor unions. The Western unions discussed with Eastern unions the amount by which wages should increase during the unification process. When wage negotiations began between the unions, Eastern unions demanded equal wages. Artificially high wages were granted to the Easterners, which was thought by those in the East to be a glorious event that would get them ever closer to the living standards of the West. But, the unions did not take into account the effects of capitalism as a system. Prices were no longer determined by the state, unemployment ballooned, and the skills of East German laborers were questioned. Higher wages did increase the standard of living, but only for those that could gain employment.⁵⁸

⁵⁶ Klodt, 321-323.

⁵⁷ Taylor, 444.

⁵⁸ Wolfgang Franz and Viktor Steiner, "Wages in the East German Transition Process: Facts and Explanations," *German Economic Review* 1, no. 3 (2000): 242.

The East Germans complained of “unfair wage developments” after negotiating for equality because their wages, productivity, and prices of goods did not match. They did not take into consideration how much the wage negotiations negatively impacted their development and investment potential. In 1992, wages in the East were comparable to the United States, but in terms of productivity rates, the East was comparable to Mexico.⁵⁹ This comparison vividly depicts the problems with wages and productivity during the unification process.

Unemployment soared in one year. In 1990, seven million were employed in East Germany so unemployment no longer seemed problematic. However, in 1991, that employment number dropped to 5.5 million, or 20 percent compared to only five percent in West Germany.⁶⁰ This drop in employment is explained by examining the labor market ratio between East and West Germany. In 1991, unit labor costs were 150.6 compared to 1998 at 124.1. Labor productivity was 31.0 in 1991 and 220.2 in 1998.⁶¹ It was more costly to hire East Germans than West Germans based on the cost of labor and with productivity level that was three-quarters lower than in Western Germany.⁶²

In addition to unemployment that resulted from the increased cost of labor, wage inequality rose dramatically. Inequality between women and men was the most dramatic. To combat this disparity women began working primarily for the public sector of the economy. Unfortunately, the amount of subsidization within the public sector meant that women were eventually laid off when the FRG decided to no longer over hire in the public sector. Furthermore, under the centrally planned system wage differentials were

⁵⁹ Franz, 244.

⁶⁰ Franz, 244.

⁶¹ Franz, Table 2, 245.

⁶² Dennis, 264.

based on education levels. The FRG did not fully realize this problem until after the unification process. Instead, artisans and master craftsmen were paid the same as unskilled industrial workers.⁶³

The combination of the high wages and capital-intensive investment, and the demands of the people in the east led to a disastrous cocktail for the eastern Länders' development.⁶⁴ Both combined to increase unemployment, reduce productivity, inadvertently de-industrialized the east more so than the privatization process, create income inequalities, remove the former GDR's comparative advantage in cheap labor that benefitted the development of other eastern bloc countries like Poland, and create deep resentment of the West by East Germans. Resentment centered on the loss of employment, East Germans ownership of their own industries and a piece of their own communities.⁶⁵

⁶³ Franz, 264-265.

⁶⁴ Taylor, 444.

⁶⁵ Smith, 112.

Chapter 3: Reforming the Social-Market: Chancellor Gerhard Schröder's Attempts at Welfare Reform

Germany was the first European welfare state. In the 1880s, Chancellor Otto von Bismarck created the foundations for state-run social insurance policies. Bismarck's vision was a three-pronged approach covering workers' compensation for work-related accidents, health insurance, and retirement assistance. Bismarck's use of these policies as a political tactic to gain much-needed support from the growing Social Democratic Party became the foundation for the pre-reform FRG welfare system.⁶⁶

Because Chancellor Bismarck began the policies in the 1880s, the current German welfare model is referred to as the Bismarckian style welfare state. The Bismarckian welfare state is supported through individual contributions from work.⁶⁷ This style is designed to maintain a reasonable standard of living upon retirement or when ill, not to protect against poverty or long-term unemployment since contributions are received from employment.⁶⁸ The present social insurance system within the FRG is comprised of three main components: pensions, unemployment, and health care. For the purposes of this work, the main focus will be given to unemployment benefit reforms because high unemployment is still a development issue for the eastern Länder.

Unification created an enormous financial burden for Germany in the 1990s. Due to pressures for a rapid unification, Chancellor Kohl enacted economic policies such as

⁶⁶ Gordan A. Craig, *Germany: 1866-1945* (New York: Oxford University Press, 1978), 150-151.

⁶⁷ Giuliano Bonoli and Bruno Palier, "When Past Reforms Open New Opportunities: Comparing Old Age Insurance Policies in Bismarckian Welfare Systems," *Social Policy and Administration* 41, no. 6 (2007): 556.

⁶⁸ Wolfgang Streeck and Christine Trampusch, "Economic Reform and the Political Economy of the German Welfare State," working paper for *Max Planck Institute for the Study of Societies* (2005): 3.

higher wages for eastern workers and capital-intensive subsidies with the intent to modernize factories (discussed in Chapter Two) but straining the welfare state. Mass unemployment within the eastern Länder caused by the unification policies combined with an already aging population in the western Länder impelled a change to the German welfare system. Chancellor Kohl had begun small reforms during the 1980s to reduce the federal deficit, but the burdens of unification reignited debt problems. When Chancellor Gerhard Schröder of the Social Democratic Party (SPD) took office in 1998 he inherited a federal deficit of approximately 40 percent of Germany's gross domestic product (GDP). The federal deficit grew from 40 percent to just under 70 percent of its GDP within 15 years (from 1991 to 2006).⁶⁹ The rapid debt escalation after unification began the largest welfare reform campaign since the founding of the Federal Republic.⁷⁰

Problems Within the Existing German System

Unification created a surplus of labor at a high cost to employers due to the wage negotiations between eastern and western unions and the government as well as the decision to subsidize capital-intensive industries. The results were factories requiring less labor since they could replace labor with capital at a much lower cost. The emphasis on capital-intensive investment ultimately increased Germany's unemployment rate to 6.9 percent in 2000.⁷¹

Unemployment, social assistance programs, and free education also contributed to unemployment by enabling young, educated people to remain in the university system for

⁶⁹ Wolfgang Streeck, *Re-Forming Capitalism: Institutional Change and the German Political Economy* (New York: Oxford University Press, 2009), 68.

⁷⁰ Achim Kemmerling and Oliver Bruttel, "'New Politics' in German Labour Market Policy? The Implications of the Recent Hartz Reforms for the German Welfare State," *West European Politics* 29, no. 2 (2006): 90.

⁷¹ Streeck, "Re-Forming Capitalism," 163.

extended periods of time, on average until they are 29 years old.⁷² Additionally, the health care system and pension systems rely on the welfare system. Industries will provide early retirement options to bring in younger employees to reduce their labor costs, resulting in a large amount of older, but still working age, people outside the labor market using the welfare system. The amount of people actively involved in the labor force in 2006 was 65 percent, five percent less than the EU's Lisbon Strategy goals for 2010.⁷³ Finally, the cost of social assistance falls on the employed. Forty percent of gross wages (the maximum allowed within Germany) are taken for various social assistance programs.⁷⁴ The percentage taken from gross wages is referred to as non-wage costs of labor. Since wages throughout Germany are already high, increasing the non-wage costs with elevated welfare system contributions neither increases employment nor provides businesses, particularly small- and medium-size business, with incentives to hire more people.

The unemployment and social assistance programs before Chancellor Schröder's reforms in Germany were generous and provided a substantial standard of living for unemployed Germans. The unemployment assistance was comprised of three main parts: unemployment benefits, unemployment assistance, and social assistance, each funded initially by employee and employer contributions. Unemployment benefits provided the recently unemployed with 67 percent of their last salary for the first 32 months. After that period expired and the person still remained unemployed he/she was given unemployment assistance indefinitely. Unemployment assistance provided 53 percent of

⁷² Streeck, "Economic Reform," 2.

⁷³ Kemmerling, 97.

⁷⁴ Kemmerling, 96.

a worker's last salary. The third part of the unemployment benefit system, social assistance, was run through the local Länder taxes for an unlimited time-period. This program was for people not qualified for unemployment benefits or assistance. Those people looking for jobs, but not qualified could still maintain a standard of living above the poverty line indefinitely. The majority of the unemployed within the eastern Länder fall into this category. Social assistance is a significant portion of the federal budget and most draining because it lacks the necessary offsetting contributions and is overly subsidized by the federal and local governments.⁷⁵

The other main problem with the welfare system is its increase in the cost of labor. Contributions to the systems are taken from the employee's gross wages and from the employer. The employer is required to contribute approximately 17 percent from the employee's gross wages, while the employee must pay forty percent as of 2006.⁷⁶ This non-wage cost is in addition to taxes. To compensate for the high cost of non-wage labor, firms will cut employees by providing them with early retirement packages. Early retirement feeds the problem because more people enter the pension system, increasing the cost of the pension system thus increasing the non-wage costs per employee. Even in 2010 the hourly labor cost are high in Germany. In the private sector the average hourly wage is 29.20 Euros, which is above the EU average (22.10 Euros). The hourly wage in the manufacturing sector is 33.10 Euros (fifth highest in the EU). To put the high cost of labor in a comparative perspective, particularly for comparative advantage in labor, the average hourly wage for a private sector employee in Poland is 7.00 Euros and for the

⁷⁵ Kemmerling, 96.

⁷⁶ Streeck, "Economic Reform," 3.

manufacturing sector the average hourly wage in Poland is 6.30 Euros.⁷⁷ The high wages combined with high non-wage labor costs contributes to high unemployment since firms do not want to hire additional costly people. This resistance to hire additional people perpetuates the long-term unemployment in the eastern Länder.⁷⁸

The FRG's deficit expanded because it had to subsidize the social benefits it provides since contributions could no longer sustain the demand for the programs. Additionally, in the early 2000s job seeker training programs and job placement programs for eastern Germans were funded through unemployment benefits costing 50 billion Euros.⁷⁹ These programs, run by the FRG, failed within the eastern Länder because of the high cost of employment. For example, in 2008 in Berlin the gross labor cost (salary) per average employee was 46,786 Euros, in Brandenburg the cost (salary) was 35,543 Euros.⁸⁰ In Mecklenburg-Vorpommern the annual gross wages have increased from 25,501 Euros in 2000 to 28,069 Euros in 2005, to 31,642 Euros in 2010.⁸¹ Finally, in the 2008 hourly labor costs in Saxony were 20.25 Euros, which was lower than the western states at 29.25 Euros an hour.⁸² The amount of Federal subsidies going to the unemployment programs in 2003 was 42.8 percent of the entire Federal budget.⁸³

⁷⁷ Matthew Allen M.C, "Economy (Germany)," in *Europe World Online*, <http://www.europaworld.com/entry/de.ec>.

⁷⁸ Streeck, "Economic Reform," 3.

⁷⁹ Streeck, "Economic Reform," 4.

⁸⁰ "Labor Costs per Full-time Unit in Industry and Services, 2008," *Statistik Berlin und Brandenburg*, <http://www.statistik-berlin-brandenburg.de/>

⁸¹ "Country Data at a Glance (Merits)," *Mecklenburg-Vorpommern Statistics*, http://www.statistik-mv.de/cms2/STAM_prod/STAM/de/start/index.jsp

⁸² Steffen Pollack, "Arbeitskosten in Sachsen 28,5 Prozent unter Westniveau," *Statistisches Landesamt des Freistaates Sachsen* (2008) <http://www.statistik.sachsen.de/html/529.htm>

⁸³ Streeck, "Economic Reform," 3-6.

The financial issues resulting from the German Bismarckian style welfare system forced Chancellor Schröder to pursue various reform initiatives; however, he faced mass opposition from the public and labor unions, ultimately slowing down the rate at which the reforms went through the Bundestag. The conflicts between the unions and the opposition party, the Christian Democratic Union (CDU), led to compromise that did not adequately solve the problems within the welfare system. The Hartz reforms were only major reform effort that Chancellor Schröder successfully passed, which were the result of a public relations crisis and the establishment of the Commission of Modern Services on the Labour Market.

Hartz Reforms

Chancellor Schröder established The Commission of Modern Services on the Labour Market in 2002 chaired by Peter Hartz Human Resource Director for Volkswagen as a result of a scandal within the Public Employment Service (PES). The scandal arose from the PES falsifying employment placement statistics by reporting higher placement numbers in order to hide the organization's inefficiencies. The scandal provided a welfare crisis for Chancellor Schröder to use in order to push his reforms through the Bundestag with the approval of the populace. The commission is known as the Hartz Reforms. They were designed to address the inefficiencies of the PES because of the scandal and also to review the federal labor market policies.⁸⁴

After six months of research and investigation, the Hartz Reforms were presented in four main groupings: Hartz I, II, III, IV. The first two acts were enacted in 2003, focusing on job training and placement as well as more defined rules for finding

⁸⁴ Kemmerling, 91.

employment, such as time limits and what types of jobs count for the placement programs. This meant a person unemployed for more than a year must take any job offer he/she receives regardless of wages.⁸⁵ Hartz Act III, enacted in 2004, reorganized the PES, which was the commission's main objective. The final Act IV focused on the unemployment benefit system, which was enacted in 2004.⁸⁶

The main objective of the Hartz Reforms was to reorganize the PES, which it effectively did through its decentralization. Decentralizing the PES dismantled its original, highly bureaucratic system consisting of three committees into a new business-like structure with a chief executive officer and a revolving management board that would rotate every five years. The reorganization allowed it to adequately run the employee placement and training programs necessary to complete its mission of monitoring and creating employment without substantial government interference. Also, part of the reorganization was to improve the job placement program by beginning individually-designed programs to assess each job seeker's unique needs. Further, the creation of job centers enabled the unemployed to go to a central location and receive all the information, which they required to find employment. These changes significantly improved the job-seeking experience from the previous spread out, disorganized, and on-size-fits-all style job placement. Further, the old system did not incorporate employers seeking new hires.⁸⁷

⁸⁵ Kemmerling, 98. Note: the unemployed more than a year cannot refuse a job even if they are overqualified for the position. Also, to activate jobseekers, sanctions of reducing benefits can be imposed at three, six, and 12 months as a way to force the unemployed to continue the searching for employment.

⁸⁶ Kemmerling, 93.

⁸⁷ Kemmerling, 94.

Another major piece of the Hartz Reforms was the adaptation of Germany's unemployment benefits system under Act IV. The first reform was to the unemployment benefit, which now only lasted one year. Once that period ended, unemployment benefits dropped to the equivalent income of just above the poverty line. The second stage was the same as the social assistance program in the original system (given to only those who did not qualify for unemployment benefits or assistance consisting of monthly income payments above the poverty line); however, the person just loses income (western Länder unemployed received €345 and eastern Länder unemployed received €331 per month), and he/she still received additional assistance for housing and health care. Finally, the old social assistance program was maintained, but only for people on disability or medically unable to work long hours.⁸⁸ The Commission claimed that these reforms would reduce German unemployment by half in three years and decrease the overall costs of the unemployment benefits system by 66 percent within that time-period.⁸⁹ What actually happened was an increase in unemployment. For example in Mecklenburg-Vorpommern, the unemployment rate increased from 17.80 percent in 2000 to 20.30 percent in 2005.⁹⁰

Schröder's policy reform Agenda 2010, instituted in March 2003 was a failure. Agenda 2010 was designed to increase German competitiveness in the global market. His plan comprised a series of major tax cuts for the population (15 billion Euros). The tax cuts were a last-ditch effort to gain public support, but they failed due to extreme

⁸⁸ Kemmerling, 96.

⁸⁹ Streeck, "Economic Reform," 11.

⁹⁰ "Country Data at a Glance: Employment (Annual Average)," *Mecklenburg-Vorpommern Statistics*, http://www.statistik-mv.de/cms2/STAM_prod/STAM/de/start/index.jsp

opposition from the CDU. The opposition party did not support reducing taxes, which they felt would increase the deficit, and the welfare system had to be financed by increasing the already high payroll contributions burdening the public.⁹¹

In sum, Schröder's reform campaigns all ended in failure, and his public support dwindled. As a result Chancellor Schröder called for early elections in 2005. Gerhard Schröder and his party, the SPD, lost to Angela Merkel from the CDU, Germany's first female and former GDR resident Chancellor.

The Rise of Chancellor Angela Merkel

Chancellor Angela Merkel grew up in Brandenburg under the GDR. She witnessed firsthand the power of the East German secret police force, the Stasi, because her father was blacklisted because he was a minister,⁹² resulting in her choice to remain out of politics until unification. Merkel's first career was as a physicist since it would keep her away from the Stasi, and scientific careers were considered very prestigious within the GDR. Once the Wall fell she began her political involvement. Upon unification she joined the CDU and chose a career in politics, and as an eastern scientist she was likely to have lost her position.⁹³

Once Merkel solidified her position as Chancellor, she wanted to reform the welfare system; however, she did not support the continuation of Schröder's welfare reforms. She believed in the market system since she understood the negative effects of

⁹¹ Streeck, "Economic Reform," 12.

⁹² Note: blackmailing was used in the article; however, because of the risks involved in being a minister in the GDR it is more likely he was blacklisted by the State Security (Stasi). Blacklisting meant complete career decimation and very invasive surveillance practices.

⁹³ Mark R. Thompson and Ludmilla Lennartz, "The Making of Chancellor Merkel," *German Politics* 15, no. 1 (2006): 90-103.

the GDR's command system. Unlike Schröder's plan she wanted to promote reform slowly to allow the population and system as a whole time to adapt to the changes.⁹⁴

Her reform package, the Leipzig Programme, consisted of four main components: introduce a flat fee for health care contributions, increase the retirement age with a minimum required number of years worked, decrease unemployment contributions, and create a three-level taxation system. Due to dropping public support for her reforms, Merkel adapted her policies. The end result was a standard 109 Euro monthly contribution to health care and a cap on unemployment contribution at no more than seven percent of gross wages. The pension reform that raised the retirement age from 60 to 67 and taxes from the new three-level system, which was capped at 37 percent of wages, would provide the welfare funding for children, low income, and the elderly. The reform packages once again reduced the party's popularity and increased fragmentation within it. To maintain the party's popularity and keep it together, Chancellor Merkel stopped reforming the system after the Leipzig Programme.⁹⁵

In 2008, the world went into an economic recession and financial crisis primarily from the United States' housing market collapse. Since 2008, Chancellor Merkel has been focused not just on saving the domestic economy within Germany, but also the entire economy of the European Union. Her Leipzig Programme led the domestic German economy to continuous positive growth for last two years. The success of Merkel's domestic policies is shown by the German Institute for Economic Research (IAB) 2011 prediction that unemployment within Germany will decrease from 2.984

⁹⁴ Clay Clemens, "2 Steps Forward, 1 Step Back: Merkel's CDU/CSU and the Politics of Welfare State Reform," *German Politics* 16, no. 2 (2007): 229-232

⁹⁵ Clemens, 235.

million in 2011 to 2.868 million in 2012. What is important to note here is from 2005 to 2011 the unemployment rate plummeted.⁹⁶ In Mecklenburg-Vorpommern the unemployment rate dropped significantly from 20.30 percent in 2005 to 12.70 percent in 2010.⁹⁷ Within Saxony-Anhalt, the average unemployment rate in 2008 was 13.9 percent⁹⁸, which dropped to 12.5 percent in 2010.⁹⁹ Saxony had an unemployment rate of 11.20 percent in 2010 versus 12.9 percent in 2009.¹⁰⁰ The region of Thüringen's unemployment rate dropped from 14.3 percent in January 2008¹⁰¹ to 7.8 percent in November 2011.¹⁰² In 2010, Berlin's unemployment rate was 15.9 percent and Brandenburg was 12.3 percent.¹⁰³ In 2005, when Schröder was still in office, over five million Germans had been unemployed since unification.¹⁰⁴ In six years, Angela Merkel's policies reduced unemployment by approximately 60 percent, which is a

⁹⁶ "German Economy Defies Crisis," *Der Spiegel*, 15 November 2011, www.derspiegel.de/international.

⁹⁷ "Country Data at a Glance: Employment (Annual Average)," *Mecklenburg-Vorpommern Statistics*, http://www.statistik-mv.de/cms2/STAM_prod/STAM/de/start/index.jsp

⁹⁸ "Unemployed and Unemployment Rates in the Country Districts in Saxony-Anhalt to Average in 2008," *Statistisches Landesamt Sachsen-Anhalt*, http://www.stala.sachsen-anhalt.de/Internet/Home/Daten_und_Fakten/1/13/132/index.html

⁹⁹ "Unemployed and Unemployment Rates in the Country Districts in Saxony-Anhalt to Average in 2010," *Statistisches Landesamt Sachsen-Anhalt*, http://www.stala.sachsen-anhalt.de/Internet/Home/Daten_und_Fakten/1/13/132/index.html

¹⁰⁰ "Labor Market," *Statistisches Landesamt des Freistaates Sachsen* <http://www.statistik.sachsen.de/genonline/online/logon>

¹⁰¹ "Labor Market Monthly Data in Thüringen 2008," *Thüringer Landesamt Für Statistik*, <http://www.tls.thueringen.de/startseite.asp>

¹⁰² "Labor Market Monthly Data in Thüringen 2011," *Thüringer Landesamt Für Statistik*, <http://www.tls.thueringen.de/startseite.asp>

¹⁰³ "Unemployment Rate," *Statistik Berlin und Brandenburg*, <http://www.statistik-berlin-brandenburg.de/>

¹⁰⁴ Gabor Steingart, "The German Defeat," *Der Spiegel*, 26 July 2005, www.derspiegel.de/international.

tremendous success. After her Chancellorship ends and more time passes, a full assessment of her reforms and economic policy will be available.

In sum, in January 2000 two years after Schröder's election the German government spent \$19 billion on welfare alone.¹⁰⁵ In addition, the costs of unification resulted in 90 billion Euros each year in transfer payments from the western Länder to the eastern Länder since 1990 to cover reconstruction and unemployment. Clearly welfare reform was necessary; however, Schröder's reform attempts failed.¹⁰⁶ Unification strained the welfare system by injecting a large number of people into the labor market with unrealistically high wages. Those who could no longer find employment relied on social assistance to maintain their standard of living. The benefits provided by the original German welfare system did not provide incentives to get eastern or even western unemployed Germans back into the labor market, and the high costs associated with non-wage labor discouraged businesses from hiring and encouraged them to provide early retirement. All of these combined to exacerbate unemployment until 2005 when Chancellor Angela Merkel won the early elections. Merkel's successful reform efforts combined with the EU's Regional Cohesion Policy's structural funds' programs within the eastern Länder are improving the eastern economy. There is again hope for development within eastern Germany 20 years after unification.

¹⁰⁵ Andreas Tzortzis, "German State Debates Welfare Reform, Wisconsin Style," *Christian Science Monitor* (2001): 7.

¹⁰⁶ William Boston, "Germany Unified, but Easterners are Dissatisfied," *Christian Science Monitor* (2004): 6-7.

Chapter 4: EU Developmental Assistance for the Former GDR

The evolution of the European Union (EU) has promoted further economic integration to benefit the development and economic competitiveness of its member states. The EU developed multiple regional cohesion policies in the form of the Structural Funds such as the European Social Fund (ESF), the European Regional Development Fund (ERDF), and the Cohesion Fund to advance its less prosperous areas. These development assistance programs aim to foster fair competition internally between member states, increase the EU's overall competitive edge in the global market, and ensure the economic stability of the entire EU.

The five new Länder are a unique case for the EU Structural Fund programs because of their complex relationship with the strong economy of West Germany. Unlike other post-communist transitioning areas in Central and Eastern Europe, East Germany inherited significant financial assistance, democratic institutions, free market infrastructure, and automatic EU membership upon its official unification with West Germany. Despite the benefits of unifying with the strongest economy in the EU, the eastern Länder still struggle to develop to a comparable level with both the EU and Germany.

The developmental challenges that the five Länder face are important to investigate as several countries in the world may experience similar transition challenges, such as North and South Korea. Furthermore, the EU prides itself on its ability to distribute aid and technical assistance throughout the world. As a soft power institution, development is a key element to the EU's foreign policy and international legitimacy. If

the EU cannot fully develop its own regions, especially a region in its wealthiest country, how credible will its development programs be perceived?

A reason former East Germany struggles to develop is because of the legacy of unification economic policies, which created endemic institutional problems within the FRG. But, the EU Regional Structural Funds' specialized development programs are assisting the five eastern regions by providing job training, job placement, and infrastructure development programs.

Long-term unemployment is an enormous issue in the east. The EU established specialized programs, such as vocational training, job placement, and Western language courses specifically address the severe long-term unemployment issue within all five Länder. Other economic issues within the region include infrastructure and educational deficits mainly from years of "Brain Drain" (highly educated people leaving the region) and above-average high school dropout rates.

The EU is attempting to correct each major issue through its regional Structural Funds. The unemployment and educational problems are addressed through its European Social Fund (ESF). Infrastructure projects such as establishing modern advanced telecommunications and rail systems fall under the auspices of the Cohesion Fund. The EU is making progress; however, many of its efforts are thwarted by the legacy of twenty-year old domestic challenges. The costs of unification, the economic policies enacted during unification under Chancellor Kohl, and the failed welfare reforms under Chancellor Gerhard Schröder all contribute to high unemployment.

Understanding the unification policies and their impacts on East Germany's development is important when assessing the success of EU Structural Funds. East

Germany benefitted from immediately gaining EU membership following unification because of its access to the EU's development programs and internal market.

History of the European Union

The EU's history began at the end of World War II when countries in Europe experienced a transformation in their view of solving disputes with violent conflict. After experiencing brutal human rights violations and modern warfare during World War II, Europe needed to develop an alternative to traditional war for conflict resolution. Economic integration emerged as the solution.

France, West Germany, Belgium, Luxembourg, the Netherlands, and Italy suffered significant infrastructure, economic, and demographic losses during the war. To assist their post-war recovery and prevent another war, the countries linked their economies together with the Treaty of Paris in 1951 to form the European Coal and Steel Community (ECSC). The ECSC formed the EU's foundation and established the importance of economic development and assistance to maintain peace and security.¹⁰⁷

The ECSC began the restoration process by sharing necessary coal and steel natural resources. The organization formed from the vision of Robert Schuman and Jean Monnet who saw the integration of Europe as necessary to maintain peace and security in Europe and fervently believed that the reconciliation of France and West Germany was a critical component to achieving it. The ideals and integrative elements established within this institution redefined Western European identity and created one of the most unique intergovernmental institutions in the world approximately forty years later.¹⁰⁸

¹⁰⁷ Neill Nugent, *The Government and Politics of the European Union* (New York: Palgrave Macmillan: 2010), 5.

¹⁰⁸ Nugent, 19-20.

With the success of the ECSC and the fears surrounding the escalating Cold War between the two superpowers the signatories began examining the possibility for further economic integration. Economic integration became the mechanism to expand peace and security within Western Europe. This view resulted in the Treaty of Rome establishing the European Economic Community (EEC) in 1957.¹⁰⁹

The EEC established a common market among the Treaty of Rome signatories. Economic policy of the EEC is explicated in four main points applicable only to signatory states. First, it abolished internal tariffs and quotas to establish the free trade area on all goods and services. Second, it established the Common External Tariff (CET) applied to all imported goods. Third, the creation of competition policies to foster economic prosperity and increase trade between EU member states and internationally. Finally, the Treaty of Rome established the free movement of people, services, and capital. These founding four points are still relevant and integral to the establishment of present EU economic policy.¹¹⁰

The Treaty of Maastricht (1992) established the EU, its current institutional framework, and the development of the common currency, the Euro. Maastricht began the supranational transformation of the EU by establishing two additional institutional pillars and introducing a common monetary policy. The treaty developed without the full approval of all its components by the European people, as evidenced by the 70 percent of the German population opposed to giving up their Deutschemark (DM) for the Euro.¹¹¹

¹⁰⁹ Nugent, 22-23.

¹¹⁰ Nugent, 24-32.

¹¹¹ Birol A. Yesilada and David M. Wood, *The Emerging European Union*, Longman: Pearson Education Inc.: 2010, 48.

The EU's evolution required member states to yield some of their national interests and sovereignty to greater European goals and ideals.

One relevant EU requirement established after Maastricht was membership criteria. Due to the legacy of communism and the harsh conditions of transition within the Central and Eastern European countries, the EU created four membership requirements. First, the country applying must demonstrate "Europeanness," meaning there is a cultural and historical connection to Europe. Second, politically, the applicant country must be a democracy characterized by rule of law and protection of human rights. Third, the country must have a free market economic system. Finally, the country must want to be part of the overall missions and values of the EU and must adopt all EU laws and regulations. The former GDR was exempt from membership requirements unlike its post-communist Central and Eastern European neighbors because it merely acceded to an existing member state.¹¹²

It is important to understand the historical development of the EU because the theme throughout its development is economic assistance, integration, and development, all of which are promoted by its Structural Funds. The EU, from its foundation as the ECSC, was designed to develop signatory states at a relatively equal rate through the elimination of quantitative and qualitative trade barriers between them. As the EU developed, the evolution of its soft power potential through economic cooperation became evident as member states maintained peace and security. With each EU enlargement, common development and economic assistance programs for less developed member states, or particular EU regions remained a critical component to maintaining the

¹¹² Yesilada, 55-67.

customs union and trade competition (both internal and external), which resonates today with the successes of its regional policies and programs.

Regional Cohesion Policies and Structural Funds

EU member states need to be adequately developed to promote internal and external competition. The current goals of the regional cohesion policy are to increase research and development and innovation and foster development in less developed regions within member states as a means for the European Union to maintain a competitive edge in the global economy.¹¹³ To remain competitive, the EU must continuously innovate in the most cost-effective manner to compete with Asia, in particular China.

Regional cohesion is necessary for the stability of the Euro and European economy. The importance of members' economic stability is more profound after the 2008/2009 financial crisis and the questionable stability of several EU member states, including Greece, Ireland, Spain, and Portugal. Due to the financial crisis and the increasing need for innovation, regional programs, specifically Structural Funds, now receive more EU funding than the Common Agricultural Policy (CAP), making the programs the largest-funded project within the EU.¹¹⁴

Further regional development funding and programs assist the EU to achieve further integration because of the increasing role of state and local government. Regional cohesion policy programs are designed specifically for the locality; therefore, the role of local government in the process can overshadow the federal government or central

¹¹³ Lain Begg, "Cohesion or Confusion: A Policy Searching for Objectives." *Journal of European Integration* 32, no. 1 (2010): 77-78.

¹¹⁴ Begg, 77.

government in countries without a federal system. Local government involvement not only assists with local problems, but also legitimizes the federal system and local institutions. Legitimizing local institutions is particularly important in the new member states of Central and Eastern Europe. The EU benefits from local governments bypassing the central government because power lines between the central and local governments are blurred. Local governments are able to bypass the central government and go directly to the EU if the central government is not adequately addressing their specific local needs. This local connection to the EU leaves the potential for further political deepening of integration between EU member states.¹¹⁵

Regional development policies and their subsequent programs are beneficial to the European Union and each recipient country. The programs require partnerships between local, national, and EU-level governing bodies to adequately design and designate funding. For countries recently transitioning from communism to democracy, the chance of regional funding incentivizes establishing a strong federal system that can work effectively with the EU. Increased training opportunities in lucrative fields combined with free labor movement benefits the local population by increasing their chance of employment. Regional Policy success enables the European Union and its member states to remain internationally competitive.¹¹⁶

EU regional cohesion policies began out of necessity because of expansion into poorer regions. Enlargement created disparities between the established and new member states that needed addressing in order to further develop the Union's economic potential.

¹¹⁵ Begg, 83.

¹¹⁶ John Bachtler and Gorzelak Grzegorz, "Reforming EU Cohesion Policy: A Reappraisal of the Performance of the Structural Funds." *Policy Studies* 28, no. 4 (2007): 317-319.

The second EU enlargement to Greece (1981) and Spain and Portugal (1986) after their authoritarian regimes collapsed in the 1970s forced the European Community (EC) to establish convergence policies to assist the new poorer states develop quickly to lessen the disparities between the existing member states. Following the end of the Cold War, regional convergence came to the forefront again with the potential for enlarging via the post-communist Central and Eastern European states. After witnessing the reconstruction expense for East German unification (the FRG debt increased to 70 percent of its GDP from 1990 to 2006),¹¹⁷ developing transition assistance to ensure successful convergence to democracies and capitalism within the former communist countries became an EU priority. The 2004 enlargement into the post-communist countries required another reassessment and reform of the policies under Agenda 2000 to accommodate the increasing number of lesser-developed countries within the EU.¹¹⁸

Driving the regional policy and structural funding is the 2010 Lisbon Strategy developed in 2007. That focuses on job creation and competitiveness through the promotion of information and communications technologies (ICT). Member states agreed that digital communications and technological development was the best solution for increasing labor productivity and EU competitiveness. Telecommunications infrastructure development is at the core of most of the structural funding including projects to increase broadband and high data transfer applications, such as 4G cellular phones. Since the commencement of the strategy broadband capabilities of the EU as a whole increased by

¹¹⁷ Streeck, "Re-forming Capitalism," 69.

¹¹⁸ Yasilada, 152.

15.7 percent, and 76 percent of teachers are able to utilize digital technologies as classroom aids.¹¹⁹

Europe 2020 is the current strategy of the Regional Policies for the 2007-2013 budget cycle. The strategy developed in March 2010 to promote five target areas: employment, innovation, education, social inclusion, and energy policies. Within these areas the EU established universal and national goals to achieve by 2020. For employment the EU strives to have 75 percent of abled people between 24 and 64 years of age employed. It plans to have at least three percent of the EU's total Gross Domestic Product (GDP) invested in Research and Development (R&D) to satisfy the area of innovation. There are two components to education: to decrease the high school dropout rate to less than ten percent and increase collegiate level education to 40 percent within the 30-34 year old range. Social inclusion areas strive to decrease poverty by 20 million people. Finally, the energy and climate change area has the most targets, which include decreasing greenhouse gas emissions to 70 percent of 1990 levels, increasing the use of renewable energy by 20 percent, and increasing energy efficiency by 20 percent.¹²⁰

The strategies are one component of the European Union Regional Policy and its funding. The strategies guide the focus of the programs that divide regions into three objective groupings based on development. Least developed regions are classified under Objective One or the Convergence Objective. Regions qualify for this objective if their Gross National Income (GNI) is under 75 percent of the EU average GNI. In the last reported cycle from 2000-2006, over two-thirds of EU structural funding is designated

¹¹⁹ European Commission, "The Lisbon Strategy and Information Society," *European Union*, March 2007, http://ec.europa.eu/information_society/eeurope/i2010/

¹²⁰ European Commission, "Europe 2020 targets," *European Union*, <http://ec.europa.eu/europe2020/targets/eu-targets/>

towards this particular group of regions, which totals over 135 billion Euros. In addition to GNI, other economic indicators are used to determine if a region qualifies for Objective One such as lack of investment, high unemployment rates, low levels of service, and lack of basic infrastructure. All five eastern Länder in Germany qualify for Objective One structural funding.¹²¹

Objective Two concentrates on regions struggling with specific structural problems, for example urban and rural development. The main difference between Objective One and Two is that regional economic indicators for Objective Two candidates are close to EU averages. In Germany, former East Berlin and the prior east-west border areas qualify under Objective Two.¹²²

Lastly, Objective Three aims to promote human development by increasing labor competitiveness among member states. The goal is to continuously decrease unemployment and increase human capital flexibility. Furthermore, Objective Three seeks to promote lifelong learning and vocational training to ensure equitable access to employment. Most of the western Länder fall into this category, but the eastern Länder do not qualify because they remain under 75 percent of the EU average GNI.¹²³

The EU established three main regional cohesion instruments to decrease economic disparities, increase job opportunities, and increase competitive industries. The three include the European Regional Development Fund (ERDF), the European Social

¹²¹ European Commission, “Regional Policy Objective One: Supporting Development in Less Prosperous Regions,” *European Union*, http://ec.europa.eu/regional_policy/objective1/

¹²² European Commission, “Regional Policy Objective Two: Revitalizing Areas Facing Structural Difficulties,” *European Union*, http://ec.europa.eu/regional_policy/objective2/

¹²³ European Commission, “Regional Policy Objective Three: Development of Human Resources,” *European Union*, http://ec.europa.eu/regional_policy/funds/prord/obj3/

Fund (ESF), and Cohesion Fund. The Common Agricultural Policy (CAP) also manages agricultural structural funding. Other programs include the European Bank for Reconstruction and Development (EBRD), the European Investment Group (EIG), which is comprised of the European Investment Bank (EIB) and European Investment Fund (EIF), and additional programs for environmental and institutional development; however, the focus of this paper will only concentrate on the three main regional structural funding programs using former East Germany as a case study.

The first structural funding group is the European Social Fund (ESF) established as the ECSC Fund for Retraining and Resettlement of Workers in 1951. In 1957 with the Treaty of Rome and the creation of the EEC, the ESF replaced the Fund for Retraining and Resettlement of Workers. As part of the EEC the ESF primarily focused on the free movement of labor and ensuring job opportunities for workers throughout the Community. After 1975, the ESF combined with the ERDF to create the EU Structural Funds, but still concentrated on job training and worker placement. It became important in the 1970s when the economy declined due to enlargement and the oil crisis. In the 1980s the ESF's identity changed slightly because of the general shift in European economic sectors from industry to services. Instead of concentrating solely on workers, the ESF began vocational training to ensure that labor could be flexible with changing technologies. Between 1986 and 1988 the ESF trained and found employment for two million people a year. In the 1990s the Structural Funds gained the Cohesion Fund for infrastructure and environmental projects to create the three main regional funding programs. Presently the ESF works within the Lisbon and Europe 2020 strategies to invest in the European people as a means to reduce unemployment and increase

knowledge as technology advances. The current budget of approximately 76 billion Euros is divided among projects within each of the 27 EU members.¹²⁴

Economic pressures in the 1970s, such as the global economic downturn, the oil crisis, and the 1975 enlargement into Greece, Spain, and Portugal led to the EEC decision to establish the second Structural Fund program, the European Regional Development Fund (ERDF) in 1975. The ERDF began with a 1.3 million European units of account (EUA) to assist with the financial pressures the EU felt in the 1970s.¹²⁵ The ERDF currently finances investments into small-and-medium-size enterprises (SMEs) to promote employment opportunities. Also, it funds infrastructure projects particularly in research and development, technological developments, and energy. In addition, it provides loans, grants, and financial tools to small towns and cities for local development. Finally, it funds technical assistance programs. In comparison to the other Structural Fund programs, the ERDF assistance is achieved through financial instruments, rather than training or infrastructure building.¹²⁶

The final structural funding program is the Cohesion Fund, officially established in 1994 and stipulated in the Maastricht Treaty to assist member states with a Gross National Income (GNI) per inhabitant less than 90 percent of the EU average. The Cohesion Fund provides economic assistance and functions only for states qualifying for the convergence objective. Its current operations for the 2007-2013 budgetary periods are mainly in Bulgaria, Cyprus, the Czech Republic, Estonia, Greece, Hungary, Latvia, Lithuania, Malta, Poland, Portugal, Romania, Slovakia and Slovenia. Activities within

¹²⁴ European Commission, “What is the ESF?” *European Union*, <http://ec.europa.eu/esf/>

¹²⁵ Yasilada, 153.

¹²⁶ European Commission, “European Regional Development Fund: The Funds,” *The European Union*, http://ec.europa.eu/regional_policy/

those member states include updating transportation networks and energy industries, specifically clean and renewable energy.¹²⁷

Each component of the Structural Funds that comprise the EU's Regional Policy strives to increase EU economic competition and development. Both goals are integral in the development of the EU as an international actor and as a credible intergovernmental institution. The EU's dedicated history to economic development and integration are critical elements to the overall long-term stability of Europe. As such, these regional programs maintain the core values established at the onset of the EU and continue to serve their purposes for new member states, or regions in the case of East Germany. The following section will examine the different programs and projects the Structural Funds utilize to assist the former GDR in increasing its development as it continues on its path towards reaching EU standards or averages.

EU Structural Funds and the Development of the Former GDR

The EU's Structural Funds contributes to the development of the former GDR. The ESF and ERDF contribute the most to the continual process of upgrading the infrastructure and employing the labor within the five eastern Länder. East Germany does not qualify for Cohesion Fund programs because all five regions' GNI is above 90 percent of the EU average. As explicated in the German history section, the unification policies initiated by Chancellor Helmut Kohl hindered eastern development by subsidizing the population and industry, rather than instituting austerity as in other communist transitions. Unification policies are one of the main reasons for the former GDR's struggling development. In the current EU budget cycle (2007-2013), eastern

¹²⁷ European Commission, "Cohesion Fund," *European Union*, http://ec.europa.eu/regional_policy/thefunds/cohesion/

Germany's GDP per capita only reaches 68 percent of western Germany's levels and less than 75 percent of the EU average. The unemployment rate is twice as high as its western counterpart. It is also important to note that Germany as a whole, even with underdevelopment in the east, exceeds EU-25 averages, demonstrating the importance of regional convergence policies bridging development gaps within particular countries. As such, it is important to examine EU programs contributing to the future success of the eastern regions within Germany.¹²⁸

As discussed previously, unification allowed East Germany to inherit West German institutions, including its vocational training. West Germany's vocational training program was designed for trainees and industries to work together through a training process to ensure employment upon course completion. East Germany needed training infrastructure, such as buildings, trainers, participating businesses, and marketing campaigns in order for the western vocational training system to work. At the onset of the program, East Germany faced a terrible shortage in training facilities as well as industries willing to participate. Industry in East Germany was slowly eroding as factories had outdated machinery and inefficient, high-paid employees. To compound the shortage of training facilities and industry partners, students across East Germany began dropping out of university to participate in the eastern region's version of the western-style vocational programs. The increased demand for the ill-prepared programs forced many students to

¹²⁸ European Commission, "European Social Fund in Germany, 2007-2013," *European Union*, <http://ec.europa.eu/esf/>

go to the western regions for training and employment, rather than remaining in the east.¹²⁹

The European Social Fund (ESF) began assisting with the vocational training situation within East Germany. The ESF historically trained young workers and placed unemployed workers with jobs in order to reduce the total unemployment rate across Europe. Language barriers became a major challenge for the ESF within East Germany. Teaching the eastern population Western languages, particularly English and French, became a top priority for the ESF to ensure that trained workers could find employment not only in western Germany, but also across the European Union.¹³⁰

The ESF program was only partly successful during the East German transition process between 1991 and 1998 because of problems encountered throughout the process such as bureaucracy. EU bureaucracy became a main problem in the new regions. Eastern regional governments experienced difficulty comprehending the EU paperwork chain to maintain training funds. The language barrier proved to be more significant than anticipated. Teachers of potential students for the vocational training program were unaware of the ESF and West German training programs. The ESF only funded half of the training, which created problems for East Germany since it could not afford to pay the other half. Finally, the eastern infrastructure was unsuitable for extensive training programs. Unification and the inheritance of the western governing institutions and

¹²⁹ Hubert Ertl, "The Transition of Vocational Education and Training in Eastern Germany: Notes on the Role of European Union Programs," *Comparative Education Review* 44, no. 4 (2000): 468-469.

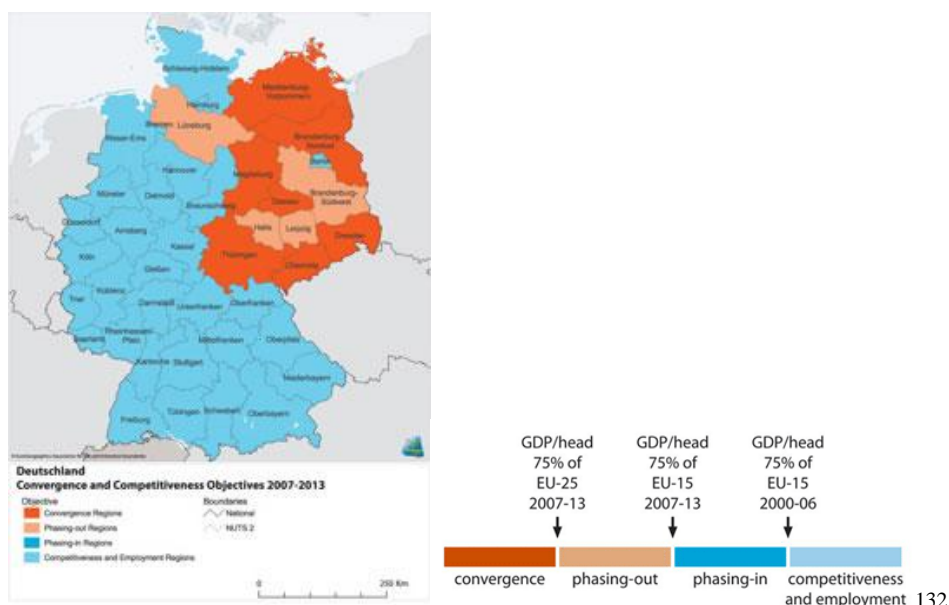
¹³⁰ Ertl, 476.

membership into the EU happened too fast for there to be an institutional framework and trained employees knowledgeable enough to sustain such a program.¹³¹

The vocational training programs faced challenges and were only partially successful in East Germany because of institutional, excess labor supply, and infrastructure problems. Since the Lisbon Strategy and Europe 2020 initiatives, several Structural Fund programs have been successful in East Germany. The following section examines the Structural Fund programs in each of the Eastern Länder.

The Structural Funds list the five former East German regions, Mecklenburg-Vorpommern, Brandenburg, Saxony-Anhalt, Saxony, and Thuringia, as eligible for funding and programs. At the onset of the Lisbon Strategy, all five Länder's Gross National Income (GNI) were 75 percent lower than the EU average qualifying them for Objective One with the Structural Funds. With the new Europe 2020 strategy and the 2007-2013 budget cycle Southern Brandenburg-Südwest and several cities, including Leipzig and Halle, increased their per capita GDP enough to be considered for Objective One phase out into Objective Two funding. The following map depicts the regions and their Objective category:

¹³¹ Ertl, 482-488.



The European Social Fund (ESF) currently is operating 18 different programs within Germany. It is working with the Federal Republic on funding programs to meet four priority objectives between 2007-2013 for the Lisbon and Europe 2020 strategies. These priorities include adaptability of workers, enhancing human capital, access to employment, and transnationality. Priority One, adaptability of workers, concentrates efforts on promoting small businesses and entrepreneurship in order to ensure skilled labor is able to integrate with changing technology and job opportunities are created through entrepreneurs. Priority Two, enhancing human capital, trains the youth and promotes lifelong learning as a way to meet the goals of higher education and reducing high school drop-out rates. Priority Three, access to employment, creates employment opportunities in efforts to reduce overall EU unemployment as well as bridge the regional unemployment gaps. Finally, Priority Four, transnationality, encourages the youth to be

¹³² European Commission, “European Social Fund in Germany, 2007-2013,” *European Commission*, <http://ec.europa.eu/esf/>

internationally involved and seeks to reduce discrimination and sexism, which aligns with global and EU- specific mission goals.¹³³

The ESF successfully completed many programs in eastern Germany. The region of Thüringen in eastern Germany experienced success with ESF programs. One goal that the region strove to reduce was long-term unemployment, which is a major problem for many eastern regions. The unemployment rate in Thüringen at the onset of the project (2007) was 67.7 percent. The project is currently subsidizing training programs for young people, women, men over 50, and the disabled to help integrate them back into the labor market. The program led to the employment of 4,033 young people, 6, 133 women, 596 men over 45, and 79 disabled people for a total of 10,841 people previously unemployed.¹³⁴

Within the region of Saxony, significant progress is being made in the current cycle. Saxony is struggling with an 8.7 percent high school dropout rate among its youth. As a result, the ESF began vocational training programs that successfully trained and employed 10,000 young people in the region between 2007 and 2009. In addition, small cooperative education programs began assisting the education of young people. Since the cooperative program began 400 young people were trained and gainfully employed. Another youth-focused program targeted subsidized scientific education, providing 193 graduates in 2009 the opportunity to complete graduate degrees. Finally, a small business initiative trained 5,800 people in advanced technologies to increase the region's small business community. Overall the region's unemployment rate dropped eight percentage

¹³³ "European Social Fund in Germany, 2007-2013," <http://ec.europa.eu/esf/>

¹³⁴ European Commission, "European Social Fund in Thüringen Germany, 2007-2013," *European Union*, <http://ec.europa.eu/esf/>

points between 2006 and 2008, but it still struggles with long-term unemployment consistent with the other eastern Länder from the unification policies and subsidization.¹³⁵

Saxony's neighbor, Saxony-Anhalt, needs even more assistance with employment. In 2006 one-tenth of the population was deemed long-term unemployed, and unemployment overall was at 18.6 percent. Due to the economic downturn, industries typical to the region like tourism, construction, and agriculture disappeared. Further, between 2005 and 2006 the population declined eight percent as people began migrating to other regions. The ESF focus in this region is job creation to reduce the unemployment rate, particularly long-term unemployment. An entrepreneurship program started in 2002 was experiencing great success by 2005 with a nine percent increase in small businesses in the region. As a result, the program is continuing through the present 2007-2013 budget cycle.¹³⁶

The northern-most region of Mecklenburg-Vorpommern suffers from a demographic crisis, low degree rates in young people, migration, and lack of competitive industries. The population declined by eight percent (1.66 million) in 2006 caused by three main factors. Out-migration to more urban areas is a contributing factor for Mecklenburg-Vorpommern's population decline. Aging populations are another factor in the population decline; however, older populations are challenging population growth throughout economically developed countries, not just the eastern regions within

¹³⁵ European Commission, "European Social Fund in Saxony Germany, 2007-2013," <http://ec.europa.eu/esf/>

¹³⁶ European Commission, "European Social Fund in Saxony-Anhalt Germany, 2007-2013," <http://ec.europa.eu/esf/>

Germany. To compound population decline, women in the region are the majority of the migrants, which is negatively impacting the birth rate.¹³⁷

In addition to population decline, high school graduates decreased nearly 50 percent since 2002 when 21,000 people obtained degrees. In 2011, the region estimates that less than 10,000 people will graduate. To combat the increasing high school dropout rate, the ESF began a micro-loan program for the region with a five million Euro budget. The main project in the region is “School Plus” that helps keep young people in school above the eighth grade. The project is currently working with 4,000-7,000 children each year to train them in skills that they are interested in as a way to encourage them to at least complete secondary education.¹³⁸

Throughout these projects there are several common issue areas that the eastern Länder face. Endemic unemployment and long-term unemployment are the main areas that the ESF is trying to impact. Both of these problems originate with unification and the social welfare system of the Federal Republic. As already discussed in the unification section, high wages negotiated at the time of unification made labor intensive employment opportunities less profitable, thus creating a situation of high unemployment. Furthermore, the projects initiated by the Federal Republic to retool factories to enhance productivity encouraged capital-intensive investment and lessened the need to employ more workers. Finally, the welfare system still needs additional reforms to decrease long-term unemployment of people dependent on state assistance and to reduce the fiscal strain on the working populations financing the system. Like many welfare states, the

¹³⁷ European Commission, “European Social Fund in Mecklenburg- West Pomeranian Germany, 2007-2013,” <http://ec.europa.eu/esf/>

¹³⁸ European Commission, “European Social Fund in Mecklenburg- West Pomeranian Germany, 2007-2013,” <http://ec.europa.eu/esf/>

people of eastern Germany are provided for by the state, which gives them little incentive to find employment.

In addition to the ESF, the other Structural Fund program involved in east German development during the 2007-2013 budget cycle is the European Regional Development Fund (ERDF). It is currently operating several programs throughout the five eastern Länder. The goals and objectives that the ERDF set forth for each region will be highlighted followed by a program example. The ESF programs are improving the situation within the eastern Länder, but are fighting an uphill battle with the welfare system because the Federal Republic perpetuates the current state of high unemployment in these regions. The recent success of Chancellor Merkel in reducing unemployment and gradually reforming the welfare system may enhance the effects of the ESF programs since unemployment benefits are becoming harder to obtain.

An ERDF project currently underway in all of Germany focuses on transport infrastructure to improve the Trans-European Transportation Network. The Trans-European Transportation Network is designed to connect the entire continent with modern, energy efficient rail systems and updated roadways, resulting in easier transportation of goods, capital, and people. The projects are allocated 2.33 billion Euros, or 5.8 percent of all funds provided to Germany. Improving transportation infrastructure within Germany's eastern regions is necessary because of the legacy of communist rule and because Germany geographically connects many of the European Union's newer and

older member states. The EU aspires to have the continent thoroughly connected to increase the sense of “Europeanness” and ensure the free movement of people.¹³⁹

Mecklenburg- Vorpommern qualified for ERDF programs because its current GDP per capita only reaches 72.56 percent of the EU-25 average. Given its lower GDP per capita, the ERDF objective within the region is creating sustainable economic growth by increasing employment rates and investing in innovative entrepreneurship as a means to attract investment. If the programs implemented within the region are successful, approximately 9,160 new jobs would be created, 22,640 jobs would be maintained, and 15 business cooperation projects would be created.¹⁴⁰

Just after unification, the ERDF began successful investment projects within eastern Germany. In the mid-1990s industry in Mecklenburg-Verpommern felt the negative economic consequences of unification. Industry was outdated and unable to compete in the global market. Lack of competitiveness resulted in factories closing and high unemployment. One company, Webasto Sirokko GmbH, wanted to survive the economic downturn and requested aid from EDRF to save its factory by upgrading the factory’s machinery and infrastructure. Aid from the ERDF enabled Webasto Sirokko GmbH to build an environmentally-friendly building and enhanced the manufacturing process of its heating and air conditioning units. The company made six million Deutschemarks in profits one year after completion and maintained 300 jobs for the

¹³⁹ European Commission, “Transport Infrastructure of the Federal Republic of Germany,” *European Commission Regional Policy*, July 07, 2007.
www.ec.europa.eu/regional_policy/country

¹⁴⁰ European Commission, “Development Programmes: Germany Operational Programme ‘Mecklenburg-Vorpommern,’” *European Commission European Regional Development Fund*, last modified September 27, 2007,
www.ec.europa.eu/regional_policy/country/.

region. The company currently supplies heating and air conditioning units for recreational vehicles and buses throughout Germany and the EU.¹⁴¹

The region of Brandenburg is receiving development funding for the 2007-2013 budget cycle totaling two billion Euros to improve business innovation and education infrastructure. The projected goals of the investment are supporting 150 new technology-based businesses; promoting 650 efficient and renewable energy projects. These projects aim to create 7,500 new jobs and enhance communication technology for the region. The projects prioritize research and development, particularly in the scientific and information technology fields, transportation infrastructure improvements, and urban development within Brandenburg.¹⁴²

Successful investment in vocational training within Brandenburg occurred in the city of Luckenwalde. Prior to unification Luckenwalde was a biotechnology center for the GDR. In the 1990s, the city suffered massive brain drain and out-migration of its highly educated youth population. Starting in 2000, the biotechnology park was rejuvenated with the assistance of the EDRF investing 475,000 Euros into the city's training programs. Vocational training began in 2002 for biology lab workers and for chemistry lab assistants in 2004. The renovated biotechnology factories near the training facilities cooperated with the student trainees to ensure employment training. The training programs' success helped the city of Luckenwalde reduce out-migration of its youth

¹⁴¹ European Commission, "Heat from the East," *European Commission Regional Policy*, last modified August 25, 2007, www.ec.europa.eu/regional_policy/.

¹⁴² European Commission, "Germany: Operational Programme Brandenburg," *European Commission Regional Policy*, last modified July 09, 2007, www.ec.europa.eu/regional_policy/country/

population. Due to the success of the vocational training, the national government may move a biotechnology-focused university to the city.¹⁴³

EU 2007-2013 investments in Saxony-Anhalt total 2.6 billion Euros. Similar to Brandenburg, the primary focus of the investment is research and development of competitive information technology and communications industries, to promote job creation, and urban development. The intent of the funding is to create 770 projects to spur innovation through research and development and 1,000 projects to generate direct investment and to create 59,000 new jobs and 4,500 new small-and-medium-size enterprises. Of the total 2.6 billion Euros invested in Saxony-Anhalt, 560 million Euros is going to urban renovation as part of urban development initiatives to modernize education throughout the region. The ERDF estimates that the investment projects within Saxony-Anhalt will increase the region's GDP by .07-1 percent as well as employ 8,000 people each year by 2013.¹⁴⁴

In Bitterfield-Wolfen within Saxony-Anhalt, the ERDF invested ten million Euros to restore the dilapidated former GDR chemical factories. In the 1990s, the chemical industry within Bitterfield-Wolfen shut down leaving 20,000 people unemployed and towns empty. In early 2001, Q-Cells AG from Berlin decided to restore the plant for solar energy production with the help of the ERDF. The plant started in 2001 with only 19 employees and one production line. By 2006, the plant had four production lines and employed 800 people. Q-Cells AG also developed a training program to educate people

¹⁴³ European Commission, "Germany: New opportunities in biotechnology," *European Commission Regional Policy*, last modified March 01, 2006, www.ec.europa.eu/regional_policy/projects/stories

¹⁴⁴ European Commission, "Germany: Operational Programme Saxony-Anhalt," *European Commission Regional Policy*, last modified October 22, 2007, www.ec.europa.eu/regional_policy/country.

interested in the solar energy market. Although the plant only employs 800 people, it is an example of ERDF assisting with region specific development. Bitterfeld-Wolfen historically had factories, and through investment the city is being restored to its industrial traditions.¹⁴⁵

Within the region of Saxony, the main focus of the ERDF is attracting foreign capital investment through innovation. Updating transportation networks and creating sustainable urban development are other aims of ERDF investment projects within the region. The projects are expected to preserve 26,570 jobs, create an additional 24,760 jobs, support investments in 836 local company projects, and assist 15 areas with urban development initiatives. To complete all the projects for Saxony, the region is receiving over 11 percent of all ERDF assistance in Germany, totaling 3,091 million Euros.¹⁴⁶

Saxony is currently undergoing a transportation upgrade throughout the region. The Federal Republic of Germany and the ERDF combined regional infrastructure endeavors to build roads connecting rural and urban areas. The Autobahn 72 connects the city of Rathendorf to Borna with a six-lane expansion between Leipzig and Chemnitz. The expansion reduces traffic between the two cities and will act as an emergency evacuation route for the area. The improved roadways are necessary because the three cities, Leipzig, Dresden, and Chemnitz, are rapidly expanding. The construction projects

¹⁴⁵ European Commission, "Germany 'Solar Tech Valley Thalheim': A lighthouse powered with energy of the future," *European Commission Regional Policy*, last modified March 01, 2006, www.ec.europa.eu/regional_policy/projects/stories

¹⁴⁶ European Commission, "Germany: Operational Programme Saxony," *European Commission Regional Policy*, last modified July 5, 2007, www.ec.europa.eu/regional_policy/country

are expected to employ 245 people for at least eight years throughout the region.¹⁴⁷

Autobahn 72 is projected to be completed in 2012.¹⁴⁸

The final region comprising the five new Länder, Thüringen, remains at less than 73 percent of the EU-25 GDP per capita income levels. Like the rest of the eastern regions, Thüringen struggles with incentives for direct investment to boost its economy and has high unemployment. The ERDF between 2007 and 2013 is contributing 1.48 billion Euros to the region's development, particularly to encourage direct investment. To develop the region, the ERDF created 1080 projects to increase research and development. Companies and research institutions provide some support 200 to of those projects such as research space and offices), and 70 are directly related to establishing infrastructure. The ERDF estimates that these projects will generate 1.7 billion Euros and create 7,000 jobs. In regards to infrastructure and environmental sustainability, 210,000 residents will be connected to advanced wastewater management systems.¹⁴⁹

In Thüringen, the ERDF is partnering with the Thüringen-Invest, a funding institution for small businesses and entrepreneurs to acquire grants and loans. In 2008, a female photographer from Armstadt in Thüringen decided to open an advanced technology photography studio in her hometown. She began with 100,000 Euros and received 19,400 Euros in grants and 18,000 Euros in loans from Thüringen-Invest to

¹⁴⁷ European Commission, "Traffic Links Connects Smooth Transport," *European Commission Regional Policy*, last modified September 20, 2010, www.ec.europa.eu/regional_policy/stories

¹⁴⁸ DEGES, "A 72: AS Rathendorf – AS Borna including B 7n," *DEGES*, <http://www.deges.de/Projekte/Sonstige-Strassenprojekte/in-Sachsen/A-72:-AS-Rathendorf-AS-Borna/A-72:-AS-Rathendorf-AS-Borna-einschliesslich-B-7n-K234.htm>

¹⁴⁹ European Commission, "Germany Operational Programme Thüringen," *European Commission Regional Policy*, last modified October 26, 2007, www.ec.europa.eu/regional_policy/programs.

begin her photography business. For her to qualify for the program she had to be a full-time entrepreneur and provide a training course for at least one employee as a job-creation mechanism for the region. The Thüringen-Invest program in September 2009 assisted 800 companies with investments. Two-hundred thirty were new businesses, and women created 30 percent of the new businesses.¹⁵⁰

The examples of regional programs currently operating in East Germany show the EU's commitment to regional development per the Lisbon Strategy and Europe 2020 initiatives. By the end of the 2007-2013 budget cycle the goals are that some of the eastern regions may be transitioning into Objective two under the Cohesion Policy. Since all of the regions are very close to the 75 percent EU-25 average, transitioning is an achievable goal. The success of development assistance in the former GDR benefits the EU as a whole because of the example the success of the eastern Länder provides the world. The EU can assist in the development of transitioning countries from both an authoritarian political system and command economic system. Additionally, eastern German development stabilizes Germany as a whole, which competitively strengthens the EU in the global market. EU development assistance in eastern Germany demonstrates the benefits of regionally-specific development goals, the importance of local governing institutions can slowly correct economic mistakes.

The above examples show the development progress that the eastern regions are making with EU Regional Structural Funds assistance. All of the programs are attempting to reverse the negative effects of the unification policies, particularly, unemployment and

¹⁵⁰ European Commission, "Fast-Developing Photo Studio," *European Commission Regional Policy*, last modified March 16, 2011, www.ec.europa.eu/regional_policy/stories

lack of job opportunities. The former communist regime left the region's labor unqualified and far too expensive for industries to revitalize the area. Additionally, unification forced outdated factories to shut down or incentivized capital-intensive factories to re-tool, leaving more East German citizens unemployed. The high long-term unemployment rates disenfranchised the youth causing out-migration and brain drain into the more prosperous western regions. These are just some of the reasons for eastern Germany's failure to develop to western levels.

Economic development and competitiveness has been the goal of the EU since its inception as the European Coal and Steel Community. As the main international aid contributor and development assistor, the EU should be able to develop its own member states. By developing its own member states the EU may be seen as a model for international development more so than it is currently.

Conclusion

In 1989, the Berlin Wall was opened, allowing East and West Berliners to reunite for the first time since the Wall went up in 1961. Once the Wall came down the rush to unification began resulting in the use of Article 23 of the German Basic Law to allow the German Democratic Republic to accede to the Federal Republic of Germany. Unification of the two Germanys occurred in 1990.

Chancellor Helmut Kohl envisioned a much slower unification process to allow for extensive policy analysis. Unfortunately, the pace of unification did not allow for lengthy analysis. Kohl initiated several unification policies that were detrimental to the economic development of the eastern Länder for twenty years; however, those policies met the political demands of the eastern Germans. These policies include the one-to-one ratio of the Deutschemark and the Ostmark up to 4,000 Ostmarks, the wage policies enabling eastern workers to be paid the same as western workers, and capital-intensive subsidies that encouraged business to convert more labor-intensive factories to capital-intensive.

Welfare system reform defined the chancellorship of Gerhard Schröder from 1998 to 2005. He gained a highly-indebted federal government with high unemployment and a welfare system that was broken by the stress of unification. He strove to reform the welfare state by forming the Commission of Modern Services on the Labour Market also known as the Hartz Reforms. The Commission's objective was primarily to reorganize the Public Employment Service and review labor market policies connected to the welfare system. The Hartz reforms passed and were enacted in 2003 and 2004. The Reforms did improve the job centers by centralizing the information for job seekers and

employers, reorganizing the Public Employment Service, and changed the qualifications for unemployment benefits to encourage the unemployed to continuously search for employment. The Hartz Reforms reduced Chancellor Schröder's popularity due to the more restrictive unemployment benefit requirements resulting in his loss of power in 2005.

Chancellor Angela Merkel, Schröder's successor, won the election in 2005 strove to reduce the deficit and reform the social welfare system to encourage labor market participation. She has been successful in reducing unemployment throughout Germany despite the global economic downturn in 2008. Her reform efforts, the Leipzig Programme, consisted of four main components: introducing a flat fee for health care contributions, increasing the retirement age with a minimum required number of years worked, decreasing unemployment contributions, and creating a three-level taxation system. All of these changes were designed to reduce the costs of the welfare system for employees, employers, and the government. In introducing these reforms Chancellor Merkel has decreased unemployment throughout Germany and specifically the five eastern Länder. Not only have her policy reforms decreased unemployment thus far, the EU Regional Cohesion policies have also provided a major contribution to the slowly increasing economic development of the eastern Länder.

As per the Lisbon Strategy and Europe 2020, the EU Regional Cohesion Funds are continuing the EU's commitment to economic development, sustainability, innovation, and competitiveness by assisting eastern Germany in increasing its development level and decreasing its productivity gap relative to the rest of the EU member states; however, the programs are fighting twenty years of economic dysfunction

from unification. The programs are creating sustainable, internationally competitive jobs, while simultaneously training the region's youth in those innovative fields. Furthermore, when towns get investment projects, their communities are revitalized, increasing the morale, and job and investment opportunities. With more time, these development programs will likely continue to increase the competitiveness of the eastern regions and hopefully continue to close the productivity gaps with western Germany. Eastern Germany will likely recover from the shock of unification and the doomed economic policies enacted under the Kohl Chancellorship.

In sum, the continuing underdevelopment in the former German Democratic Republic is largely a legacy of Kohl's unification policies. Unification was a large undertaking for the Federal Republic given the former GDR's dire economic situation of from the communist regime's poor central planning. During the year leading up to unification, politics overwhelmed economics, perhaps even Chancellor Kohl himself. The recent reductions in unemployment within the eastern Länder give hope that with more time the eastern Länder will develop to their full potential.

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