Too Much Faith in the Wisdom of the Market

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is at best distorted. After all, the US aid amounted to less than 2% of the "trizonal" national product (substantially less than its contribution to the UK, for example), and served not least US sales interests.

It was the democratic system of the West and the social market economy which ultimately proved so hugely superior to the "socialism" of the GDR. And that is why the gates of this self-imposed prison were prised open not from the outside, but from the inside. The Wall was pushed over in 1989 by the uprising of the oppressed. No-once came to colonise. But the freedom-deprived vacuum of the GDR was inevitably immediately filled by the free "West", in the widest sense of the term. GDR products immediately disappeared from the shelves: an unmistakable warning of what was to come.

And so the rebuilding of eastern Germany after 1989 was very different from that of West Germany after 1949: it was much more than a physical reconstruction of previously efficient production sites or a modernisation of products. In 1989, the east was initially lacking in entrepreneurs responsible for their own assets and companies with markets for their products, a democratic administration, a justice system based on the rule of law, a democratic system of political parties, a government system based on this, etc. All of this had been promoted by the Western occupying powers in the Federal Republic after 1945. In the east, by contrast, the roots of civil society inherited from earlier days had been completely torn out.

III

For this reason, the advice offered by every economic and sociological theory in 1989 had to be: give the GDR region lots of time to develop on its own initially, e.g. as part of a confederation. But in practice, this alternative was never on the cards. The main reason why was not the eastern German cry of "if the deutschmark doesn't come to us, we'll go to it", as the placards of the time put it. The existing Federal Republic could probably have coped with a large influx of GDR citizens just as well as or perhaps even better than it has coped with the massive financial transfers. But no responsible politician in the east or the west could advocate the re-establishment of tariff and currency borders in Germany. No citizen would have tolerated them.

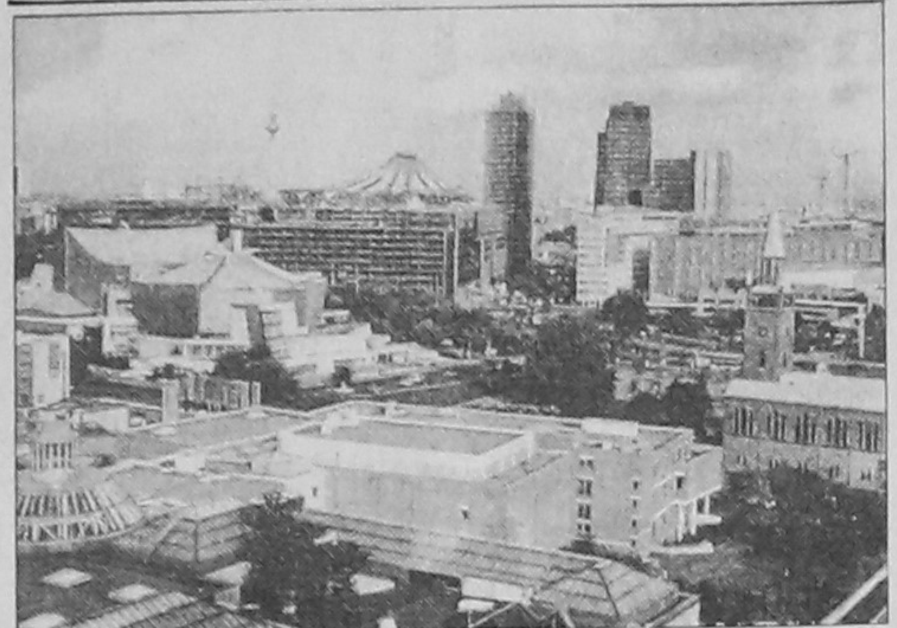
So anyone assessing the process of reunification following 1989 needs to start from two facts: on the one hand, the GDR was in no position to become an integral part of what was perhaps the most competitive Western market democracy, the Federal Republic of Germany, in such a short time – but on the other, this immediate integration was inevitable in reality. The serious consequences of rapid reunification were as predictable as they were unavoidable. Paradoxically, this inevitability was actually due to the massive economic and social disparities: if these had been less, the GDR citizens would presumably not have wanted such a rapid reunification.

In other words, the reconstruction and rebuilding of the GDR after 1989 had to take place in a market system (of the existing Federal Republic – starting from almost totally nationalised firms run by communist party functionaries. If any rebuilding at all was to take place, it would be necessary to begin by altering these structures. Privatisation was therefore the starting point for all reforms. As a consequence, it is the focal point for criticism today. Let us remind ourselves of the facts: the GDR, with a population larger than that of the Netherlands, had bred massive corporate dinosaurs in its desperate attempt to become self-sufficient. In fact, almost the whole of East German industry consisted in the end of just 132 "combines" (by comparison, at the time industry in the West consisted of some 38,000 firms). If one were first to restructure these "companies" and only subsequently transfer them to private investors – as was often called for – it would have been necessary for government agencies (like in GDR days) to decide down to the last detail who got how much restructuring money for what and for how long. This would have required constant monitoring of the competitiveness of each individual combine or part thereof. Just imagine a bureaucratic apparatus responsible for deciding right down, perhaps, to the last 10,000 marks, whether this or that investment was still appropriate for this or that site or whether – for example – it would be better to replace the management of the company, and so on. And to do this for virtually all companies in the new Lander! It might have been theoretically feasible, but it was totally impossible in practice.

What was needed was entrepreneurs who were prepared to take on the decentralised responsibility for a combine or a part of one. People who were ready to stake their own money (however much that might be) and who thus had to assess the risks of the company. Generally, such solvent entrepreneurs were only to be found in the West.

Obviously, this is not to deny the fact that in the course of these privatisation mistakes were made, fraud took place and sometimes companies were even deliberately destroyed to cut out competition from eastern Germany. Such a radical restructuring does not proceed like the meetings of the General Synod. Why, for example, was it necessary to privatise the trading organisations into western hands, since the western traders almost inevitably brought their familiar western goods across with them? Why did land for production sites have to be valued at such high prices – generally far above the market price today? Why replace many competent eastern German managers for political reasons? Certainly, much could have been done better.

But let us never forget: the West was not responsible for the pre-1989 social and economic destruction of East Germany which made this radical change inevitable, it was the failed communist system. And so one cannot place the main blame for the present situation on the West.



A time of change: Sony and Daimler Chrysler area at Potsdamer Platz, Berlin.

IV

Nevertheless, the politicians from Western Germany can still be accused of turning a blind eye to the predictably great difficulties. All too often, they drew an untenable comparison with West Germany after 1949; in fact, the 1948 currency reform even became an issue in the first free elections to the People's Chamber of the GDR on 18 March 1990. And so the reconstruction of the economy in the east was blocked right from the start by the fact that a majority of politicians and business people claimed that a perked-up infrastructure and rapidly privatised companies would create economic recovery more or less automatically. And not at some unknown point in the future, but rapidly. In fact, in view of the injections of financial support from Western Germany, many people even expected a more rapid recovery in the East than had taken place in the West following 1949. And yet people knew that Western Germany also had structurally weak areas, despite good infrastructure. So where did they expect the unique advantage of the GDR to be found? Where was the extremely large industrial workforce of 1989 supposed to find its markets?

Three excuses are repeatedly made for the fact that the recovery in Eastern Germany did not go as expected: the allegedly wrong exchange rate used when the deutschmark was introduced in 1990; too rapid an increase in wages; and the loss of the markets in the former Soviet bloc.

When the Wall came down, the deutschmark and the dollar immediately became the unofficial official currency of the GDR, which still existed at that time. This "monetary union" took place all by itself, well before the West German government announced its intention to do this on 1 July 1990. The only way to avoid it would have been to establish a new state and tariff frontier with border controls. Who was supposed to secure such a border? What else could the Federal Government have done?

On the subject of exchange rates: for private monetary assets, which at the time totalled 191 billion marks (not deutschmarks!) in East Germany, adults under the age of 60 were given an exchange rate of 1 to 1 for the first 4000 marks, and generally 1 to 2 for amounts above this. In view of the considerable excess money supply in the GDR – like the West Germans prior to their currency reform in 1948, the East Germans held a lot of worthless money – it seemed likely that there could be a sudden rise in inflation, but the Bundesbank and the private citizens of the GDR ultimately acted so sensibly that this danger was averted. Any less favourable exchange rate for the citizens of East Germany would have exacerbated what today is still a large gap in asset levels between East and West. (The eastern share of private monetary assets, which currently total DM 3.2 trillion, stands at less than 10%).

It is correct that the 1:1 conversion of corporate debt presented problems for many firms. However, many of these "inherited debts" were subsequently cancelled by the Treuhand and its successor, the BvS. And so here again the conversion rate had virtually no serious negative consequences.

Secondly, wages: in 1989, average gross wages in the West were nominally three times as high as in the East (1322 GDR marks compared with 3966 deutschmarks). There were some suggestions that the initial wages should have been converted not at 1:1 but at roughly 1:2, but this would have meant that, whilst after monetary union prices were pretty much the same in East and West (except for rents), the workers in the GDR would only have taken home between 500 and 600 deutschmarks (!) a month. That would have been unacceptable. In view of the price trends in the east of Germany, even the wages converted at 1:1 soon came under pressure for an increase. Too soon, as sensible economic experts rightly point out. But still not soon enough for some people in the east, such as those in the civil service who now have to get by on 86.5% of the western salary (except for those working for land Berlin) and work longer hours, whilst their purchasing power advantage has shrunk to 8% (from one third!).

The third excuse usually given is that the GDR companies lost their export markets in the East, and that this could not have been predicted. But, firstly, even the GDR exported only one-third of its output, which was a rather low figure for what had once been such an open economy in that area (degree of integration in 1936: 54%) and for a relatively small country (the Netherlands are now at over 50%). For this reason, the loss to western suppliers of the domestic markets in the GDR was far more serious. And, secondly, who could have expected even an Eastern Europe with a stabilised economy to continue buying goods from ex-GDR firms, given the fact that they would now have to be paid for in hard currency and that the Western products were better?

V

In 1990, one thing was obvious: the products, prices, quality and management of the old Federal Republic, and of the West in general, were so superior to those of the East that, without additional protection, the dilapidated economic structure of the East would collapse within a few weeks. Incredibly, however, the "market" economists underestimated the power of the market. And this underestimation of the consequences of the superiority of the West led to a crucial error in the strategy used to rebuild the East: market forces and competition not only build things up – they can also destroy inferior economic systems in open competition. In the former GDR, this meant that, until at least 1995 (when separate statistics were still kept for East and West), the eastern German "output gap" (in international terms, one would speak of a trade deficit) amounted to more than DM 200 billion each year. Even today, it will not be much lower.

It might have been possible to grant local suppliers, for example, more substantial advantages (local content) when building infrastructure; if necessary, the existing rules on tender procedures could have been suspended. But such proposals were immediately rejected: they were disparaged as "market economy with contraceptives" (Lambsdorff).

The one-sided trust placed in market forces led to a further misjudgement with serious consequences: in general, the rebuilding of the economy was supported in the form of depreciation allowances for investment in the East and not in the form of a referential tax arrangement for the 'new' Lander themselves, as the FDP had proposed in 1990. The opponents of a low-tax area feared the sort of misdirected developments associated with the subsidies for former West Berlin. Today, however, we know that the high depreciation allowances not only favoured a formation of western (rather than eastern) capital, but also resulted in the building of excessively capital-intensive production sites. These in turn only had a minor impact on employment, but often resulted in misplaced investment (office buildings, for example) and expensive overcapacities.

When in 1993 the Federation of German Industries again cried out for a tax preference for value-added by the manufacturing sector in Eastern Germany, Bonn refused to listen, placing its trust in market forces. Ultimately, this meant that the Federal Government quite simply failed to utilise its right, reconfirmed in the Maastricht Treaty, to give the East every sort of state aid "insofar as such aid is required in order to compensate for the economic disadvantages caused by... division" (at the time Article 92(2)c of the EC Treaty).

And so the industrial recovery became slower and slower and thus more and more expensive. In fact, roughly three-quarters of the annual transfer payments of approx. DM 150 billion end up being used for consumption and social security; only one-quarter or so goes into investment. And since, when it came to financing the rebuilding, the politicians did not dare to take the route which economic logic would normally dictate, i.e. increased consumption taxes (value-added tax) (here, the political parties blocked one another), the federal Government's policy ultimately resulted in the explosion of debt whose consequences are now placing such a burden on the whole of Germany in the form of the "austerity programme."

VI

Today, the high level of unemployment in the east marks a German land-scape which is deeply divided, both morally and socially. Even ten years on, internal unity has still not been achieved, and we will have to keep working at it for many years. This also has serious political consequences.

In the east, the PDS, which is the successor to the SED, the GDR's communist party, has not only come up close behind the SPD in the Lander parliaments: it actually threatens to relegate the SPD to the status of a third force. But the PDS would never have been established if the western political parties had been as lenient to SED members as they were to Nazi party members after 1945. Some talented individuals in business, science and society were thus unnecessarily driven into the PDS.

At heart, this PDS is still opposed to the market economy: like all Marxist parties, it fails to understand that a country's social strengths need to be underpinned by an efficient competition-driven economy. It fails to realise that democracy and the market economy are inseparable. The FDP and the Greens, who have traditionally been on hand in the West to arrange a shift in power within the market economy framework, are virtually non-existent in the east. But this will not only have an impact in Eastern Germany: we will increasingly feel the new distribution of power in Federal elections too.

Democracy and the market economy are not so firmly established in the east. And, as the Kosovo War has shown, there are also substantial differences in the way global political developments are assessed in the east and the west.

VII

What needs to be done? We shall continue to need a lot of patience, a lot of time and money. Even if the adjustment of the economic structures is advancing further, it will be a long time before east and west arrive at the same level, given the slow growth rates. Misplaced expectations must not be reawakened. It is therefore important for the government to survey the situation after ten years and to set out the next ten years of the project of rebuilding the east with clearly defined objectives, timetables and financial requirements, so that the Germans know what to expect and can review the progress made.

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