Caught in the monetarist debt trap

The dramatic increase of the public debt in eastern Germany has sparked a debate on a debt moratorium.

A small news item on Feb. 16 shed more light on the economic situation in Germany than most elaborate analyses by "experts": The municipal magistrate of Rostock, the biggest port on the Baltic coast, declared that the city could not meet the month's payroll for its 6,100 employees; it ran out of money at the end of January.

Rostock cannot take new bridge loans because it has reached the legal limit of DM 104 million ($65 million) for borrowings. It is short another DM 78 million that could have been in the municipal coffers long ago, mostly overdue transfers from the state of Mecklenburg-Prepomerania which cannot pay either, as the federal government in Bonn is late with its own transfers to the state government.

The story of Rostock, the capital of Mecklenburg-Prepomerania, is alarming, since this state is the poorest, with the highest jobless rate, among the five eastern German states and has the smallest tax base. Lacking sufficient revenue, the state, its capital, and many other municipalities have become hostage to creditors.

In discussion with this author, an aide to the state parliament of Saxe-Anhalt, one of the five eastern states, said: "We are caught in a debt trap from which, as the economic situation looks now, there is no escape." The state had a tax/income ratio of 25% in 1992 and expects one of 28% for 1993, which means that it can cover only a quarter of its expenses, depends on the federal government for funds, and is forced to borrow short term from banks at non-subsidized interest rates. As the state carries over old debt from one year to the next, the interest rate it pays is rising.

Servicing the old debt of the pre-unification communist regime in eastern Germany, and the new debt accumulated since October 1990, already absorbs 30% of the tax income of the administrations in the east. This percentage is going up because the austerity-minded federal government is delaying transfers. Eastern states and local administrations have to borrow new short-term money at exorbitant interest rates above the average 9% money market level.

This explains, for example, how at the municipal level, the old debt of the eastern German housing sector will jump from DM 38 billion at the end of 1990 to DM 52 billion by the end of 1993—a 37.5% gain in three years.

Because of sluggish new investments in the productive sector, tax revenues are not expected to grow by more than an annual rate of 3% for the next years. There is no way to catch up with the growth of the debt.

The illusion that present policies of slow investment and cost reduction might improve things in eastern Germany, is also attacked in a new study by the German Labor Federation, which says that only an average annual economic growth rate of 17% will permit significant improvements. The study is quite appropriate with that figure, but it still respects a taboo which only a few have been willing to touch, so far: the proposal of a moratorium on the old debt and its legitimacy.

The eastern municipalities, whose three-year grace period for housing sector debt (granted by Bonn when the two Germanys were reunified) will expire at the end of 1993, are in the forefront of the public debate about a moratorium. On Jan. 27, the magistrate of Erfurt, the capital of Thuringia, appealed to the federal government to cancel the old debt and thereby allow municipal housing agencies to use their income for investing in new construction and restoration projects, instead of debt servicing.

Bonn, especially the Ministry of Finance, has insisted that the debt be recognized and paid. The key argument of ministry officials has been that a debt moratorium of such a scope, DM 52 billion by early 1994, would send shocks through the world of banking and credit, destabilize international monetary structures, and destroy the basis on which the postwar system of western economic policy has been built.

This monetarist view, which is turning government officials in Bonn into mouthpieces for the International Monetary Fund, is diametrically opposed to the interests of the 16 million people living in the eastern states—20% of the nation. The Erfurt magistrate's move reflects, as this author learned, a rebellious mood in 145 other eastern municipalities, including Rostock.

The Rostock default will help to finally put the question about the "rationality" of a system that keeps people in a lethal debt trap on the political agenda of a leading industrial nation. This is something other parts of the world can profit from: The debt dynamic which Germans are struggling against now, is the same one that has blocked economic development in the Third World for decades. A new world economic order is long overdue, and the east Germans can help to create it.