Policy blunders wipe out industry of eastern Germany almost overnight

by Lothar Komp

The following was translated from German by Edward Carl.

Wrong policy turns since reunification have inevitably brought Germany to a dead end, in which the vultures are circling over an exhausted economy. The scavengers are certain to make a killing. According to estimates by the Hermes credit guarantee agency, the number of corporate bankruptcies in the coming year is going to rise sharply. The construction sector is especially hard hit. While the tax revenue receipts of the federal government, states, and municipalities remain below expected levels, finance ministers and treasurers are all downsizing plans for infrastructure investment—an essential ingredient for future economic growth. In addition, in eastern Germany, housing and industrial construction stimulus measures in effect up until now, will be cut from 1996 on. Along with this decline in construction activity, the most important pillars of economic development in eastern Germany are now threatened with being knocked out from under the economy. Hermes is talking about a possible 80% increase in bankruptcies in the eastern construction industry in the next year. A chain reaction is feared, in which the structure of the recently incorporated and, in most cases, inadequately capitalized enterprises in the eastern states, could collapse like a house of cards. A new wave of mass unemployment would inevitably be the consequence.

Five years after reunification, a stable, self-driven economic development process is manifestly out of the question for the eastern part of the nation. Following one of the fastest deindustrializations ever to have taken place during peacetime, out of the 3 million industrial jobs that existed in East Germany before 1990, only 600,000 are still left today. (See **Figures 1** and **2** for the collapse in number and electricity use in industrial firms, and **Figure 3** for the number of business failures.) That is decidedly too few workers to even simply cover eastern Germany's own industrial goods requirement.

In order to bridge this huge gap in production, each year it has been necessary to effect the transfer of federal funds in the range of hundreds of billions of deutschemarks, in return for which the public mountain of debt has grown larger and larger. The braking maneuver of Finance Minister Theo Waigel, by which he wants to force the economy through the eye of the needle of the Maastricht criteria, is simply making everything that much worse.

Eurasian infrastructure development

The critical "navigational errors" of the captains in Bonn responsible for the present course, were made five years ago. In November 1989, the federal government came face-to-face with a decision of far-reaching consequences. The historical challenge presented by the fall of the Berlin Wall and the already foreseeable collapse of the Soviet system, brought forth a vision of German economic policy, in the center of which stood the reconstruction of the East by means of great infrastructure projects.

The opportunity was uniquely favorable: On the one side were the Comecon States (the U.S.S.R.'s former trade bloc), the modernization of whose railroad networks, roadways, power plants, and industrial installations, within the framework of a new "Marshall Plan," would have resulted in a tremendous capital goods investment requirement. Immediately bordering these States to the west, was the world's largest capital goods exporter, the Federal Republic of Germany, which had suffered the loss of important customers in the Middle East and Ibero-America. And, the prospect of German reunification appeared to be an ideal framework in which to work, not only for the economic reconstruction of eastern Europe and the U.S.S.R.'s successor-States, but furthermore, on account of the implications of East Germany's preexisting foreign-trade relationships, for its own reconstruction within a unified Germany.

In no other location were these considerations more clearly expounded than in the "Productive Triangle Paris-Berlin-Vienna" proposal that was put forward by American economist Lyndon LaRouche in late 1989. The focal point of this "Grand Design" was massive investment in the modernization of the infrastructure and productive apparatus of an economic area which was approximately geographically described by the spherical triangle Paris, Berlin, and Vienna. In it, there exists, in the most concentrated area, a globally unique agglomeration of densely populated and highly productive industrial regions. A powerful leap of productivity of this central area, would be radiated out along development corridors into the various industrial concentrations of Eurasia; for example, let us specify just two development corridors: Paris-Berlin-Warsaw-Minsk-Moscow, and Frankfurt-Dresden-Krakow-Lemberg-Kiev. Within a specified time frame, the economic buildup along these routes could include

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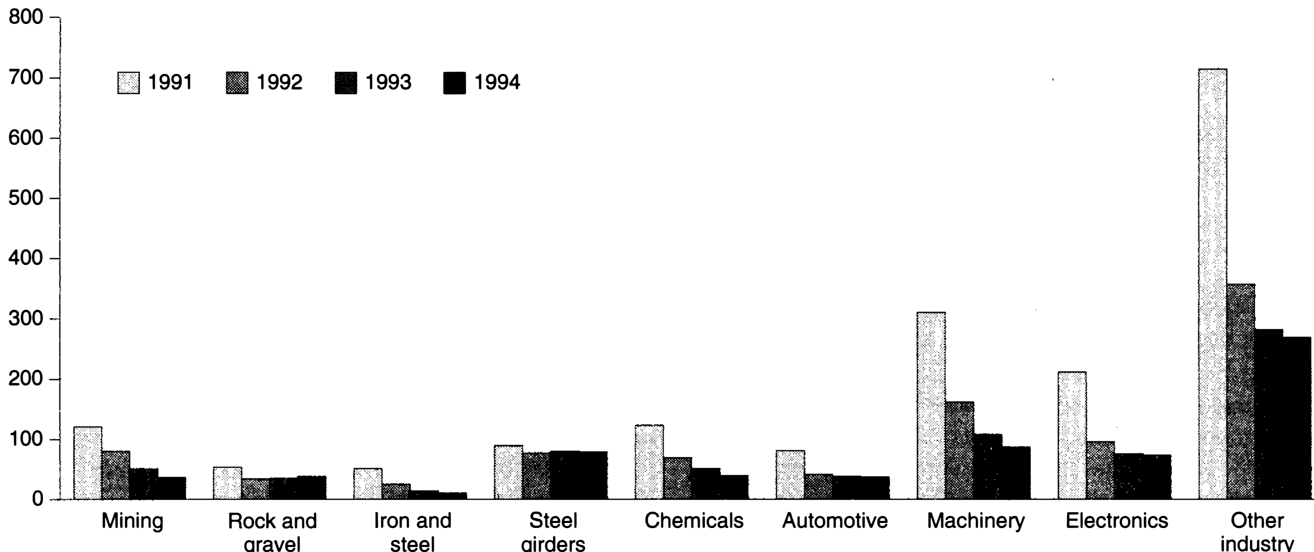
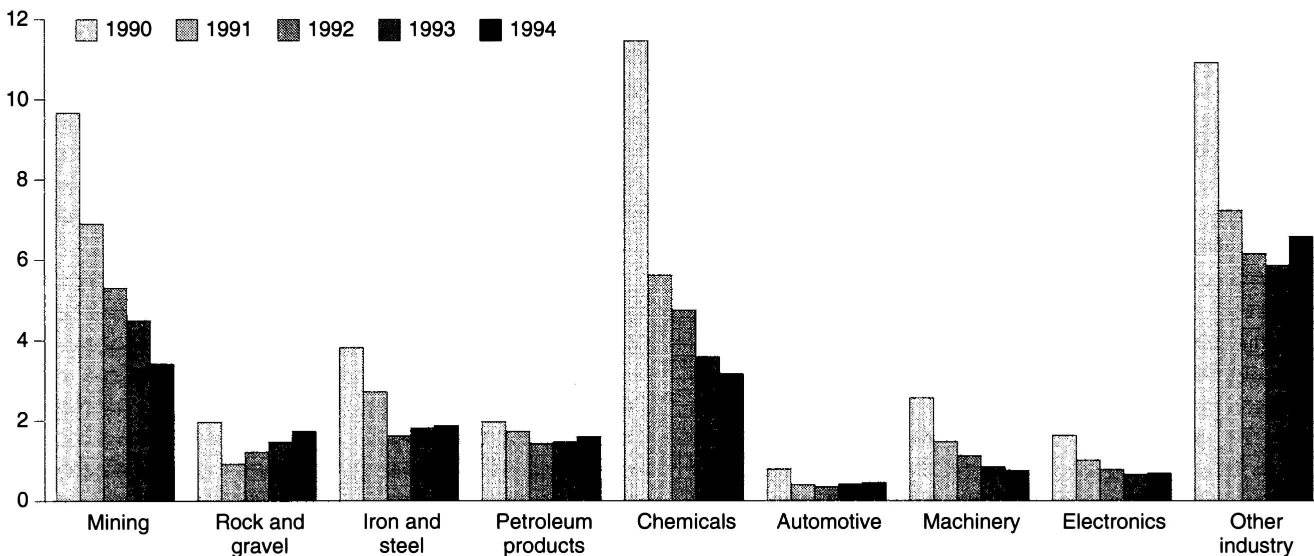
FIGURE 1
Industrial employment, new federal states, 1991-94
(thousands)



Sources: German Federal Statistical Bureau. EIR.

FIGURE 2
Industrial electricity consumption, new federal states, 1990-94
(terawatt-hours)



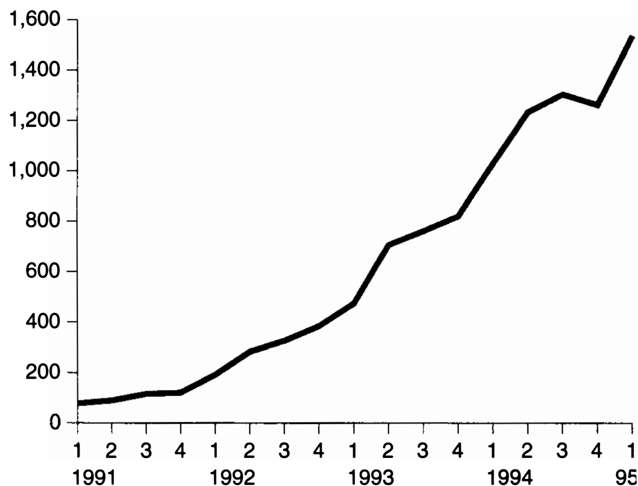
Sources: German Federal Statistical Bureau, EIR.

high-speed railroads, power-generating stations, telecommunications, and other infrastructure, the development of new population centers, plus small and medium-size industry.

The opportunity is lost

Such a policy could have been seriously looked at by the federal government. For example, Alfred Herrhausen, the chairman of the board of directors of Deutsche Bank, called

FIGURE 3
Total number of business failures, new federal states
(number of failures in quarter)



Sources: German Federal Statistical Bureau, EIR.

for the creation of a development bank to serve as a model Bank for Reconstruction, for the purpose of financing infrastructure projects in central and eastern Europe. Also, a far-reaching cancellation of old debt that had originated under the communist system, ought to have flanked these efforts.

However, there was suddenly a precisely targetted propaganda campaign coming out of Britain, which painted every German economic initiative in the East as "proof" that a new "Fourth Reich" was about to be established. One member of British Prime Minister Margaret Thatcher's cabinet publicly compared Chancellor Helmut Kohl to Adolf Hitler, and, he was elevated forthwith to the House of Lords. And then, in November 1989, Herrhausen was murdered, which assassination was officially pronounced (according to the accepted rules of political behavior) to have been perpetrated by members of a (nonexistent) "third generation" of the Red Army Fraction (RAF), i.e., the Baader-Meinhof Gang.

The German federal government paid careful attention to the lesson: Reunification would be permitted; however, for geopolitical reasons, instead of a "Marshall Plan" for eastern Europe, the International Monetary Fund was to constitute the overriding framework.

The pragmatic about-face conducted by the Bonn government, for the purpose of obeisance to the "balance of power" gameplan, constituted the cardinal mistake that first made the whole gamut of Germany's economic problems in 1995 possible. Indeed, the disparity of living standards between western and eastern Germany, measured in terms of a per-capita consumption of goods and services, has slowly converged, down to the lower levels in the east. However, due to the catastrophic loss of industrial jobs, production has dramatically fallen below consumption. While DM 470 billion (roughly $294 billion) worth of products and services in total were consumed in the new, eastern states in 1994, the total value of goods produced, and services rendered, amounted to no more than DM 260 billion ($163 billion). That means that if one were to think of the new federal states (the former East Germany) as a self-contained economic unit, the result would be a "balance of trade deficit" of DM 210 billion ($131 billion), which would be an excessive level even for the United States, which has more than 15 times the population.

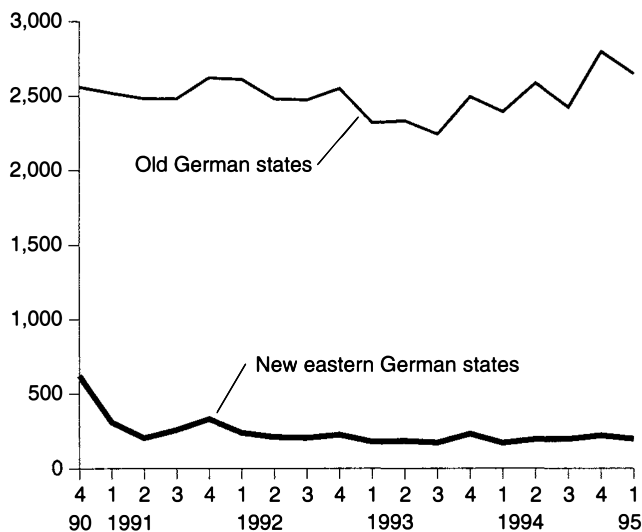
Capital goods production abandoned

Temporarily, the hole in production created by five years of the policy of the Treuhand agency (responsible for reorganizing former East German State-run firms) is being plugged up through gigantic public funds-transfers from the rest of the country. According to estimates of the Munich-based Institute for Economic Research (IFO), a private think-tank, altogether this amounted to about DM 600 billion ($375 billion) in 1991 through 1994. The year 1995 will add on to that nearly DM 200 billion more. Therefore, one mustn't reproach the chancellor for inordinate stinginess. However, the many billions are, first and foremost, only serving immediate consumption needs. The idea of reconstruction of an export-intensive capital goods production sector was dropped before it ever got off the ground, because of the desolate economic situation of most of the eastern European States.

Following World War II, Germany was able to avoid being transformed into a deindustrialized "sheep's meadow," per the Morgenthau Plan's intent. Nevertheless, if one compares the "Industrial Curtailment Program" of 1946 with the deindustrialization of the eastern German states, in only five years of a "free market economy," the parallels become clear. The Berlin-based German Institute for Economics Research (DIW), a private think-tank, characterized the new economic structures of eastern Germany as a typical "dependency economy," in which all of the industrial production is once again consumed locally. The export of goods with high value-added is not occurring. And this is in an economic zone which, prior to World War II, exhibited a higher degree of dependence on foreign trade than did western Germany.

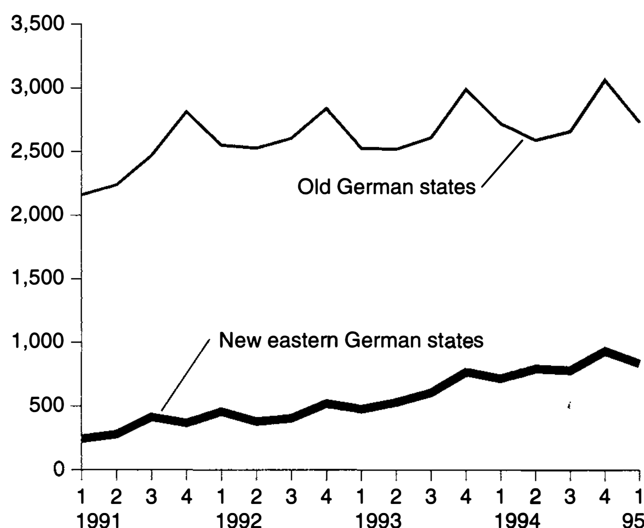
The level of industrialization in eastern Germany, involving 48% of all employed persons, was even higher than in the territory of the old West German states (42%). Machine-building played an exemplary role. Taking former East Germany and West Germany as a whole, three-quarters of all office machines produced were manufactured within the boundaries of the former East German states. With regard to textile machinery and paper processing equipment, it was two-thirds; for printing equipment, nearly half. Despite Soviet demontage, in which factories were dismantled or removed, and decades of communist economic mismanagement, still the machine-building industry in Chemnitz and

FIGURE 4
Export volume per capita
(deutschemarks, by quarter)



Sources: German Federal Statistical Bureau, EIR.

FIGURE 5
Per-capita tax revenues, federal, state, and municipal
(deutschemarks, by quarter)



Sources: German Federal Statistical Bureau, EIR.

Leipzig, the optics industry in Jena, the electronics industry in Erfurt and Dresden, the auto and truck assembly industry in Eisenach, and the shipbuilding industry in Rostock, all continued to maintain their leading role as capital-goods exporters in the Comecon sector. In the mid-1980s, about 40% of agricultural equipment, 50% of metal-forming machinery, 60% of cranes, and 35% of railway cars, all for export to the Soviet Union, had East Germany as their place of manufacture.

Trade relations disrupted

First, because of the interruption of eastern trade based on the transfer-ruble in the course of the German monetary unification, and, then, a little bit later, with the beginning of shock therapy in eastern Europe, the trade relationships were abruptly broken asunder. In the last quarter of 1990, exports from the new, eastern federal states to central and eastern Europe still amounted to DM 8 billion ($5.3 billion), clearly surpassing those of the old, western federal states, of DM 6 billion ($4 billion). However, in the course of 1991, the total exports of the eastern federal states collapsed by 54%; and overall, between 1990 and 1994, by around 80%. Today, as a rule, only those enterprises with more than 500 employees maintain a significant portion (about 32%) of their sales as exports. For business enterprises with fewer than 50 employees, the corresponding proportion is only 4%. Export-oriented medium-size industrial concerns (known as the *Mittelstand*), which, at least until the mid-1980s, used to be considered the benchmark of the West Germany economy, fdo not exist in eastern Germany, and under current conditions, cannot even be established. Even the transfer of hundreds of billions of deutschemarks, given this state of affairs, can hardly be expected to improve conditions very much.

When the Treuhand took over the State-run industries of East Germany in 1990, they still employed 4 million persons. Contrary to promises that 1.5 million of these jobs would be saved, the firms were mostly privatized and many jobs were lost. During the selloff, the Treuhand received DM 67 billion in net proceeds, while it had to shell out DM 295 billion in expenditures drawn by enterprises—DM 75 billion of that alone just in assuming the old, pre-unification debt of the enterprises. In the end, the Treuhand was left holding the bag for DM 230 billion of debt.

Nevertheless, the buyers of the industrial concerns made investment pledges of a total of DM 54 billion. The lion's share of the promised investments falls in the years 1995 and 1996. So, it will soon be seen, just what these promises were worth. Afterwards, in addition to considerable public measures to encourage investment in the goods-producing economy, there also were direct public investments into infrastructure. According to statements by the IFO think-tank, the State supported investments into the eastern German industrial economy of DM 54 billion in the years 1990 to 1993.

The money flowed from numerous sources. There were the "Common Task of Improvement of the Economic Structure" program; European Reparations Program credits, the German government-run Marshall Plan successor credit institution; the Ownership-Capital Aid Program; investment sub-

sidies; and special depreciation allowances. During the same period, in the new federal states, around DM 105 billion of public infrastructure investments were also made. Among these, DM 38 billion was put into transportation and DM 29 billion into telecommunications. So far, so good. Today, the telephones work better and there are also a couple of better roads. Yet, what is the situation with productive investments?

Investment in the services sector

Perhaps half of all investment in eastern Germany between 1991 and 1994 went into the services sector; in all, nearly DM 380 billion. Nearly 3.3 million people of the total of 6.3 million employed (excluding peddlers) on average in 1994, had jobs in the service sector—nearly 600,000 in the private sector and 900,000 in the public sector. In manufacturing industries, by comparison, investments were a much more modest DM 70 billion, at most DM 20 billion per year. Here, investment in the raw materials- and intermediate goods-industries are significantly dominant overall, absorbing nearly 50%. In the western part of Germany in 1994, by comparison, it was only 27%.

In the capital goods industry, it is exactly the inverse. While these make up half of all investments into manufactured goods in western Germany, in eastern Germany it is only one-quarter. In machine-building and in the electronics industry, in 1994, investments totaled DM 1 billion. Investments in automobile production, following the termination of individual larger projects, were again already strongly retrogressing, falling in 1994 to a total of DM 600 million. Overall, the eastern federal states' proportion of capital stock of the manufacturing industries in Germany is still retrogressing.

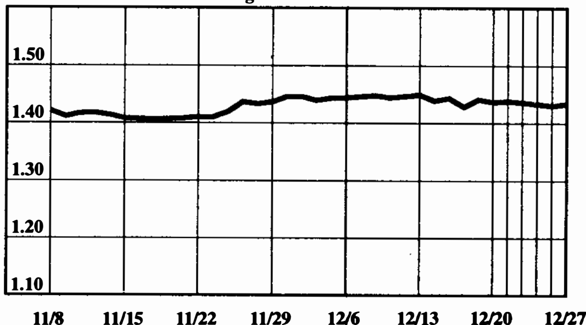
The destruction of industrial jobs, therefore, has still not reached an end. In particular, the number of jobs in steel and chemicals is continuing to decline, just as it is in the machine-tool industry. Despite the construction boom of the past years, and the corresponding demand for construction machinery, eastern Germany's establishment of its own independent production of construction machinery has not taken place. And this, even though the construction industry in the new states today has twice as much activity in total as that which had gone on in West Germany in the 1950s, during the high point of its construction boom. Altogether, in the eastern states, only 7% of employees work in industry, compared to 12% in the western states. While a good one-fifth of the German population is in the new states, this area has only 5% of total German industrial production. In electronics goods, it has less than 4%; in chemicals, 2%; and of the total German export trade, it has just 1.7% (see **Figure 4**).

No wonder that eastern tax revenue receipts per capita remain at a level several times lower than those of the western part of Germany (see **Figure 5**). This devastating industrial disintegration has to finally be brought to an end. Only if Germany rises to the historical challenge of the reconstruction of eastern Europe, can this be accomplished.

Currency Rates

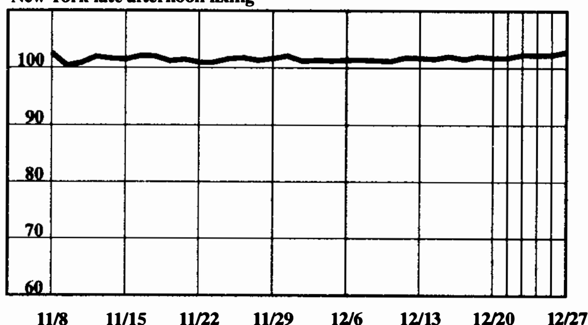
The dollar in deutschemarks

New York late afternoon fixing



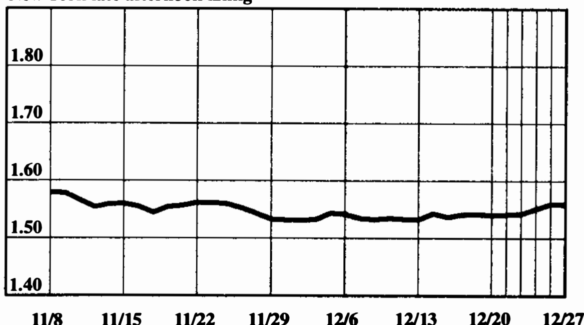
The dollar in yen

New York late afternoon fixing



The British pound in dollars

New York late afternoon fixing



The dollar in Swiss francs

New York late afternoon fixing