UNIVERSITY OF ILLINOIS

May 04 19 92

THIS IS TO CERTIFY THAT THE THESIS PREPARED UNDER MY SUPERVISION BY

Michael J. Condron

ENTITLED Economic Consequences of German Unification

IS APPROVED BY ME AS FULFILLING THIS PART OF THE REQUIREMENTS FOR THE

DEGREE OF Bachelor of Science

in Political Science

Instructor in Charge

APPROVED:

HEAD OF DEPARTMENT OF Political Science

O-1364

Economic Consequences

of

German Unification

by

Michael J. Condron

Thesis

for the

Degree of Bachelor of Science

in Political Science

College of Liberal Arts and Sciences

University of Illinois

Urbana, Illinios

1992

Table of Contents

1. Introduction

On July 1 1990, the two postwar halves of Germany signed a treaty of historic proportion. Here, an agreement on monetary, economic, and social union came into force immediately establishing West Germany's "social market economy" as the norm for all Germany. Officially, the constituent Länder, or states, of the German Democratic Republic shed the last vestiges of their Soviet-created structure behind the iron curtain and acceded to the Federal Republic of Germany on October 3, 1990.[1] With this, the two Germanies quickly became one in name. An enthusiastic East became absorbed into a more wealthy, more developed, democratic nation that boasted a free market economy.

Yet, today, many uncertainties still exist over this expedient move towards unification. When economic equality is discussed, Germans speak in terms of years, but when asked how long it will take to achieve "inner unity," they often speak in terms of generations[2]. Furthermore, politics, economics, and foreign relations continue to be topics of uncertainty for a united Germany. The purpose of this thesis is to examine and explain the need for a fast German unification while noting and forecasting its economic consequences both on a domestic and international level.

---

1 The Economist Intelligence Unit, Germany: Country Profile, (London: Business International Limited, 1991-92), p. 3.

2 Stephen Kinzer, The New York Times, Saturday, April 18, 1992, p. A4, col. 1, lines 12-18.

2. Background

In order to effectively examine the economic implications of monetary and political reunification in Germany it is first necessary to gain a historical perspective. In particular, by investigating past economic activity in Germany one can arrive at a more informed conclusion as to why an expedient reunification in 1990 was necessary.

Germany is a relatively young country which emerged from a collection of small and medium sized states in the 19th century. According to Gustav Stopler, "It is a common belief that Germany owed her rapid ascent to the rank of the foremost industrial power on the continent of Europe to the founding of the Reich in 1871."[3] Like the United States of America, the German Reich began as a loose confederation of sovereign states, and this status survived until the revolution of 1918.

When the Reich was founded, Germany was still divided into seven separate currency areas. According to Stopler, a unified currency system of the Reich was set up in three stages.[4] (1) In 1871 a law regulating the minting of coins was passed. The mark was adopted as the currency unit, its ratio to the values of the circulating silver coinage was defined, and the silver coins were withdrawn. (2) In 1873 the gold standard was

---

[3] Gustav Stopler, The German Economy: 1870 To The Present, (New York: Harcourt, Brace & World, Inc., 1967), p. 13.

[4] Ibid., p. 19.

established by law, and the use of silver was reduced to small coins. (3) In 1875 one of the thirty-three banks of issue, the Prussian Bank, was reorganized as the Reichbank. Here, we see that while the Reich unification of currency did occur, it was a gradual process established to accommodate a smooth transition for its member states.

Following Germany's defeat in the first world war war and the exile of Kaiser Wilhelm, the Weimar Republic was founded in 1919. According to Karl Hardach, "inflation and weighty reparation demands principally accounted for the economic chaos during the first years of Weimar."[5] While a period of stabilization and prosperity did occur, by 1928 Germany was feeling the effects of the Great Depression triggered in the United States. This economic slump is often ated as one of the explanatory factors for the rise of fascism.[6] It is here that Hitler's takeover was greeted with a considerable amount of relief. The November 1932 German elections indicate that the combined vote of the NSDAP (Nazis) and Communists exceeded fifty percent.[7] Therefore, the rise of Hitler and the Third Reich in Germany was due in large part, to troubled economic times.

In the aftermath of the second world war, Germany was occupied by

---

[5] Karl Hardach, The Political Economy of Germany in the Twentieth Century, (Berkely: University of California Press, 1980), p. 38.

[6] The Economist Intelligence Unit, Germany: Country Profile, (London: Business International Limited, 1991-92), p. 4.

[7] Ibid.

the victorious powers - Britain, France, the USA and the USSR - each power occupying a zone of the country. The situation was much the same in all four occupation zones of Germany: the productive potential was largely destroyed, the population stricken by the direct and indirect effects of war, and acute material distress was widespread.[8] According to EIU Country Profile, "Rising East-West tension played a major role in encouraging the first three countries to accelerate moves towards unification and granting political responsibility under their political control."[9] On September 1, 1948, the Parliamentary Council, acting on the authority of the Western allies, began to draft a Basic Law. Included in this constitution was article twenty-nine, which allowed for eventual absorption of East Germany into this new unification. "In fact", according to Helmut Böhme, "the Basic Law denied East Germany's existence as a separate country, a move that would have serious future implications."[10] It is here that, while not officially recognized, the two Germanies split for all practical purposes, not to see reunification for another forty years.

In 1948 West Germany embarked on a currency reform strategy that has become regarded as an "economic miracle". Here is how a former

---

[8] Reinhard Pohl, Handbook of the Economy of the German Democratic Republic, (Westmead: Saxon House, 1979), p. 1.

[9] The Economist Intelligence Unit, Germany: Country Profile, (London: Business International Limited, 1991-92), p. 4.

[10] Helmut Böhme, An Introduction to the Social and Economic History of Germany, (New York: St. Martin's Press, 1978), p. 116.

governor of the American Federal Reserve described the effect of currency reform in West Germany in 1948:

> On June 1 1948, goods reappeared in the stores, money resumed its normal function, black and grey markets reverted to a minor role, foraging trips to the country ceased, labor productivity increased, an output took off on its great upward surge. The spirit of the country changed overnight. The grey, hungry, dead-looking figures wandering about the streets in their everlasting search for food came to life, as pocketing their DM40, they went on a first spending spree.[11]

What happened to spur this exhausted economy into a frenzy overnight? According to Herbert Giersch, "West Germany's rapid postwar recovery was due to hard work."[12] Here, human capital was deemed more important than physical capital. In 1948, West Germany had an ample supply of human capital despite losses inflicted by the war. Another reason for West Germany's turnaround was their inclusion in the Marshall Plan in April, 1948. Here, the United States offered European countries substantial aid on the condition that they propose a concerted plan of reconstruction. According to Stopler, the Marshall Plan, currency reform, and the decision in favor of a market economy were the pillars for reconstruction in West Germany.[13] Whatever the reason or reasons, West

---

[11] "A Survey of New Germany", <u>The Economist</u>, June 30, 1990, p. 10.

[12] Herbert Giersch, <u>Towards a Market Economy in Central and Eastern Europe</u>, (Berlin: Springer-Verlag, 1991), p. 1.

[13] Gustav Stopler, <u>The German Economy: 1870 To The Present</u>, (New York: Harcourt, Brace & World, Inc., 1967), p. 236.

Germany's great leap from central planning to a more or less free market is frequently cited as an example for the Central and East European countries waiting to transform their Soviet-type economies today.[14]

For East Germany, postwar economic reform pursued a different path. According to David Childs, "The Soviet Zone of Germany was, apart from the Western sections of Czechoslovakia and the former German areas of Poland, the first, and so far the only, advanced industrial region to attempt to build Soviet-style socialism."[15] According to Pohl, the main features of this model were:

a) Political and economic power vested in the Communist Party; b) social - i.e. state or collective - ownership of the means of production; c) central planning, administration and supervision of the economy. [16] Throughout GDR history economic planning was governed by the targets set by the top-level political authorities referred to as medium term plans or "perspective plans". These blueprints, covering a number of years, were in principle the foremost scheduling instruments, providing a solid basis from which the annual economic plans were to be derived.[17] Therefore,

---

[14] Holger Schmieding, "West Germany's Economic Reforms of 1948: The Lessons for Central and Eastern Europe Today", Towards a Market Economy in Central and Eastern Europe, (Berlin: Springer-Verlag, 1991), p. 23.

[15] David Childs, The GDR: Moscow's German Ally, (London: Unwin Hyman, 1988), p. 141.

[16] Reinhard Pohl, Handbook of the Economy of the German Democratic Republic, (Westmead: Saxon House, 1979), p. 3.

the GDR embraced an economic policy of a planned command economy dedicated to industrial growth.

According to Childs, the GDR economy suffered numerous obstacles that hampered economic success.[18] Apparently after the war, both the Americans and the Soviets wooed away key industrial GDR individuals as well as stripped the East of its productive resources. Thus, the East could not rely on its strength in human capital as did the West in 1948. Furthermore, the GDR did not receive Marshall Aid. In fact, its foreign trade was actually hampered in that relations with Western Europe were virtually extinguished after 1946. Another barrier to economic success mentioned by Childs is the fact that many GDR industries had been and continued to rely on components from West Germany to assemble its products. One example Childs offers is the automobile industry. Before the war, thirty-three percent of vehicle production originated in the GDR, yet the same area was only responsible for only fourteen percent of the components. Tires, glass, spark plugs, electrical parts, and cables were brought from factories in the western parts of Germany. Therefore, it is reasonable to suggest that the German Democratic Republic did, indeed, suffer economic perils not experienced by its western counterpart.

Another point of interest in East Germany's history is its continued

---

17 Ibid., p. 5.

18 David Childs, The GDR: Moscow's German Ally, (London: Unwin Hyman, 1988), p. 141.

struggle to be recognized as a separate entity, apart from West Germany. As mentioned earlier, West Germany's Basic Law incorporated a provision for East German unification (A clause that the GDR would later take them up on). However, according to Henry Krisch, throughout its history, the GDR had pursued a policy of isolation, or Abgrenzung from the West.

> With the integration of the GDR into the East European alliance system in the mid-1950's, the regime's chief concern in relation to West Germany became to secure from the world, and especially from Bonn, an acceptance of the GDR's independent status.[19]

As the 1961 construction of the Berlin Wall is known historically for its prevention of immigrants from the East to the West, Childs notes that the Wall also became a symbol of East German isolation, independence, and need for recognition.[20] In 1971, the GDR received this recognition with the Four Power Agreement on Berlin and the Treaty of Basic relations between the two German states. According to Krisch, The Four Power Agreement, negotiated by the United States, Great Britain, France, and the USSR clearly put an end to the chief instrument for political pressure in German affairs: the deliberate harassment of transit traffic between Berlin and West Germany.[21] Furthermore, the agreement set the stage for

---

[19] Henry Krisch, The German Democratic Republic: The Search For Identity, (Boulder: Westview Press, 1985), p. 76.

[20] David Childs, The GDR: Moscow's German Ally, (London: Unwin Hyman, 1988), p. 65.

negotiation of the first general treaty between the two German states, the *Grundlagenvertrang* of 1972. Here, for the first time. the Bonn government recognized the GDR as a fully sovereign state within secure and accepted borders. With this, the German Democratic Republic was successful (on paper at least) in accomplishing its policy of Abgrenzung, effectively carving out a timeless niche for itself in a divided European economy. Or so it thought.

By investigating Germany's background it is possible to more effectively compare the 1990 reunification of Germany. A number of lessons can be implemented for future reference. For one, the founding of the German Reich led to Germany's success in industry. Following political union, a gradual monetary union was implemented in a three phase tier. Second, the rise of the Hitler and the Third Reich was partially due to economic despair from Germany's defeat in World War I. Third, the Basic Law, drafted by the Western allies of World War II, allowed for eventual absorption of East Germany to the West. Fourth, as Germany divided, two different models of contrasting economic theory came into existence. Fifth, West Germany's economic recovery of 1948 has become an example for many Central and East European socialist countries in transition to a free market economy. And finally, throughout its history,

---

[21] Henry Krisch, The German Democratic Republic: The Search For Identity, (Boulder: Westview Press, 1985), p. 76.

east Germany has strongly fought to be recognized apart from the West.

3. Reasons for Unification

The German reunification took place in two phases. The first phase occurred on July 1, 1991. Here, a state treaty rushed economic union by transforming East Germany into a market economy thus giving it freedom to establish commerce with private ownership, free prices, and free wages.[22] In effect, the East German sovereign monetary policy was disbanded and replaced by the West. Furthermore, on this day, the West German Bundesbank took monetary responsibility for both East and West Germany and the Deutsche mark replaced the Ostmark in East Germany. However, this phase did not mark the official unification of Germany.

The second phase took place on October 3, 1990. It is here that Germany became officially (politically) reunited after forty years of existing in two different political and ideological realms. Thus, five new Länder became incorporated into the West German Federal Republic and East Germany's socialist government was dissolved.

While the second phase was essential for official, democratic reunification, it is the focus of this thesis to investigate the first, "speedy" phase of economic unification from which the second phase, political unification. has followed. Mr. Gary Geipel amplifies this reasoning. "The course of economic union will determine to a large extent

---

[22] Serge Schmemann, The New York Times, Sunday July 1, 1990, p. A6, col. 1, lines 5-8.

the behavior of a unified German state."[23] The economic variable in Germany's unification equation, therefore, must be confronted.

As discussed earlier, economic union had been realized with striking speed: on February 7, 1990 the government of the Federal Republic of Germany, under the auspices of Mr. Helmut Kohl, proposed that the two German states create a monetary union, whereby the Deutsche mark would become the sole legal tender of the East. On May 18, 1990 the state treaty on the creation of an economic union was signed by the representatives of the two governments. By July 1 the economic union came into effect, less than four months after the initial proposal was made.

The proposal to first create a monetary union reverses the order of events that history and economic logic would appear to impose. Referring back to the original founding of the Reich, political unity occurred before a gradual monetary union was installed. However, German reunification in 1990 proved just the opposite. In terms of economic logic, according to the Economic Commission for Europe,

> Monetary union would have been ideally the culmination of an adjustment process in the German Democratic Republic which would have taken place over several years, and at the end of which the German Democratic Republic would have significantly narrowed the productivity gap between it and the Federal Republic of Germany[24].

---

[23] Gary Geipel, "The Implications of German Economic Unification", (Indianapolis: Hudson Institute, 1991), No. 123, p. 1.

This process would have started with a basic re-orientation of economic principles towards a market economy system, including the necessary legal and institutional framework, and a new independent currency. In such an approach the exchange rate would be expected to play the role of a shock absorber which via devaluation would enable price competitiveness to be improved during the process of removing various rigidities and other adjustment problems[25]. While this option for unification seemed reasonable, speedy monetary union, often referred to as shock therapy, was installed.

According to The Economist: A Survey of New Germany, immediate economic unification occurred for four essential reasons, all of which merit further elaboration.[26] First, the Soviet Union no longer had the will to sustain the East German order - the line of fear that reached back to the Kremlin had snapped. Second, the communist regime was shown to be more corrupt than most East Germans had remotely realized. Third, East German migration to the West put intense pressure on Bonn and made gradual change in East Germany almost impossible. Fourth, when Mr. Helmut Kohl gambled an East German election on the promise of a quick currency union, his alliance there won it hands down (4).

---

[24] Economic Commission for Europe, "The Unification of Germany", Economic Bulletin for Europe, (New York: United Nation Press, 1991), p. 89.

[25] Ibid.

[26] "A Survey of New Germany", The Economist, June 30, 1990, p. 4.

Considering East Germany's escape from the Soviet Union's stronghold, one needs to look no further than Soviet leader, Mikhail Gorbachev's reaction or lack thereof toward East German immigration to the West. According to The Economist, in September of 1989 the government of Hungary began to gradually relax its border patrol with Austria.[27] With this, thousands of East Germans began to use their relatively easy access to Hungary to gain passage to the West. Gorbachev's reaction to this exodus was one of inaction. "This non-signal triggered", according to Country Profile, "mass demonstrations which eventually led to the symbolic and historic opening of the Berlin Wall in November 1989."[28] In effect, the opənness of Gorbachev's policies (glasnost) and his plans for political and economic reconstruction directly conflicted with the GDR's political goals resulting in a decay of a once tightly-held, Soviet-dominated relationship with East Germany.[29]

While the Soviet Union was loosening its grip on East Germany, Erich Honecker and the Socialist Unity Party of Germany were tightening their own. According to Childs, a number of political figures in the SED were dismissing Gorbachev's call for glasnost and instead, focusing on taking up

---

[27] Ibid.

[28] The Economist Intelligence Unit, Germany: Country Profile, (London: Business International Limited, 1991-92), p. 9.

[29] David Childs, The GDR: Moscow's German Ally, (London: Unwin Hyman, 1988), p. 326.

the slack in control left by the Soviets.[30] Reports received by East German citizens indicate that Honecker had ordered border patrol to shoot on sight "wall jumpers" and anyone who attempted to undermine the SED and its policies.[31] In fact, only after Honecker was deposed from the Politburo, did citizens begin to fully realize the injustices Honecker and his regime had committed (Stasi spy reports, government perks, etc.). Today, the German government is attempting to extradite Honecker from asylum to be tried for treason.[32]

While soured relations with the Soviet Union and corruption from within East Germany's regime may help explain the need for a change, immigration of East German citizens to the West seems to account for the expedience for this economic union. As GDR's Prime Minister and replacement for Mr. Honecker, Egon Krenz took the historic decision to open the border with West Germany and the Berlin Wall in November 1989, immigrants were pouring into the West at a rate of 2000 per day.[33]

The most immediate question that needs to be answered is why East Germans began emigrating at such a rapid rate from their homeland?

---

[30] Ibid., p. 327.

[31] Stephen Kinzer, The New York Times, Saturday, April 18, 1992, p. A4, col. 2, lines 15-20.

[32] Ibid.

[33] Gary Geipel, "The Implications of German Economic Unification", (Indianapolis: Hudson Institute, 1991), No. 123, p. 2.

According to The Economist, the primary reason for excessive emigration from the East was its decaying command economy.[34] By pursuing the policy of Abgrenzung, East German industry became isolated from western developments and more or less, refrained from making many consumer-oriented economic or technological advancements of their own.[35] According to David Childs, while GDR publications continuously professed new victories in battle for industrial development, GDR citizens were questioning why its living standards were so much lower than those of West Germany.[36] Therefore when Egon Krenz liberated borders, an onslaught of eastern citizens chose to migrate to a more wealthy, stable, and vibrant West Germany.

Another question that merits consideration is why West Germany felt it necessary to accept these immigrants from the East in the first place? As mentioned earlier, when West Germany drafted its Basic Law in 1949, it considered the East to be a nonparticipating partner in this agreement. According to Böhme,

> For the most part, throughout its history West Germany has attempted to maintain nationalistic ties with the East. As the East Germans have continually tried to remain a separate entity, the West

---

34 "A Survey of New Germany", The Economist, June 30, 1990, p. 6.

35 Ibid.

36 David Childs, The GDR: Moscow's German Ally, (London: Unwin Hyman, 1988), p. 182.

has done just the opposite.[37]

Therefore, it seems that the initial reason for acceptance of East-to-West migration had been a continued West German interest in preserving nationalism.

While Western nationalism may have been the motivating factor for prolonged migration in the past, in fact, it was not a surge of national pride that brought on the West German initiative of unification. Instead, it was the negative effects of excessive immigration from the East that forced the West to its knees begging for a solution.[38] Economically, the West could not support the over 450,000 immigrants that had left the East since 1989.[39] Westerners could simply no longer tolerate housing, employing, and feeding their wayward, eastern brothers.

West German Chancellor Helmut Kohl believed that only through immediate unification could East Germany be stabilized to a point in which eastern immigration could be controlled. Thus, by unifying and encouraging economic development in the East, Kohl believed that he could entice eastern citizens to remain in the East. He thus abandoned an earlier plan that had envisaged a step-by-step approach culminating in

---

37 Helmut Böhme, An Introduction to the Social and Economic History of Germany, (New York: St. Martin's Press, 1978), p. 99.

38 "A Survey of New Germany", The Economist, June 30, 1990, p. 5.

39 Christopher Farrands, "Prospects for Technological Competitiveness in the Fine New Länder", EIU European Trends, No. 2, 1991, p. 65.

monetary union at the end of 1992."[40] While West Germans voiced concerns over currency inflation and higher taxes, they were faced with a greater, resource-draining, immigration problem. Therefore they were forced to choose the lesser of two evils.[41]

Though East Germans saw grandiose inequality when they looked westward and were losing thousands of citizens daily, GDR nationalists had their own reservations over unification with the West. For one, during its forty two-year history the GDR became regarded as one of the more productive economies of the East European nations. By the mid 1970's, East Germany's GNP was twice that of Poland, one-third as much as the USSR and three times that of Yugoslavia.[42] For the most part, consistencies in this differential remained until German unification. Here, while East Germans observed economic inequalities with the West (shoddy consumer goods, lower wages, etc.) they were apprehensive of losing their economic stature in East Europe.

Another concern over economic unification expressed by East Germans was the possibility of unemployment. While free market economies of the West maintained competitiveness by permitting market forces to determine a rate of unemployment, in a command economy

---

40 "A Survey of New Germany", The Economist, June 30, 1990, p. 6.

41 Ibid.

42 David Childs, The GDR: Moscow's German Ally, (London: Unwin Hyman, 1988), p. 147.

holding a job is an obligation to the state. Therefore, historically, unemployment rates in the East have been significantly lower than those of the West.[43] Considering this, one can relate to East Germans' fears of unemployment in converting to a free market economy.

Another reservation expressed by East Germans was the future of its currency and its purchasing power in competitive western markets. GDR citizens realizing that their currency, the Ostmark, was worth only a little over half that of the West feared excessive devaluation of their currency.[44] Therefore, while currency conversion from the Ostmark to the D-mark, could bring the GDR a stable currency with undeniable western purchasing power, it was uncertain as to what the rate of exchange would be if and when monetary union was to occur.

A final consideration debated by East Germans was the preservation of its national identity. By acceding to the West, East Germany would be sacrificing the individuality which it had fought for so long to achieve. In fact, by unifying with the West, East Germans were forced to admit the defeat of communism. "A command economy is an utterly hopeless way of running an advanced society: not even the Germans could make it work."[45] According to Farrands this forfeiture of recognition occurred with the 1989 razing of the Berlin Wall. "The fall of the Wall represented an East

---

[43] Ibid.

[44] Exchange Rate on July 1, 1990 is .60 per West German mark.

[45] "A Survey of New Germany", The Economist, June 30, 1990, p. 1.

German resignation of its once historical need for national recognition, and instead, represented a dire need for economic and political aid from the West."[46] Therefore, while the East expressed reservations over unification, it was more important for them to establish a path that could lead to equality with the West.

The political event that gave economic union of the Germanies its needed support was elections in the East which resulted in success for West German's Helmut Kohl and his policy of quick monetary union.[47] In March of 1990, a conservative Christian Democratic alliance, led by Mr. Lothar de Maiziere, won the East German election. Mr. de Maiziere professed complete support for Mr. Kohl's ten-point economic unification plan which had been disclosed in late November 1990.[48] Therefore, a vote for de Maiziere was an East German vote for economic unification. Thus, by popular support, East Germany elected to become one with the West.

---

[46] Christopher Farrands, "Prospects for Technological Competitiveness in the Fine New Länder", EIU European Trends, No. 2, 1991, p. 65.

[47] "A Survey of New Germany", The Economist, June 30, 1990, p. 5.

[48] Ibid.

4. Economic Unification

The state treaty signed on May 18 1990 sets out the general principles and details for economic, monetary, and social union. As is stated, the two German states regarded the treaty as an intermediate step towards political unification.[49] The date of political unification was then unknown. Nevertheless, by the time the unity treaty was passed by the two German parliaments on September 21, 1990 the legal foundations for economic and monetary integration of the two Germanies had already been laid.[50]

In a televised address on June 30, 1990, the evening before the surrender of East Germany's economy to West Germany, Prime Minister de Maiziere urged East Germans to face the "decisive step" with courage and hope.[51] He went on to describe the monetary union as "the bridge to unification of the two German states."[52] Indeed he was correct.

In effect, on July 1 the first state treaty in over forty years brought about a merging of these two ideologically opposed countries. The

---

49 Economic Commission for Europe, "The Unification of Germany", Economic Bulletin for Europe, (New York: United Nation Press, 1991), p. 91.

50 Ibid.

51 Serge Schmemann, The New York Times, Sunday July 1, 1990, p. A6, col. 1, lines 1-5.

52 Ibid.

particulars of the treaty are described below:

• East Germany becomes a market economy with freedom to establish business with private ownership, free prices, and free wages.

• East Germany's sovereignty in monetary policy ends.

• The West German Bundesbank takes monetary responsibility for East and West Germany.

• The customs borders of the two Germanies moves to the countries' respective borders with foreign countries, creating an all-German market and an economic union.

• Salaries, pensions and scholarships are paid in West Germany's currency, the Deutsche mark, beginning on this date.

• East Germany adapts its social system to the West German one, step by step, thereby creating a social union.[53]

Another point of interest in German economic union is the exchange rate that was used. In order to ease East Germans concerns over currency devaluation, Mr. Kohl felt it necessary to secure a favorable exchange rate for the East. While the Bundesbank suggested a standard rate of two Ostmarks for one D-mark, Kohl established a system in which each adult East German was allowed to exchange 4,000 marks of savings at a rate of one to one for West German marks.[54] Children under fourteen could

---

[53] Ibid.

[54] Economic Commission for Europe, "The Unification of Germany", Economic Bulletin for Europe, (New York: United Nation Press, 1991), p.94.

receive only 2,000 marks, while persons over sixty could exchange up to 6,000 at this one-for-on rate.[55] This favorable rate helped gain East German support for monetary union with polls showing over seventy-five percent approval ratings from GDR citizens.[56]

---

55 Ibid.

56 Serge Schmemann, The New York Times, Sunday July 1, 1990, p. A6, col. 2, lines 15-25.

Modalities of the Monetary Union: Conversion rates

A. Bank Deposits

1. Individuals residing in the German Democratic Republic

(a) A per caput endowment, which varied with the age of the individual (cut-off date 1 July 1990), could be converted at par:

Age	Maximum amount (of Mark into DM)
0 - 13	2 000
14 - 58	4 000
59 and above	6 000

(b) All deposits exceeding the maximum amounts above were converted at a rate of 2 Marks against 1 Deutschmark.

2. Individuals residing outside the German Democratic Republic

Bank deposits existing on 31 December 1989 were converted at a rate of 2 Marks = 1 DM. Any deposits created as from 1 January 1990 were converted at a rate of 3:1.

3. Legal persons and other institutions

(a) Residing in the German Democratic Republic: as 1 (b) above.

(b) Residing outside the German Democratic Republic: As for 2 above.

B. Assets and liabilities denominated in German Democratic Republic Marks

1. Basic principle: all assets and liabilities denominated in German Democratic Republic Marks before 1 July 1990 were converted into DM, with debtors paying the creditors 1 DM for every 2 German Democratic Republic Marks.Bonn, 18 May 1990

2. The following liabilities and claims, however, converted at a rate of 1:1:

- wages and salaries at the levels fixed in wage agreements in force on 1 May 1990;
- pensions which became due after 30 June 1989;
- rent, leasehold and other recurrent payments due after 30 June 1990, except for recurrent payments into and out of life insurance, and private old age insurance.

Source:Anlage I. *Bulletin*, Presse- und Informationsamt der Bundesregierung.

Bonn, 18 May 1990

As discussed earlier, this *de jure*, or immediate monetary and social union provided essentially for the extension of the Federal Republic's "soziale Marktirtschaft" (social market economy) to the GDR, with the latter adopting all relevant economic, financial, and social legislation of the FRG. In the same vein, it was expected that socialist principles, central planning, and the state monopoly of foreign trade would have to be abandoned.[57] Here, one can certainly comprehend the major adjustment pressure borne on the shoulders of every GDR citizen.

With this in mind, the radical changes to which the east German economy was subjected were accompanied by various measures designed to ease the adjustment pressures. According to the Economic Commission for Europe, these measures comprise:

- financial assistance to the public sector;

- measures to ease tensions in the labor market;

- measures to ease the structural adjustment of companies to the new competitive environment and to stimulate investment in general(93).

Examining the public sector, in the state treaty of May 1990 it was stated that the Federal Republic would make funds available to the German Democratic Republic to cover the larger part (about two thirds) of its projected deficit for the second half of 1990 and for 1991 to provide start-up finance for the social security system which has been brought in

[57] Economic Commission for Europe, "The Unification of Germany", Economic Bulletin for Europe, (New York: United Nation Press, 1991), p.91.

line with that of the Federal Republic of Germany. The total transfer payments for 1991 were projected at DM 38 billion.[58] However, in the meantime it had turned out that these projections were based on too optimistic assumptions about economic developments in east Germany after July 1.[59] At the end of September 1990, the federal government passed a third supplementary budget largely devoted to meeting these larger than expected official transfer payments, which were estimated at about DM50 billion for 1990. As of June 1991, the Federal government continued to pass new legislation for united Germany with estimates as high as DM75 billion for its 1991 subsidies to the East.[60]

To support the financing of the east German public sector budget the Federal Republic of Germany set up a special fund, the so-called *German unity fund.* This provides for total transfer payments of DM 115 billion up to 1994, of which DM 95 billion are to be raised by borrowing.[61]

Considering the labor market measures, as discussed earlier the effects of the introduction of a market economy were expected to lead to considerable disturbances in the east German labor market. To alleviate

---

58 Ibid., p. 93.

59 Ibid., p. 94.

60 The Economist Intelligence Unit, Germany: Country Profile. (London: Business International Limited, 1991-92), p. 41.

61 [illegible] "The Unification of Germany", [illegible] Press, 1991), p. [illegible].

the adjustment problems the German authorities implemented - in addition to the introduction of the Federal Republic's social security system - revision in both the Labor Promotion Law and early retirement benefits.[62] Under the modified Labor Adjustment Law, employees in east Germany who have experienced a cut-back in working hours could receive short-time working benefits (65 percent of the previous net income) not only if short-time was caused by a temporary shortfall of orders but also if the cause was the fundamental restructuring of the company. Here, short-time benefits would be paid even if it was expected that neither the company nor the specific job supported would survive this new, competitive environment.

In terms of early retirement revisions, employees over the age of 57 could receive early retirements for a period of up to three years. These benefits amounted up to 65 percent of their last average net income.[63] Furthermore, female workers were entitled to early retirement benefits from the age of 55 for up to a period of fifteen years if they had applied by the end of 1990. This last provision was explained by the much higher labor force participation rate that prevailed in the German Democratic republic in comparison with the Federal Republic of Germany and the expectation that a sizeable part of the adjustment burden in the eastern

---

62 Ibid., p. 93.

63 Ibid.

labor market would fall on female workers.[64]

With regards to the enterprise sector, the trust fund for the privatization of state assets was authorized by the unity treaty to borrow up to DM 25 billion in 1990-1 to support the restructuring and consolidation of firms in the five new Lander. According to Economic Commission for Europe, this borrowing was supposed to be covered eventually by revenues from the privatization of state assets.

> In fact, revenues from the sale of state assets will have to be used to support the structural adjustment of the former GDR economy and after that, to pay back, to the extent possible, the accumulated debt of its public sector.[65]

In addition to the activities of the trust fund the German authorities have been providing investment subsidy schemes and soft loans facilities to stimulate investment both by the private sector and by the local and regional authorities in east Germany. The total funds available amount to more than DM 35 billion up to 1994.[66]

The German authorities have also made available - outside the arrangements of the state and unification treaties - loans at favorable conditions to stimulate investment by small and medium-sized enterprises in the eastern Länder. A major source of these loans is the

---

64 Ibid.

65 Ibid., p. 94

66 Ibid.

ERP special fund, which originated in the Marshall Aid Program of 1948-1952.[67] The "ERP loans" available for 1990 and 1991 amounted to DM 7.5 billion and DM 6 billion respectively.

Another attempt to ease the effects of adjustment pressure was a short-term relaxation by the Federal Republic on sales tax for goods originating in east Germany. According to the Economic Commission, this provision was phased out at the end of March 1991.[68] By investigating these measures one can see that attempts were indeed made by the Federal Republic to help alleviate some of the adjustment burden felt in the East.

While primarily this event marked the absorption of the East economy into the West, July 1 became a date with many far reaching implications. In fact, this treaty opened the flood-gate for many unanswered questions.[69] First, the "two plus four" talks involving the two Germanies and the four World War II allies - the United States, the Soviet Union, Britain, and France were assembled to establish Germany's new role on the political scene, including its membership in NATO. Second, it was uncertain as to how a departure of all foreign troops would be accomplished . In particular the maintenance cost of approximately

---

67 Ibid.

68 Ibid., p. 95.

69 Serge Schmemann, The New York Times, Sunday July 1, 1990, p. A6, col. 3.

380,000 Soviet troops were expected to be carried by East Germany, and then eventually returned after a transition period, which Germany was expected to finance. Third, came the question of continued trade links between East Germany and the Soviet Union. Unfortunately, a number of East German companies produced goods that were important to the Soviet Union, but that had little value in a free market. The status of these companies and their continuance of Soviet trade was still undetermined at this point. Fourth, thousands of Vietnamese and other third world workers were in East Germany under contract and there future employment needed to be determined. Fifth, the question of whether East Germany would be subject to the same strict environmental regulations as those of the West needed to be answered. Sixth, was the important and complicated challenge of determining the status of property claims from previous owners. At the time of monetary union this was still unclear. Seventh, the important problem of what legal system would apply to the East was still being deliberated. It seemed that while much of the West German Constitution and most national and European Community laws would be extended to the East, a transitional period would exist in which East German laws would continue to apply. Eighth, it was unclear as to which, if any East German leaders, including the deposed Erich Honecker would have to face charges under a united German legal system. Ninth, on the subject of education it was still undetermined whether grades from East German institutions would be accepted at West German universities. Tenth, questions of establishing personal data for the East such as postal codes, telephone area codes, and auto registration codes was yet to be determined. Finally, the question of moving the nation's capital from Bonn back to Berlin was at the top of many politician's agendas. According to Schmemann, it seemed that the majority of citizens were in favor of this move. However the costs could be expensive, possibly outweighing the effects it would have on domestic and foreign relations.[70] Here, one can see that while, economic unification was the first step in uniting the Germanies, it certainly was not the last.

---

70 Ibid.

5. Domestic Economic Consequences (East)

While a number of unanswered questions pose difficulty for a unified Germany, it is the purpose of this thesis to address issues from an economic standpoint. This is based on the earlier assertion that economic consequences have been the primary determinant for German unification.[71] In order to better comprehend these economic consequences the subject will be divided into three categories: domestic (east and west) - issues of which will be discussed in this and the following section; and international - issues of which will be discussed in the final section.

While criticism may be offered for Mr. Kohl's decision for quick economic union it may have been the most efficient way to bring the two Germanies together. As noted by Andreas Westphal, a fast monetary union was the only way to stop citizens from migrating to West Germany. Furthermore, this shock therapy may have been the least expensive way to achieve unification in the long-run, in that quick monetary union brought the advantage of establishing a stable money, a two tier banking system, and the legal system of a market economy - problems that other formerly planned economies had not been able to solve.[72]

---

[71] Gary Geipel, "The Implications of German Economic Unification", (Indianapolis: Hudson Institute, 1991), No. 123, p.1.

[72] Andreas Westphal, "The Economic Consequences of German Unification", EIU Trends, No. 2, 1991, p. 58.

However, as in any speedy process, there are many economic consequences that must be taken into account. By investigating these results, one can make a more informed decision as to whether this expedient unification was wise. As noted by Geipel, "Never has such a rapid merger been attempted between two regions with such different economic histories and levels of development."[73] Therefore, an examination of this union should be beneficial in helping to understand both its positive and negative consequences.

In spite of the advantages of this speedy monetary union, it may be advantageous to recall the arguments of the Bundesbank and those economists in favor of a slower, more gradual strategy. According to Westphal, the main argument was that in 1989 productivity in East Germany was about a quarter of that in West Germany.[74] To make East Germany a region of united Germany - so the argument went - would be tantamount to the destruction of East German industry. It would not be possible for a region of relatively low productivity to compete with a region with substantially higher productivity within the same area. The exchange rate was recommended as the instrument to protect East German industry. With this, unification could have been brought about after the

---

73 Gary Geipel, "The Implications of German Economic Unification", (Indianapolis: Hudson Institute, 1991), No. 123, p.1.

74 Andreas Westphal, "The Economic Consequences of German Unification", EIU Trends, No. 2, 1991, p. 58.

productivity gap between East and West Germany had been substantially reduced. However, this strategy, according to Westphal, would have encouraged export led growth in East Germany, with relatively bad terms of trade and the maintenance of comparatively low real incomes in East Germany for quite a while.[75]

Although there may have been no realistic alternative to fast monetary union, the fears of its opponents were nearly justified by events. According to Westphal, "Since the beginning of the currency union the East German region has seen an increased regional trade deficit and a corresponding surplus in the regional capital balance."[76] Here, it is important to stress that most of the capital inflow consisted of transfer payments of the federal government while private productive investment was very low. In 1991, while transfer payments were estimated to be DM38 billion, private enterprises were planning to invest only about DM18 billion in east Germany.[77]

Unfortunately, any positive effects of these investments may have been counteracted by closures and layoffs in the eastern regions of Germany. According to Westphal, "Most of the private investment is not directed to new capacity, but replaces unproductive equipment with the

---

75 Ibid., p. 59.

76 Ibid.

77 Ibid.

most advanced West German equipment."[78] Every takeover of an East German enterprise (VEB) is accompanied by the elimination of enormous over-staffing. As a result even a sharp acceleration of private investment would probably not lead to an increase in the number of employees. Therefore, it is important to consider the effects of high unemployment in the former GDR.

It had been expected that unemployment would be one of the first immediately visible consequences of German economic union. "Open unemployment is a new phenomenon in east Germany where for more than forty years excess labor has been hidden."[79] Layoffs in the German Democratic Republic had begun before the economic union entered into force. At the end of June 1990 there were 142,000 persons unemployed. By the end of September this figure had risen to nearly 445,000, which corresponds to an unemployment rate of roughly five percent.[80] However, according to this report, a better indicator of the deterioration in the east German labor market is the rapidly rising number of persons working part-time: these numbered 1.78 million at the end of September, while in July 1990 these came to only 0.65 million[81]. This steep rise has to be seen in

---

[78] Ibid.

[79] Economic Commission for Europe, "The Unification of Germany", Economic Bulletin for Europe, (New York: United Nation Press, 1991), p.98.

[80] Ibid.

[81] Ibid.

connection with the provisions for part-time working benefits which are more generous than those available in the Federal Republic. Therefore, it is safe to say that unemployment has certainly become a consequence of immediate economic unification.

As discussed earlier, productivity in east Germany appears to be far below that of its counterpart. In fact, according to the Economic Bulletin for Europe, productivity is instrumental in shaping future employment in the East. "The extent of unemployment will largely be determined by the degree to which west German and foreign companies regard the German Democratic Republic not only as a profitable market for their products but also as a location for productive activities."[82] Given that east Germany is, on average, a low productivity region compared with the Federal Republic of Germany and that the exchange rate is no longer available as a policy instrument, much will depend on the level and expected future rate of change of wages in determining the price competitiveness of firms and the attractiveness of east Germany as a location of production.

As the question productivity in the east is a consequence of economic unification so too is the problem of quality. According to a June 30, 1990 edition of The Economist, "East Germany makes about everything a modern man could list - one shoddy version of each."[83] Two thirds of

---

[82] Ibid., p. 99.

[83] "A Survey of New Germany", The Economist, June 30, 1990, p. 6.

East German industry GNP was in manufacturing, energy, and mining, (West Germany, 35%) and one third is exported, mainly to COMECON countries whose unquestioning custom leaves the supplier with no idea whether his products are world class or not[84] Therefore, at the time of unification, it was undetermined which eastern products could compete with those of the west. By 1991 subsequent issues of The Economist revealed the answer to this uncertainty. Approximately 65 percent of all public firms will be disposed of in the east.[85] Therefore, it seems that while many eastern firms may be rendered uncompetitive there are some firms that can be revived to compete with the west. Furthermore, many of these firms may continue to exist based solely on a continued demand from countries of Eastern Europe who have historically relied and continue to depend on products from the East.

Conversion of these publicly held companies to more competitive, privately owned companies presents particular difficulties for the East. Publicly owned companies came into being during the 1950's under Soviet supervision.

> Enterprises were placed under state administration and, after 1948, under the German Economic Commission, whose branches became the industrial ministries of the new GDR government. These plants were designated "People's Own Enterprises" (Volkseigene, or VEB) and were organized into associations of enterprises (VVBs) as

---

[84] Ibid.

[85] "Hand of Kindness", The Economist, March 21, 1992, p. 71.

well.[86]

By this time, more than half of the property in the GDR was state (or co-op) controlled. These VEB's continued to exist at the time of economic unification and accounted for the majority of its economic enterprise. Here, a plan needed to be arrived at for conversion of these VEB's.

At the time of economic unification many speculated as to the convertibility of these VEB's On June 25, Mr. Richard Pohl, the East German economics minister, said that his ministry had reviewed 3,000 East German companies and found that 30 percent were capable of competing in the open market, 50 percent need overhauling to survive, and 20 percent were doomed to bankruptcy. [87] Reports today tell us that even these estimates were optimistic.

The plan for privatization of these VEB's was to assemble the Treuhandanstalt, an East German agency committed to specifically aid in the privatization of east German public companies. Initial concerns were expressed at the construction of the agency in 1990. "The Treuhand is composed of former Communist bureaucrats interested primarily in maintaining their power and maximizing their gains from a shift to a market economy."[88] However, according to the March 21, 1992 edition of

---

[86] Economic Commission for Europe, "The Unification of Germany", Economic Bulletin for Europe, (New York: United Nation Press, 1991), p.92.

[87] "A Survey of New Germany", The Economist, June 30, 1990, p. 12.

[88] Ferdinand Protzmsan, The New York Times, Thursday, September 20, 1990, p.

The Economist, in less than two years this agency has put thousands of enterprises into private ownership, attracted billions of D-marks in new investment, and secured job guarantees for roughly one million workers.[89] Today, a debate exists in Germany, and elsewhere, over whether the Treuhand's approach is the correct one.

Under the Hammer

Status of Treuhand firms as of end November 1991

	no.	% of total
*Firms disposed of in their entirety**	4,125	38.0
Sold to the private sector	2,467	22.7
of which: sold as MBO's	602	5.5
sold to foreigners	223	2.1
Reprivatized (returned to previous owners)	463	4.3
Transferred to local authorities	250	2.3
Being closed	636	5.8
Other (wound up through closure, merger, or splitting up)	241	2.2
Enterprises still to be disposed of	6,744	62.0
majority owned by private sector	557	5.1
majority owned by Treuhand	6,187	56.9
Total	10,869	100.0

Source: Carlin & Mayer * Includes incomplete transactions

C17, col. 2, lines 40-50.

[89] "Hand of Kindness", The Economist, March 21, 1992, p. 71.

The Treuhand's achievements are summarized in this table, drawn from a study by Colin Mayer of City University Business School and Wendy Carlin of University College London. By the end of November 1991, the Treuhand had disposed of 4,125 enterprises in various ways. A more recent count puts disposals to date at more than 5,000. Some 6,000 enterprises remain to be privatized.[90] This record is impressive when one compares the progress of restructuring attempts to those of other East European command economies. According to Alan Gelb, Poland and Yugoslavia have only just recently established public restructuring agencies. In 1991, Poland, which is the stronger of the two cases, had disposed of 120 public companies and had converted only 75.[91] From this, the other East European countries in reform, as of June 1991, had not yet even begun to tackle this problem in earnest. Therefore, one can conclude that the Treuhand is, in fact, doing its job as efficiently as this conversion process will allow.

The major criticism of the Treuhand to date has been the heavy involvement and cost incurred by the agency. Carlin and Mayer, however, contend that such intimate intrusion into the running of the business, and the often heavy costs incurred by the Treuhand.

For the result is to avoid costs that otherwise would have been

---

[90] Ibid.

[91] Alan H. Gelb and Cheryl W. Gray, The Transformation of Economics in Central and Eastern Europe, (Washington D.C.: The World Bank, 1991), p. 23

incurred - including the fiscal burden of unemployment benefits, as well as the broader political and social costs of an uncushioned collapse in the east.[92]

However, a counter-argument offered by Roger Dornbush and Holger Wolf of MIT suggest that the Treuhand may be spending a fortune on preserving industries that are by their nature obsolete. As discussed earlier, productivity and quality in the east historically have operated at a level drastically lower than that of the West. It may be possible that the Treuhand is subsidizing the privatization of firms which cannot compete with the West. Of course, free market competition will certainly determine the viability of these firms in the long-run. The only real question is whether it is worthwhile for the Treuhand to be incurring such heavy costs at Germany's expense. Therefore, the Treuhand's operational style remains one of the outstanding issues of debate.

Unfortunately, the Treuhand is also experiencing difficulty and outright aggression from East European citizens. On April 1, 1991 the head of the Agency, Herr Rohwedder, was assassinated by a rebel faction in east Germany.[93] "This," according to Farrands, "has only emphasized the sense of political insecurity which has surfaced in the east."[94] In fact, it leads one to question why some citizens are so upset over the Treuhand's

---

92 "Hand of Kindness", The Economist, March 21, 1992, p. 71.

93 Christopher Farrands, "Prospects for Technological Competitiveness in the Fine New Länder", EIU European Trends, No. 2, 1991, p. 65.

94 Ibid.

actions?

While from a broad perspective the Treuhand is making east Germany a more efficient market for its long run viability, in the short term, individuals are losing their jobs and small family businesses. While this pruning will certainly make Germany a more competitive market, many individuals are unhappy being unemployed and are choosing to take it out on the Treuhand.[95] Therefore, from this, one can see that while the privatization of VEB's is an economic effect of unification it is to this date uncertain whether the Treuhand's approach to privatization is of positive or negative consequence.

Another related consequence of unification is the need in the East for managers with experience and/or training in performing under a free market economy. According to the June 30, 1990 edition of The Economist, "Forty years of communism have been just long enough to kill off the understanding in East Germany of how enterprise works. Those who remember are now too old or tired to go back to it. Their young successors know prices, costs and balance sheets only as bureaucratic fictions."[96] Managers in east Germany do not know how to sell things. They have never had to. There products were simply distributed by the state. Indeed, there is a great need for skilled mangers in the east.

---

95 Ibid., p. 66.

96 "A Survey of New Germany", The Economist, June 30, 1990, p. 13.

Many west German and American firms have discovered this need for capitalist knowledge in the east and are capitalizing themselves by opening up their facilities to the East. For example, Columbia Executive Programs in 1990 specifically designed a management program targeted to educate east German businessmen, held in Lake Como, Italy. Over fifteen programs were designed with east Germany in mind.[97] Therefore, it is safe to say that the need to train managers in the East will continue to be an economic effect of German unification.

Economic unification allowed east Germany the opportunity to truly discover its uncompetitive quality and low standards of productivity in comparison with western standards. It is well noted that the Soviet Union dismantled and sent home much of East Germany's capital stock after the war. "But less well-known", according to The Economist, "is that East Germans thereafter plundered it themselves, running down its capital stock and ruining its environment to bridge the gap between cheap consumption and expensive supply."[98] As discussed earlier, compared with the rest of the socialist bloc East Germany was regarded as one of the strongest economies. According to Gelb,

> Post-unification research revealed that the East's economy, environment and infrastructure were in worse condition then the Communist government had led people to believe. It seemed as if the

---

[97] Ibid., p. 7.

[98] Ibid., p. 5.

> East had made no change to their country since the split in 1948. This, unfortunately has caused estimates for the cost of unification to increase dramatically. Today, many expect total costs of unification to amount to over two trillion D-marks.[99]

Therefore, by researching the economic consequences of East German neglect of its economy, infrastructure, and environment one can gain a better sense as to why unification costs have been sorely underestimated.

Plundering of the economy has been at its most damaging in industry. Mr. Werner Scheer, director of the country's Special Steel Kombinat, based in Brandenburg, explains that East German managers could make no use of depreciation charges to finance investment: they had no "own resources."[100] All profit after paying variable costs was sent straight to government as "fresh" investment. Here, central whim came into play. If your company was in a favored industry, such as energy, micro electronics or heavy machinery, you got modernized. If, like Mr. Harry Strohbach, the managing director of VEB Prefo, a small Dresden toymaker, you were ignored. "Investment? What investment? Prefo has not bought new equipment for over a decade."[101] From this, it is possible to understand how productivity and quality could be low and uncompetitive with the free market economy of the West.

---

99 Alan H. Gelb and Cheryl W. Gray, The Transformation of Economies in Central and Eastern Europe, (Washington D.C.: The World Bank, 1991), p. 63

100 "A Survey of New Germany", The Economist, June 30, 1990, p. 5.

101 Ibid.

Towards the end of East Germany's history, the communist GDR government began to recognize its economic inequality with the West. Unfortunately, the German leaders pursued an uninspiring method for regaining their competitive edge. Led by Erich Honecker and his chief economic advisor, Mr. Gunter Mittag, the GDR government concentrated on bolstering economic productivity and quality by forcing technological advancement in the east. However, according to The Economist, the GDR government concentrated more on pet visions than on the struggle to meet the needs of its people.[102] Their crowning achievement was to invest 14 billion Ostmarks during the 1980's in the development of a four-megabit memory chip. Robotron, the country's badly-listing computer flagship, Carl Zeiss of Jena, a great but struggling optical name, and the country's Microelectronic Kombinat were the beneficiaries of this project. Officials from these projects now admit that it was all a waste of money. With the fall of the Berlin Wall in 1989 many of the technical experts hired to advance this project left for the West to pursue more viable and rewarding projects. By the time of economic union production had been abandoned.

Here, we are provided of an example in which the GDR government, while recognizing a differential in productivity and quality, blatantly continued a project that had no viable positive economic results.

---

[102] Ibid.

Furthermore, we observe GDR officials making a fatal mistake: that of allowing an all important pool of human capital to migrate to the West. As discussed earlier, one of the central tenets of the West German economic recovery in 1948 was their retention of a strong and enthusiastic work force. Therefore, the GDR made a poor decision in continuing to squelch its human and capital resources while the West has become more productive and quality conscious.

What can be done to sharpen east Germany's economic competitive edge? Almost all research institutes recommend that wage increases in east Germany be strictly limited to productivity increases. According to Westphal, this implies that wages should stimulate the function of an exchange rate.[103] However, such recommendations are clearly an illusion. Within one currency area there exists the law of one price for labor: there are powerful market forces promoting the divergence of productivity gains and wage increases; the mobility of labor may not eliminate regional differences, but it is greatly reducing them.[104]

Therefore, it seems that wage rate policy may be a flawed instrument for the purposes of regional policy. The metal workers union (IG Metal) has already reached an agreement that by 1994 the wage

---

103 Andreas Westphal, "The Economic Consequences of German Unification", EIU Trends, No. 2, 1991, p. 59.

104 Ibid.

differential between the East and the West will be eliminated.[105] It is most likely that during this time span the gap between the average productivity levels cannot be closed. In earlier exchanges between the two countries differences in productivity could be reflected by a fluctuating exchange rate. However, this is impossible when the same currency exists in both regions. Thus, wage rate differential and its reconciliation with productivity will continue to be a topic of discussion in Germany.

Another constraint in the East with regards to unification is the need to rebuild infrastructure within the region. According to June 30, 1990 edition of The Economist, "The productive services of the economy are thin."[106] They are epitomized by a chain of shops in the villages called "service shops" (cleaning, mending, cobbling)- "a planner's pathetic answer to the intangible part of a modern economy."[107] In east Germany, it seems as if time has stood still with regard to the development of its infrastructure

The shortcomings of the telephone system are striking. Only seven percent of households have a telephone, while in West Germany virtually everyone does. As of 1990, there were only a few hundred lines stretching

---

105 Ibid.

106 "A Survey of New Germany", The Economist, June 30, 1990, p. 9.

107 Ibid.

outside of the country[108]. This is a most potent form of isolation, making it more or less impossible for western businessmen to arrange meetings in the East until they arrive. According to the June 1990 edition of the The Economist, 8 million telephone connections will be installed over the next seven years as part of the DM 55 billion job of bringing the east German system up to par.[109]

Transport also needs attention. As discussed earlier, the former GDR had been a command economy that had been continuously plundered. Some 30 percent of the rail network is single-track today because the Russians used trains on one track to cart away the rails from the other. Hitler's motorways are now fully depreciated, to put it mildly. Bouncing over their ruts takes the western driver back forty years to an unfenced dual-carriage ways, rustic effect bridges and a fellow motorist seen every kilometer or so in a car that makes a Beetle look futuristic.[110] At the time of unification East German transport minister, Mr. Horst Gibtner, estimated that up to DM 200 billion of investment would be needed to restore the roads and railways, link canals to West Germany's, resurrect the Baltic seaports, modernize the urban roads and build a new

---

108 Adrian Webb, "The Future of Berlin", EIU European Trends, No. 2, 1991, p. 69.

109 "A Survey of New Germany", The Economist, June 30, 1990, p. 9.

110 Ibid., p. 5.

international airport for Berlin.[111]

While estimates for complete infrastructure restoration a.e uncertain, they are certainly vast. At the time of monetary union, Geipel estimated a range between DM500-800 billion ($300-500 billion).[112] Unfortunately, as unification became a reality estimates increased to upwards of DM1 trillion.[113] Regardless of cost, however, there is no denial that infrastructure buildup is necessary in the East and odds are that the gradual inflow of such measures will provide the backbone of East Germany's economic regeneration. Therefore, restoration of east Germany's infrastructure is and will continue to be a result of German unification.

As Germans experience difficulty estimating the cost of restoration of its infrastructure, they must also consider other costs of restoration such as the private, residential market. The housing stock in East Germany is decrepit. Before unification some 42 percent of it remained in private hands. However according to The Economist, central allocation and absolute rent control have had their predictable effects.[114] Two-fifths of

---

111 Ibid., p. 9.

112 Gary Geipel, "The Implications of German Economic Unification", (Indianapolis: Hudson Institute, 1991), No. 123, p 2.

113 Adrian Webb, "The Future of Berlin", EIU European Trends, No. 2, 1991, p. 69.

114 "A Survey of New Germany", The Economist, June 30, 1990, p.5.

the housing was built before the first world war and does not appear to have seen a paintbrush since. In 1989, people in East Germany spent just three percent on their homes and it showed. Therefore, unification brings with it a great demand for infrastructure and residential restructuring.

Another consequence of German unification that has economic implications is the topic of environmental pollution in the East. According to Krisch, 80 percent of all of east Germany's energy has been provided by brown coal, or lignite. Unfortunately, brown coal is one of the most serious environmental polluting elements.[115] According to the June 30 edition of The Economist,

> In the winter months brown coal permeates the landscape. In addition, it (East Germany) has clung to a coal-based chemicals industry. The country's sulphur-dioxide figures are dreadful, as are the quantities of chemical water that it dumps into its rivers.[116]

According to Stanley Kabala, the intensity of pollution in a region can be gauged by comparing sulfur dioxide levels. West German deposits had reached roughly 10 tons per square kilometer annually by the middle of the 1980's. In contrast East Germany had average annual deposits of 35 tons.[117] Furthermore, in comparing emissions per dollar of GNP (grams)

---

115 Henry Krisch, The German Democratic Republic: The Search For Identity, (Boulder: Westview Press, 1985), p. 104.

116 "A Survey of New Germany", The Economist, June 30, 1990, p. 19.

117 Stanley J. Kabala, "The Financial Morass in Eastern Europe", Current

we see an even greater disparity: West-1; East-31. This extreme variance in air pollution is also present for water pollution. In fact, Germany's Elbe River is now known to carry effluents from the East to the Baltic, where they contribute to the deterioration of that sea. Therefore, this problem of environmental pollution in the East is not one to be taken lightly.

The monetary estimates for cleaning up the existing damage and converting east Germany to an "environmentally acceptable" country are astronomical. According to John Davies, cleaning up the atmosphere, rivers underground water, and rubbish dumps could cost DM211 billion by the year 2000.[118] Also, one has to take into account the fact that east Germany may lose massive income with respect to the chemical and energy producing industries. "While these industries are already facing difficulties of entering a competitive market, they may be wiped out all together by environmental clean-up costs" (Farrands 64).

It has been suggested that the reasons for excessive pollution in the East are due to the nature of its former command economy. Kabala suggests that systems such as that of the former GDR contain a bias toward heavy and extractive industries and production processes with low efficiency levels in the use of energy and materials.[119] This results in

---

History, Novemcber 1991, p384-5.

118 John Davies, "Germany", The Europe Review, Vol. 6, 1991-2, p. 75

119 Stanley J. Kabala, "The Financial Morass in Eastern Europe", Current

having high energy intensity levels in these economies. When this energy is principally derived from coal without the benefit of pollution control devices, as it was in the East, high levels of energy mean high levels of pollution. Therefore, direct investment in industrial capacity in the former GDR occurred at the expense of consumption, social goods, and, later, the environment.

A question that can be raised is why economic unification put such a constraint on east Germany's environmental policy? According to The Economist, "The European Commission is increasingly the rule-setter for environmental matters in the EC, and for east Germany to even have a chance of assimilation into the community, they must greatly reduce environmental hazards in their region."[120] Also, as an enthusiastically "green country", west Germany has been pushing in the same direction. The EC has already required that all east German power stations meet west Germany's tough standards by 1996. With political unification now a reality, soon all western regulations will apply to the east. Today, it is still uncertain as to the speed with which Euro-rules will be applied to east Germany and its products.[121] Nevertheless, it is clear that that environmental concerns are certainly a consequence of unification whose

---

History, Novemcber 1991, p384-5.

120 "A Survey of New Germany", The Economist, June 30, 1990, p. 19.

121 Christopher Farrands, "Prospects for Technological Competitiveness in the Fine New Länder", EIU European Trends, No. 2, 1991, p. 65.

effects will be felt for quite a while.

A final consequence of economic unification that should be taken into account is the effects of further migration throughout the different regions of Germany. According to Stephen Kinzer more than 150,000 refugees had arrived to the West in 1991 and 75,000 additional one's were expected by the year's end.[122] Many of these are immigrants are from Vietnam, Mozambique, the Soviet Union, and Eastern Europe. However, it is estimated that close to 45 percent of this number are east Germans who are migrating to the West. According to Westphal, "There is now no way to prevent a further strong migration from east to west Germany: a low level of relative nominal incomes leads to unemployment, resulting in migration as well."[123] In the short run migration will reduce unemployment - not by creating new jobs but by depopulating many regions in east Germany. Westphal goes on to suggest that the probable result will be the prosperity of "islands of high productivity" in some parts of east Germany, while most of its regions will become depressed in economic and social terms for quite a while.[124]

It seems almost ironic that the immediate and primary reason for

---

[122] Stephen Kinzer, The New York Times, Saturday, April 18, 1992, p. A1, col. 1, lines 52-61.

[123] Andreas Westphal, "The Economic Consequences of German Unification", EIU Trends, No. 2, 1991, p. 59.

[124] Ibid.

expedient monetary union, controlling excessive migration to the west, is now deemed unavoidable and acceptable. According to Ronald Asmus, "West Germany has decided for the age-old adage, if you can't beat 'em than join 'em."[125] However, at the time of unification West Germany believed that an expedient process would offer East Germans the type of guarantees that might stanch the flow of refugees and convince them to stay where they are and rebuild.[126] Why is it that thousands of east Germans continue to migrate to the West?

As discussed earlier, the primary reason for continued migration to the West involves the availability of work in the West. According to John Davies, "The shortage of skilled workers in western Germany has been relieved by the influx from the east, where unemployment is growing rapidly."[127] In effect, overmaned and uncompetitive enterprises in eastern Germany are shredding many workers who are taking their skills to a demanding West. Also, while the wage differential is becoming a diminishing factor, it still exists. Therefore, a number of Easterners are taking advantage of higher, western wages. Furthermore, according to Westphal, as job insecurity and shorter hours are becoming a reality in the east, many citizens are exercising their newly-found right of free choice

---

125 Christopher Farrands, "Prospects for Technological Competitiveness in the Fine New Länder", EIU European Trends, No. 2, 1991, p. 65.

126 Ibid.

127 John Davies, "Germany", The Europe Review, Vol. 6, 1991-2, p. 75

and are opting to work in the West.

A final thought on the subject of eastern citizens migrating to the West also comes from Westphal. Here, he suggests that many Easterners are moving west for psychological reasons.[128] In effect, eastern citizens are in the process of denying any and all facets of socialism and thus, turn there attention to a wealthier, more productive West. According to the April 4, 1992 edition of The Economist, "As the Germans cry for the head of former deposed East German leader, Erich Honecker former GDR citizens find themselves abandoning a system which they had believed in for over forty years."[129] Here, one can observe that psychological implications do exist for the tens of thousands that migrate to the West as well as for overall unification.

128 Andreas Westphal, "The Economic Consequences of German Unification", EIU Trends, No. 2, 1991, p. 59.

129 "A Survey of New Germany", The Economist, June 30, 1990, p. 57.

6. Domestic Economic Consequences (West)

As the East and West became one, a number of West German citizens expressed their discomfort with the merger. According to the June 30, 1990 edition of The Economist, "To hear some German officials talk you might think that this (economic union) was a burden grudgingly shouldered on behalf of the West to help keep the East stable."[130] In part, it was. As already discussed, West Germany, led by Mr. Helmut Kohl, opted for a quick monetary union primarily to resolve the problems of excessive immigration from the East. However when German leaders look a decade or so ahead, their eyes gleam. According to a recent poll, more than half of Germany's top managers and politicians believe that in the long term there will be bigger business opportunities in Eastern Europe than in Western Europe.[131] By merging itself with the East, Germany has opened up the possibility for becoming the economic superpower of the East as well as the West. The purpose of this section is to discuss economic consequences that the West is experiencing from its economic union with the East.

According to the Economic Commission for Europe, "Basically, unification acts like an autonomous increase in external demand for the

---

[130] Ibid., 4.

[131] Ibid., 51.

Federal Republic's economy.[132] There is a large pent-up demand for western consumer goods in east Germany. At the same time, the creation of new enterprises, the restructuring of existing ones and the need for sizeable infrastructure investments will stimulate the demand not only for investment goods but also for other goods such as material supplies.[133] Therefore, West Germany stands much to gain in its unity with the East.

While there are many opportunities to be seized in the East, there can also be much to be lost by the West. At the time of unification West German citizens expressed their fears that unity would result in excessive inflation and higher taxes. With regard to inflation, West Germans, realizing a considerable surge in eastern demand for western goods, expected an inflationary spending spree that would raise the already high capacity utilization rates in west German industry.[134] However, according to the Economic Commission for Europe, this has not occurred. In fact the average savings ratio in the East was about twice (13%) that of the West, where it was over six percent.[135]

132 Economic Commission for Europe, "The Unification of Germany", Economic Bulletin for Europe, (New York: United Nation Press, 1991), p.103.

133 Ibid.

134 Andreas Westphal, "The Economic Consequences of German Unification", EIU Trends, No. 2, 1991, p. 58.

135 Economic Commission for Europe, "The Unification of Germany", Economic

Why didn't inflationary spending become a factor in Germany? According to the Economic Commission for Europe, this can be explained by several factors.[136] First, there was, and continues to be, a general uncertainty for individuals about their job security. Also, households in east Germany, for the first time, had been given opportunities for long-term financial investments with attractive rates of return. This has tended to reduce the time preference of consumption. Another factor that has quelled inflationary spending in support for savings is the prospect of private ownership of real estate. Therefore, while expectations of inflationary spending were present, actions of east Germans have proved otherwise, thus easing west German's fears.

This newly found savings in east Germany has helped cause interest rates to creep up. The International Monetary Fund indicates that the German discount rate has jumped from 6.0 percent in 1990 to 8.0 percent from 1992.[137] From this, one can conclude that increased savings in the East have indeed allowed for higher interest rates as expected in the West.

While west German fears of inflation went mostly unjustified, it seems that they were correct in their expectations of higher taxes. At the

Bulletin for Europe. (New York: United Nation Press, 1991), p.103.

[136]Ibid.

[137] International Monetary Fund, International Financial Statistics, April 1992, Volume XLV, No. 4, p. 247.

time of economic unification, Mr. Kohl predicted that industrial modernization costs would be paid in large measure by private industry with the government acting merely to provide tax and financing incentives in the East[138]. However, by early 1990, Chancellor Kohl appeared to waver on his pledge of no new taxes as his "German Unity Fund" containing DM115 billion ($72 billion) proved to be insufficient. As already discussed, the government in 1990 had been forced to bring in three supplementary budgets to cover rapidly rising costs associated with German unification and to absorb East Germany's deficit-ridden budget. Now it agreed on spending DM411 billion in the East for 1991, a one year budget growth rate of over thirty percent.[139] "The only option for reconciliation" according to Davies, "was to increase taxes for German citizens."[140]

The tax rises agreed upon, to the citizen's dismay, included a special levy on income tax from July 1, 1991 to June 30, 1992 (increasing the tax burden by 7.5 percent during that twelve month period), plus higher taxes on petrol, heating, oil, gas, cigarettes and tobacco.[141] Also,

---

138 Gary Geipel, "The Implications of German Economic Unification", (Indianapolis: Hudson Institute, 1991), No. 123, p3.

139 John Davies, "Germany", The Europe Review, Vol. 6, 1991-2, p. 72

140 Ibid., p. 73.

141 Ibid.

considerable discontent was displayed by the public over a decision to raise an extra DM2 billion levy a year on Bundepost Telekom's profits for 1991 and 1992.[142] However, on Mr. Kohl's intervention, the government found a compromise in which it would take advance payments from Telekom, thus averting an unpopular rise in phone bills. Regardless, a shortfall in the government's budgetary unification costs has certainly put an unexpected burden on taxpayers who are now questioning the validity of future government predictions for the effects of German unification.

West Germans have also experienced side-effects of monetary union whereby the question of property rights in the East have arisen. According to a West German spokesmen at the time of economic unification, "the more we stress that the principle of private property is vital to a working economy, the harder it is to ignore property claims from the past."[143] This issue is extremely complex because of the expropriations that have taken place over the last forty years. After the state treaty was signed on October 3, 1990, the two governments agreed, in a joint declaration, on rules and procedures that allow for either a return of property to its previous owners or for compensation to be paid for expropriations that have taken place since 1949. Expropriations which took place during the period 1945 to 1949 will not be undone. The reason for this being that

---

142 Bundepost Telekom is the east German telephone service company

143 "A Survey of New Germany", The Economist, June 30, 1990, p. 14.

during this time frame, much of this property was distributed as war reparations. And also, the GDR communist regime was not assembled until 1949 and thus, could not be responsible for property that had been seized.[144] However, the question of financial compensation for property taken during this period has been left open.[145]

The unity treaty stipulates the return of property to former owners as a basic right. However, according to the Economic Commission for Europe, there are substantial exceptions to this rule: the return of land and buildings is excluded if they have been turned into a public utility, have become part of a compound construction, or have been used for entrepreneurial purposes.[146] In addition, it is stated that property will not be returned if the previous owner asserts a claim after an investment project has been planned. This last provision is intended to prevent investment projects from being hindered by unclear private property rights over land and real estate currently owned by the state. In all of these cases the former owner will receive financial compensation[147].

For west Germans, this proves a complicated, yet potentially

[144] Reinhard Pohl, Handbook of the Economy of the German Democratic Republic, (Westmead: Saxon House, 1979), p. 5.

[145] Economic Commission for Europe, "The Unification of Germany", Economic Bulletin for Europe, (New York: United Nation Press, 1991), p.91.

[146] Ibid., 92.

[147] Ibid.

rewarding issue. For one, many are former east German citizens who immigrated to the west leaving behind property which they now wish to claim. According to The Economist, a recently formed East German Tenant's initiative claimed that, at the time of monetary union, there were already one million claims from West Germans wishing to regain their properties.[148] However, citizens have found a tough going of trying to reclaim property that falls under investment or entrepreneurial status. On the flip-side, much western investment and entrepreneurial excitement has been quelled because of fear of forced compensation for claims on land in the future. According to Westphal, private investment risks are being avoided because land registry offices are desperately understaffed and land registers are for the most part in complete disorder where they still exist at all[149]. Thus, many investors are holding off until property rights issues are fully resolved.

Another implication of unification that receives much attention in the West is the German government's decline from a spending surplus to a deficit. In 1989, West Germany experienced a DM5.5 billion while by June of 1990 they were in a deficit of DM 6.8 billion.[150] For the most part,

---

148 "A Survey of New Germany", The Economist, June 30, 1990, p. 14.

149 Andreas Westphal, "The Economic Consequences of German Unification", EIU Trends, No. 2, 1991, p. 60.

150 Economic Commission for Europe, "The Unification of Germany", Economic Bulletin for Europe, (New York: United Nation Press, 1991), p.106.

critics have made light of this decline because it is matched by a decline in German net capital exports, which have meant a reduction of financial funds to other countries.[151] However, according to Davies, "Although a deficit will occur in the upcoming years for Germany, an economic evaluation based on a cost-benefit analysis indicates that costs far outweigh the benefits."[152] Therefore, while the transfer of real resources from the rest of the world to Germany does result in a budgetary spending deficit, the benefits of unification, such as the expansion of markets, additional qualified labor, and injection of additional capital warrants this decline in the longer run.

Another related factor of unification that has caused some concern is a decline in Germany's Gross National Product (GNP). In 1991, this output measure fell both in the second and third quarters, which according to the American definition means recession.[153] Furthermore, it seems that growth is further on the decline in 1992. However, according to The Economist, Germany's gross domestic product has in fact, increased during this same time-frame by a robust 3.0 percent[154]. The difference between these two measures is as follows: GNP equals GDP plus "net factor income

---

[151] Ibid., 108.

[152] John Davies, "Germany", The Europe Review, Vol. 6, 1991-2, p. 74

[153] International Monetary Fund, International Financial Statistics, April 1992, Volume XLV, No. 4, p. 247.

[154] "Grossly Distorted Picture", The Economist, December 14, 1991, p.79.

from abroad", ie. profits, investment income and workers' remittances. Most industrial economies now use GDP to hedge against volatile short-term swings in international activity. The big gap between GNP and GDP in Germany is due to the growing number of eastern Germans who work in the western part (figures for all Germany not yet available), but send their wages to their families in the East, misleadingly depressing the GNP measure for the West.[155] Therefore, while overall GNP should not be affected, individual East-West GNP's which continues to be calculated and used as international measures for economic status in Germany are being miscalculated. Thus, it is possible that while west German GNP is on the decline, in the aggregate, unified gross domestic product, which excludes foreign income from abroad is increasing.

155 Ibid.

7. International Economic Consequences

While the majority of economic implications of German unification have been viewed from a domestic perspective, it is also necessary to consider economic consequences of German unification from an international viewpoint. Two questions are raised: What will be Germany's new role in East Europe?; and What will be Germany's new role in West Europe? By investigating these two questions it will be possible to gain a better understanding as to the significance of expedient unification in Germany.

Considering the East, the breakup of the Soviet Union and the move towards a market economy in other reforming countries of Eastern Europe presents many uncertainties for a united Germany. As east Germans satisfy their consumer urge for western goods, a demand for eastern products has obviously declined. According to the Economic Commission for Europe, "German consumers have turned away not only from domestic products but also from those imported by the CMEA (Council of Mutual Economic Assistance). Furthermore many east German firms are finding material supplies and machinery at lower prices in western markets."[156] As a consequence, east German firms cancelled, on a large scale, orders which had been firmly contracted before the economic union came into

---

[156] Economic Commission for Europe, "The Unification of Germany", Economic Bulletin for Europe, (New York: United Nation Press, 1991), p.107.

effect. The slump in east German production and the prospect of bankruptcy for many firms also depressed imports. The net outcome of these changes has been an accumulation of a sizeable trade surplus with the CMEA since the economic union came into effect.[157]

In the state treaties uniting the economies of West and East Germany, the West German government pledges itself to honor the commitments of East German enterprises with trading partners in the CMEA. In fact, the treaty calls for the expansion of ties with the CMEA countries, provided that "market economic principles" are the guiding force[158]. Unfortunately, as discussed earlier, many Eastern European countries are finding that their products are simply no longer accepted by east German clients. [159] Here, the elimination of central planning and the opening of the GDR to Western products makes it very difficult for east German firms to maintain either their delivery or purchase commitments.

On January 1, 1991, all German transactions with the CMEA countries began their denomination in hard currency. With this, the ability for trade with the east has become more desirable in that transactions can be completed with more security. Of course, CMEA clients will not be in a position to pay for east German goods in hard currency, unless their

---

157 Ibid.

158 Rolan Schönfeld, "Unification and the Future of German Trade", Gary Geipel ed., The Future of Germany, (Indianapolis: Hudson Institute, 1991), p 85.

159 Ibid.

own sales to Germany and resulting hard currency income can be guaranteed.[160] Therefore, it is of great importance that a unified Germany recover the former GDR's historical markets.

Despite the range of problems, trade between eastern Germany and the CMEA countries is of considerable importance. According to Schönfeld, 44 percent of East German trade involved CMEA, and 23 percent the Soviet Union alone.[161]

With regards to the Soviet Union, the USSR and the GDR had been each other's most important trading partners. In the 1980's, the GDR consistently accounted for between 10 and 12 percent of Soviet imports and exports.[162] In the other direction, the Soviet Union had a virtual monopoly on energy and raw material supplies to the GDR. Almost all oil and natural gas consumed in East Germany came from the USSR.[163] Although the USSR and GDR are no more, it will certainly be important for the two to foster relations within their new contexts. According to Schönfeld, "The continuation of trade with the Soviet Union and other CMEA countries will no doubt ease the transition to the free market for numerous east German companies."[164] Therefore, continued economic

---

160 Ibid., p.86.

161 Ibid.

162 Ibid., p. 87.

163 Ibid.

trade is essential for both the sake of Germany as well as the new Commonwealth of Independent States (CIS) and other CMEA countries. Here, it is believed that by working together, these former command economies can improve their chances of making a smooth transition to a free market economy.

Investigating German relations with the West, following unification, it is necessary to examine what Germany's new role will be in a new Europe. According to Hans Willgerodt, "The prospect of a united Germany is frightening for many countries and for some Germans as well."[165] Aside from the possibilities for political and militaristic ambitions, Germany is on the verge of becoming an economic superpower. Therefore, it is without doubt that many uncertainties exist for economic concerns in the West.

While the Federal Republic conducted more than half of its foreign trade with the European Community, economic ties between East Germany and the EC countries (with the exception of West Germany, of course) were minor. According to Schönfeld, the GDR was regarded by other EC countries as any other non-member "third country,", which meant that it was subject to tariffs.[166] Therefore, when economic unification occurred,

---

164 Ibid., p. 89.

165 Hans Wilgerodt, "German Economic Integration in a West European Perspective", Towards a Market Economy in Central and Eastern Europe, (Berlin: Springer-Verlag, 1991), p. 163

166 Rolan Schönfeld, "Unification and the Future of German Trade", Gary

it was no doubt questionable as to how the former GDR would now be treated. In December 1989, the EC Commission supported West Germany's right to unify with East Germany without losing its status as an EC member.[167] Therefore, German unification became regarded by the EC as simply, an enlargement of West Germany and thus, did not require the GDR to apply for membership.

One of the most difficult consequences of German unification is that the East will be required to heed all laws and regulation of the EC. According to The Economist, the EC Commission decided at its April 1990 meeting to bring East Germany into the Community in three phases.[168] The first phase began with Germany monetary union on July 1, 1990. In this phase, East Germany adopted the bulk of West German laws, which already conform to EC statutes. The second took place at political unification of the two Germanies. During the second phase, the number of east German exemptions from EC trade regulations was minimized. Here, the greatest problems have been caused in the EC's attempts to subject east Germany's agriculture sector, which was highly subsidized and is very uncompetitive, to its regulatory mechanisms.[169] Also during this phase,

---

Geipel ed.,The Future of Germany, (Indianapolis: Hudson Institute, 1991), p 90.

167 Ibid., p. 90.

168 "A Survey of New Germany", The Economist, June 30, 1990, p. 16

169 Rolan Schönfeld, "Unification and the Future of German Trade", Gary Geipel ed.,The Future of Germany, (Indianapolis: Hudson Institute, 1991), p 90.

other EC members have gradually phased out quotas on East German goods. It is not until the third phase, which will occur at a yet-to-be-determined date, that full application of Community law and the complete integration of east Germany into the EC will take place. In the interim, east Germany has been able to draw on various EC funds to assist its restructuring and modernization.[170] However, it has been observed that other less developed EC countries, such as Greece, Spain, and Portugal, have pointed out the social responsibility that the Federal Republic has for the East and have fought any reductions to their own assistance from the EC.

As discussed, there are many fears that have arisen in other EC countries as a result Germany's expedient monetary union. According to Schönfeld, "Most of these fears center on the sheer economic weight and resulting political dominance that Germany could have in Europe."[171] There are also concerns that Germany's economic focus will shift more to central and Eastern Europe, at the expense of its interest in EC integration. Others worry that the sheer cost of modernizing east Germany will limit Germany's important role as a financial contributor to the EC. And finally, other countries worry about Germany's increasing debt load and it implication for world capital markets.[172]

---

170 Ibid., p. 91.

171 Ibid.

172 Ibid.

According to Schönfeld, it is not realistic that a united Germany will neglect it obligations to the European Community.

> It is precisely a speedy EC integration that will strengthen the productivity of the German economy and therefore ease the burden of unification. Ties to the Soviet Union and other eastern and southern European countries are no replacement for a strong relationship with the EC.[173]

Schönfeld goes on to suggest that the German government has made clear its interest in the coordination with the European integration process. Furthermore, it is suggested that all member countries from the EC, as well as all other industrial countries, can profit from trade and investment with the opportunities in east Germany. However, as already discussed, these firms have experienced some difficulties (property rights, capital restoration, management education, etc.) in capitalizing on these opportunities in the East. Therefore, while many hazards continue to exist for investment in east Germany, continued relations with the West will only foster stronger production in united Germany. While we have only provided an overview on the international topics that relate to unification in Germany, it is important to recognize that numerous economic implications do exist. Furthermore, it has been observed that the same factors which inhibit west German investment in the East also apply on an international level.

---

173 Ibid., p. 92.

8. Conclusion

While July 1, 1990 designates the date in which East and West Germany became economically unified, it certainly does not qualify as the date in which the economies became one entity. As we have demonstrated that German unification was expedient, it is still obvious that this union did not occur in one fell swoop. In fact, German unification is a process just as it was when original unification occurred with the founding of the Reich in 1918.

While both are classified as a process, there the similarity ends. German economic reunification in 1990 occurred in just the opposite manner of the Reich's founding. In 1990, monetary reunion occurred before political. This decision surprised many critics. However, we have proven that this expedient, awkward process was necessary given the conditions at hand.

Furthermore, we have proven that while this process was a fast one, it left behind a number of economic consequences affecting matters domestically and internationally. While these implications are numerous and of different degree they all have one thing in common: a need to be investigated. By examining these consequences it is hoped that further attention will be given to these subjects in relation to the new unified Germany as well as Eastern and Central Europe which are experiencing growing pains in their transition to free market economies.

8. Bibliography

Asmus, Ronald D. "A United Germany", Foreign Affairs. Spring 1990, pp.63-76.

Backer, John, H. Priming the German Economy: American Occupational Policies 1945-1948. Durkham: Duke University Press, 1971.

Brown, J.F. Surge to Freedom. 1989. pp. 125-146.

Böhme, Helmut. An Introduction to the Social and Economic History of Germany. New York: St. Martin's Press, 1978.

Childs, David. The GDR: Moscow's German Ally. London: Unwin Hyman,1988.

Commander, Simon, ed., Managing Inflation in Socialist Economies in Transition. Washington D.C.: The World Bank, 1991.

Commission of the European Communities, "Germany", European Economy: Annual Report 1991-92, pp.39-44.

Davies, John. "Germany", The Europe Review: The Economic and Business Report. Edison: Hunter Publishing Inc., 1991-92.

Economic Commission for Europe, Economic Bulletin for Europe. Volume 42, 1990, pp. 89-107.

The Economist Intelligence Unit. Germany: Country Profile: Annual Survey of Political and Economic Background. London: Business International Limitied, 1991-92.

"Evolution in Europe: The Pieces of the German Pie", New York Times. October 3, 1990, Sect. A. p.8.

Farrands, Christopher. "Prospects for Technological Competitiveness in the Five New Länder", European Trends. Number 2, 1991, pp.63-67.

Geipel, Gary L., ed., The Future of Germany. Indianapolis: Hudson Institute, 1990.

Geipel, Gary L. "The Implications of German Economic Unification". Indianapolis: Hudson Institute, 1990.

Gelb, Alan, H. and Gray, Cheryl, W. The Transformation of Economies in Central and Eastern Europe. Washington D.C.: The World Bank, 1991.

"Germany's Eastern Question", The Economist. February 29, 1992, pp. 51-52.

Giersch, Herbert, ed., Towards a Market Economy in Central and Eastern Europe. Berlin: Springer-Verlag, 1991.

"Grossly Distorted Picture", The Economist. Decmber 14, 1991, p.79.

"Hand of Kindness", The Economist. March 21, 1992, p.71

Hardach, Karl. The Political Economy of Germany in the Twentieth Century. Berkeley: University of California Press, 1980.

Haustein, Heinz-Dieter. "Experiences and Prospects: The Case of the GDR", Giersch, Herbert, ed., Towards a Market Economy in Central and Eastern Europe. Berlin: Springer-Verlag, 1991, pp.143-154.

Hillenbrand, Martin J. The Future of Berlin. Montclair: Allanheld, Osmun Publishers, 1980.

International Monetary Fund. International Financial Statistics. April 1992, Volume XLV, Number 4, pp.244-247.

James, Harold. The German Slump: Politics and Economics 1924-1936. Oxford: Clarendon Press, 1986.

Kabala, Stanley, J. "The Environmental Morass in Eastern Europe", Current History. November 1992. pp. 384-5.

Kinzer, Stephen. New York Times. October 1. 1991. Sect. A p.1,8.

Kinzer, Stephen. New York Times Magazine. April 12, 1992, p. 24-52.

Kinzer, Stephen. New York Times. April 18, 1992, Sect. A p.1,4.

Krisch, Henry. The German Democratic Republic: The Search for Identity, Boulder: Westview Press, 1985.

McCauley, Martin. The German Democratic Republic Since 1945. London: The MacMillian Press LTD, 1983.

Pohl, Reinhard, ed., Handbook of the Economy of the German Democratic Republic. Westmead: Saxon House, 1977.

"So Much Power, So Little Purpose", The Economist. January 18, 1992, pp. 47-48.

Schmemann, Serge. "East German Gaze Ahead, Hopefully", New York Times. July 1, 1990, Sect. A, p. 6.

Schmieding, Holger. "West Germany's Economic Reforms of 1948: The Lessons for Central and Eastern Europe Today", Giersch, Herbert, ed., Towards a Market Economy in Central and Eastern Europe. Berlin: Springer-Verlag, 1991, pp.23-54.

Schönfeld, Ronald. "Unification and the Future of German Trade", ed., The Future of Germany, Indianapolis: Hudson Institute, 1990.

Schnitzer, Martin. East and West Germany: A Comparative Analysis. New York: Praeger Publishers, 1972.

"The Spontaneous Union", The Economist. June 30, 1990. pp. 4-22.

Starr, Richard F. East-Central Europe and the USSR. New York: St. Martin's Press, 1991.

Stopler, Gustav. The German Economy: 1870 to the Present. New York: Harcourt, Brace, & World, 1967.

Stopler, Gustav. Germany Between East and West. New York: National Planning Association, 1960.

Strasse, Wilhelm Peck GDR Facts and Figures. Panorama DDR, 1981.

Tagliabue, John. New York Times. November 1, 1991, Sect.A, p. 6.

Webb, Adrian. "The Furture of Berlin". European Trends. Number 2, 1991, pp.68-78.

Whestphal, Andreas. "Economic Consequences of German Unification". European Trends. Number 2, 1991, pp.58-62.

Willgerodt, Hans. "German Economic Intergration in a European Perspective". Giersch, Herbert, ed., Towards a Market Economy in Central and Eastern Europe Berlin: Springer-Verlag, 1991, pp.155-168.

Windelen, Heinrich. Basic aspects of German Reunification. Bamberg: St.Otto- Verlag, 1984.