

East German Privatization Process during the German Unification: Evaluating Economic and Social Impact of Treuhand Transactions

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German Unification: Quick Facts

- The idea of the Treuhandanstalt, the East German privatization agency, came from the leaders of the East German political opposition. It aimed for an equal division of all government property and its redistribution to the East German people, which would have been between 25,000 and 120,000 DM per person.
- West German chancellor Kohl promised a prosperous economy in only a couple of years, giving hope to East German people and leading them to put the power in the hands of the Western leaders.
- For political reasons, the exchange rate during the Monetary Unification was set at 2:1 and 1:1 East German Marks for a D-Mark (for assets and wages respectively), much below the estimated market exchange rate.
- Instead of restructuring the former East German enterprises or keeping the old management, Treuhand often sold them off to new investors on poor contract terms, which led to white-collar crime, closed businesses, and millions of lost jobs.

Thesis

The conflict between political and economic decision-makers of German unification complicated the privatization process in East Germany, resulting in contradictory actions by the Treuhand agency and prolonging the economic and social division of its two parts.

Introduction to German Unification

On October 3, 1990, after over 40 years of separation, East and West Germany became one country. West Germany had been a democratic state with a thriving market economy, which had experienced a "miraculous" recovery from the destruction of the war. Meanwhile East Germany, a centrally planned economy, was indebted to the West and dependent on its Eastern Block partners.

By the 1980s, the East German economy was a leader in the Eastern Block, but it lagged behind Western Europe in its output and productivity. The country's production relied mostly on combines—big outmoded industrial enterprises with a poorly motivated work force.

The 1980s brought the spirit of people power to Eastern Europe. Inspired by Gorbachev's call for a more liberal regime, East German citizens began demonstrating on September 4, 1989, forcing the government to ease all travel restrictions. On November 9, 1989, the Berlin Wall fell under popular pressure, claiming no victims except the Iron Curtain.

German Economic, Monetary and Social Union (GEMSU)

After the fall of the Wall it became clear that the previously stable centrally planned economy of the East came to an end. Political leaders of both East and West were now fighting for the new no-man's land, proposing their short and long-term plans. A decision had to be made whether to keep East Germany as a sovereign country or unite it with the West. Free voting on March 18, 1990, showed that most East Germans were in favor of unification.

The main question was now on the transformation of the former East Germany and its integration into the market economy of the West. The currency union of 1990 was a quick solution for speeding up the process, but the high exchange rate complicated the economic transition even further. Political decision prevailed over the economically rational one, ignoring the substantial output and productivity gaps between the two countries. The result was a deep economic downturn, destruction of the East German markets, bankruptcy of East German enterprises and high unemployment.

East German Privatization

East German economic transition from a planned to a free market model was the responsibility of the Treuhandanstalt, an agency designed to move all public enterprises and common property into private hands. The official guidelines were set politically and called for selling off viable companies quickly and closing down the rest.

In the early stages of privatization the German government counted on receiving substantial profit from the privatization contracts. It was later found that due to insufficient information and an optimistic West German political agenda the assets of former East Germany were overvalued. Instead of restructuring the East German enterprises into competitive businesses, the Treuhand had to sell the companies in as-is condition, creating opportunities for destructive speculation and white-collar crime. Over 2.5 Million East German workers got laid off and could not find new positions in the unfamiliar market economy.

At the end of its term in 1995, the Treuhand ended up with over 200 Billion D-Mark in debt and an unsolved tension between private and public sectors. In the mid-1990s, as privatization was completed and government subsidy programs came to an end, the growth in the East slowed down and has recovered only slowly since. In 1995, the unemployment rate in the West was slightly above 8%, while in the East, where the population was about 16 million people, it was almost 14%. While over the next 20 years the percentage of unemployed has gone down to a slightly lower level in both parts, wages and living standard are still higher in the West.

1980s: centralized production and foreign debt lead to East Germany's economic downturn

Fall 1989: "We Are the People" protests for civil rights happen all over East Germany

1989

November 9, 1989: the Berlin Wall falls
November 28, 1989: West Germany announces its Ten Point Program for German Unification

January 20, 1990: England and France express their concerns about a unified Germany

1990

June 17, 1990: West German Ministry of Finance takes over Treuhand
July 1, 1990: German Economic, Monetary and Social Union

March 1, 1990: privatization agency (Treuhand) is established
March 18, 1990: first free elections take place in East Germany; people vote for parties in favor of unification

August 31, 1990: Treuhand becomes Article 25 of the Unification Treaty
October 3, 1990: Political Union

April 1, 1991: Assassination of Treuhand's chairman

1991

July 3, 1992: Treuhand no longer funded by the federal government

1992

December 31, 1994: Treuhand closed with a debt of over 200 Billion D-Mark and remaining unsold assets

1994

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