 by Volker Hassmann

Monetarist solutions won't work

The German economy is in a bad slump, but Moelleman's recipes will make it much worse.

German Economics Minister Jürgen Moellemann has called for drastic action to keep a vicious cycle of stagnation in the west from undermining recovery in the eastern states, during the recent budget debate in parliament. "Most of the economic indicators point downward. The expected relief from exports is not within reach," he said. His call for tough fiscal austerity, public spending cuts, corporate tax reform, wage restraint, and large-scale deregulation, circulating in a ministry strategy paper, has been criticized by parts of Chancellor Helmut Kohl's Christian Democratic Union (CDU), and rejected outright by the opposition Social Democrats and the trade unions.

Moellemann's plan fits into a stream of proposals from the liberal-conservative Kohl government which business leaders have scored as "a constant flow of half-baked ideas," like the low-interest, tax-free "German Bond," or forcing non-investing high earners to buy government bonds to help rebuild the east German economy. The chancellor has lost touch with the business sector and has been repeatedly attacked for ignoring the economic crisis. Bonn policies threaten to ruin the economy, charged the chief executive of the federation of medium-sized businesses, Dieter Haerthe: "The government keeps on demanding better performance without creating the necessary policy framework."

In his state of the nation address, Kohl admitted that he, "like all others," had been wrong and nobody knew how big a liability the debt left over from unification would be. The official guess is that when the Treuhandanstalt—the agency selling off East German assets—ends its task at the end of 1994, its debts will total DM 250 billion ($173 billion). The other fund that assumed old corporate debts of the former communist enterprises, which the Bonn government refuses to write off, is likely to total DM 120 billion. These agencies' funds are supposed to be incorporated into the German budget over coming years, and the interest burden will make the deficit even worse.

Already, the budget for servicing old debt is the second largest category in the budget, with DM 58 billion this fiscal year and DM 59 billion or more for FY 1993. The budget for social support and welfare (which also is meant to mollify the effects of the high interest rate policy on industry and employment) is category number one, at DM 98.8 billion. New borrowings for next fiscal year are DM 38 billion. German total debt will pass DM 1.3 trillion by 1992's end and hit a record DM 1.34 trillion in 1993.

Since the economic strategy for the eastern states has failed so far, shrinking production and job losses there have cut the tax base to 20-28% of what it ought to be, and require continued subsidies from the western states. This will worsen if Moellemann, who tells investors there to "forget the markets in eastern Europe," has his way. Most industrial firms in the five eastern states are surviving only because of exports, albeit on a much reduced level, to their traditional markets in the old Comecon. The Institute for Economic Research in the east German city of Halle warns that the collapse of eastern industrial production will worsen. The engineering sector, hit by the collapse in trade with eastern Europe, was producing in May just 25% of its monthly output for the second half of 1990. Bonn's Economics Ministry reckons that even if production and services in the new states increase by 100% till 1996, jobs will shrink by 8%.

In western Germany, the economy is slumping badly. Industrial output has been declining since 1992 began. Capital goods orders dropped by 8% in July. The machine tool sector, the backbone of German stability, lost 20% of its orders in 1991 and will likely lose another 25% this year. From June 1991 to June 1992, insolvencies rose by 24%. Huge job cuts are planned in the machine tool, auto, electrical, and chemical sectors. Western Germany is short 3 billion apartments. According to Caritas, 1 in 10 Germans lives below the poverty level and the number is rising; 4.2 million are on welfare.

Some economists have been warning that more fiscal austerity or monetarist belt-tightening will not stimulate the needed flow of productive investments into the physical economy in the east. Projects for transport or housing do exist. Herbert Ehrenberg, a former Social Democratic labor minister, argues that capital for infrastructure investments in the DM 100 billion range is available on the German capital market. These funds can be mobilized without risk, if investments are geared to productive use. East German states and cities should be exempt from interest for the next six years, under a scheme in which the German central bank will sell part of its substantial gold reserves.