

# Eastern Germany ten years later: the unfinished challenge of reconstruction

by Lothar Komp

More investments have been made into the eastern parts of Germany since the fall of the Berlin Wall than in all other eastern European countries taken together. By the end of 1998, more than 1,300 billion deutschemarks had been invested in urgently needed transportation arteries, in far too few new production facilities, in countless supermarkets, and now and then in office complexes (which remain unoccupied). Yet, today, the eastern states of Germany have rates of unemployment double those of the rest of the country, and only half of the western states' economic productivity, tax revenue, and industrial jobs per capita.

The process by which the east was supposed to catch up with the west stalled in mid-route, and the gap between east and west, has actually opened wider over the past two years. The first, "booster stage" of reconstruction has burned out, and unless the second state ignites soon—which has to include the reindustrialization of eastern Germany and the re-establishment of the traditional export markets in eastern Europe and Russia—there will be a collapse into economic and political chaos.

## The LaRouche plan of 1990

In October 1988, when prominent West German politicians publicly labeled the constitutional provision for the reunification of Germany as "unrealistic," or even a "delusion," Lyndon LaRouche, at a press conference in Berlin, spoke about the imminent collapse of the economies of the eastern system. He offered the Soviet leadership a comprehensive program for economic reconstruction, which would have begun in an exemplary way in Poland, if, in exchange, the Soviet leadership agreed to German reunification. Thirteen months later, the Berlin Wall came down.

In 1990, LaRouche presented a detailed plan for the industrial and infrastructure development of the East, the "Paris-Berlin-Vienna Productive Triangle." LaRouche stressed that, after 50 years of neglected investments in industry and infrastructure, the immense challenge could only be met if the unprecedented density of machine-tool capacities in the Paris-Berlin-Vienna triangle region were mobilized. This economic development in eastern Europe would also create

the most favorable conditions for the modernization of industry and infrastructure in the eastern part of Germany, including the creation of technologically advanced, middle-sized industries.

But all of the German federal government's plans and designs in this direction were dropped, at the latest following the assassinations of Deutsche Bank Chairman Alfred Herrhausen on Nov. 30, 1989, and of Karsten Rohwedder, head of the Treuhand agency (which was responsible for reorganizing industry in eastern Germany), on April 1, 1991. Instead, efforts were limited to the isolated development of eastern Germany. The result of this misguided policy was inevitable. The old export markets to the East collapsed, while at the same time, the Maastricht Treaty's austerity policy unleashed a devastating recession in western Europe. In such an environment, the reconstruction of the East was transformed into entrepreneurial cannibalism: In exchange for short-term investments and promises to create jobs, the Treuhand gave away east German firms to Western firms. At the drop of a hat, 3 million industrial jobs disappeared, together with a priceless treasure in skills and experience, which would have been crucially important for reconstruction of the former East bloc.

## Enormous state investments . . .

Fortunately, the German federal government did not always abide by the letter of the radical free-market economic recipes which were being preached, in chorus with the International Monetary Fund, against eastern Europe and Russia. Up to the end of 1997, the state invested a total of DM 162 billion in east German infrastructure, of which DM 76 billion went for transportation (DM 40 billion for rail lines, DM 21 billion for federal highways, DM 14 billion in public transportation and local roads, and DM 1.6 billion for waterways). In the process, 11,500 kilometers of roads and 5,300 km of rail lines were either modernized or newly built. Some DM 50 billion were invested in east German telecommunications, and another DM 36 billion in economic infrastructure.

In addition to its own investments, the federal government also kept its hand in the game with respect to invest-

ments by private parties in the new states. But, in contrast to the dirigistic promotion of investments that prevailed in the immediate post-World War II period in West Germany, which were key to its postwar “economic miracle,” and which were based on a farsighted plan for economic reconstruction, this time the government distributed money as if out of a watering can. By the end of 1997, that amounted to DM 22 billion in investment grants, and DM 47 billion in special amortization investments into private economy to the tune of DM 510 billion. Many of the promoted projects were very important for the region’s economic development, but others were pure waste.

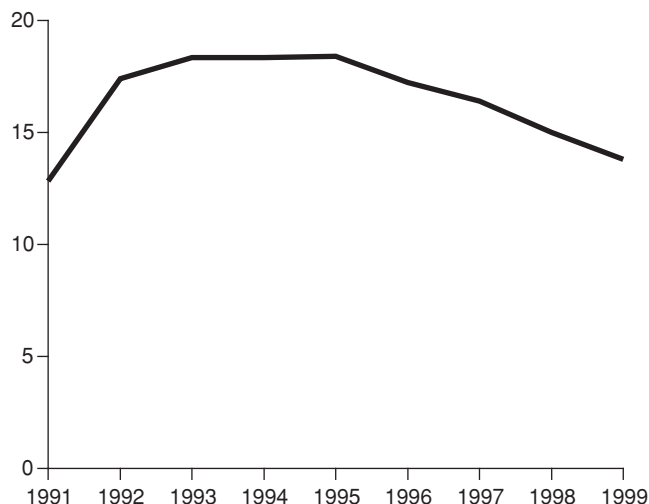
Another DM 38 billion was provided by the government for investment seeding in the framework of “social tasks,” which spawned investments on a volume of DM 181 billion. In addition, firms which made investments, and homeowners, were supported with credits; here the Kreditanstalt für Wiederaufbau (Reconstruction Bank) played a prominent role. By the end of 1997, the Kreditanstalt had provided 720,000 individual credits in the new states of Germany, at a volume of DM 121 billion. These credits leveraged investments of DM 210 billion, modernized more than 3 million housing units, and secured or created some 2.5 million jobs.

All in all, the total of public and private investments into Germany’s new states during 1991-98, according to calculations of the IFO Institute, reached a volume of DM 1,300 billion. The largest chunk, DM 430 billion, went into the account of firms in the service sector, while investments in industry, construction, and agriculture together accounted for only DM 320 billion. Another DM 330 billion went into housing construction, and the remainder of DM 220 billion was direct federal government investment, primarily for modernizing infrastructure.

And yet, these impressive figures can’t hide an alarming trend. Although the economic performance of the new states of Germany is still far below the western level, and although there is still an immense demand for investment in modernization of infrastructure, public budgets and private firms have recently begun to wind down their investment plans (see **Figure 1**). Investments by eastern German municipalities into infrastructure, for example, were reduced in steps from DM 18.7 billion in 1992, to DM 12.9 billion in 1998. A considerable share of the private investment made in the past years was only investment pledged by western firms when they took over privatized eastern firms. But these contractually fixed investments passed their peak in 1995-96, and this activity has now run its course. While investments in eastern German processing industries during 1993-95 were well over DM 18 billion, they are now below DM 14 billion. The downward trend would have been steeper, had it not been for a few large industrial projects (especially in chemicals and electrical technology), for which no follow-on is in sight, and which are now peaking.

**FIGURE 1**  
**Capital investments by the eastern German industrial sector (companies with at least 20 employees), 1991-99**

(in billion deutschemarks)



Source: IFO Institute.

### ... but no targetted industrial development

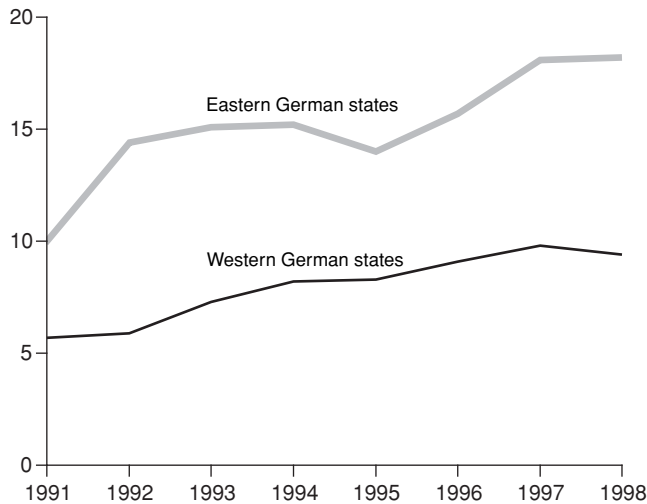
The situation on the labor market is already worse than bleak. Compared to 10 million employed in 1989, there are now only 6 million employed in the new German states (see **Figure 2**). Some 1.5 million people have left their home states for economic reasons. There are more than 600,000 commuters who still live in the east, but who earn their money in the west. Another 1.5 million are registered as unemployed. Of the remaining 6 million jobs, 1 million are sustained only by state programs. The construction sector, which had become the pillar of the economy, has been collapsing over the past two years, and the bottom is not in sight.

The lack of industrial jobs in the new states is catastrophic. In the summer of 1999, the number of industrial employees in eastern Germany (including mining and quarries) was below 600,000 (see **Table 1**). Apart from a few show-factories — in the automobile sector, for example — or in electrical technology, the new states have become an industrial wasteland. In the process, Berlin, which was once the largest industrial city in Europe, has been deindustrialized at a breathtaking pace: Some 270,000 of its 400,000 industrial jobs at the beginning of the decade have disappeared, and this happened primarily in the western section of the city. The impact on public budgets is considerable: Per-capita tax revenues of communities are at 40% of the prevailing western levels. And the approximate equalization of living standards in both parts of Germany

FIGURE 2

**The official unemployment rate in Germany, 1991-98**

(percent)



Source: Federal Labor Agency.

can only be sustained for the foreseeable future by annual transfers of nearly DM 200 billion.

**Machine tools as a technological motor**

Remaining industrial capacities suffer from an acute lack of research funding by which new products and processes are developed, and by means of which jobs can be secured over the long term. With low profit margins and extremely thin capitalization, many eastern German industrial firms cannot afford to finance their own research activities. Research and development personnel have wilted from 80,000, at the time the Berlin Wall came down, to 19,000. Without state support for R&D, which has declined since 1996, the situation would be considerably worse. The lack of industrial research is expressed in the fact that *only 3.6%* of total German exports come from eastern German production.

The strength of the machine sector, especially machine-tool firms, is of central importance for the intensity of research in any industrial region. Continuous technological innovation, which is characteristic of every export-intensive machine industry, has a particularly powerful spin-off effect on other industrial sectors—for example, production of new materials, or measuring and control technologies. A quarter of the total industrial research in eastern Germany today, is accounted for by the machinery sector. But, this is the sector which has been hit hardest of all industrial sectors since 1989 (see **Figure 3**). For example, Saxony’s machinery sector, with its facilities in Chemnitz and elsewhere, was at the top of

TABLE 1

**Industrial jobs per 1,000 residents (only firms with at least 20 employees)**

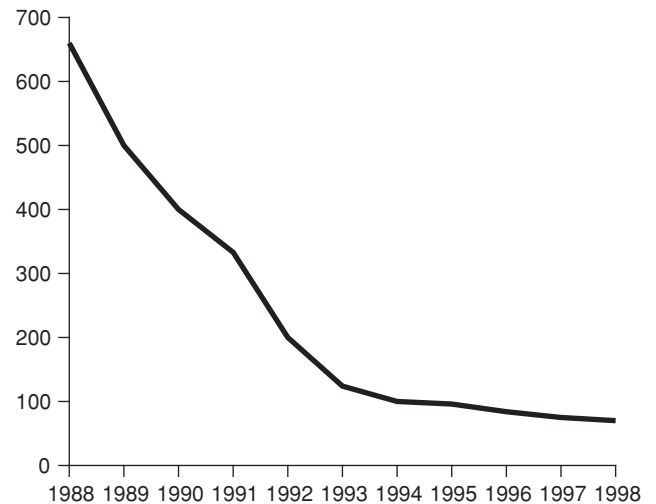
Berlin	36
Brandenburg	36
Mecklenburg-Prepomerania	24
Saxony	44
Saxony-Anhalt	38
Thuringia	43
West German (average)	85
Baden-Württemberg	117

technological performance worldwide at the end of the 19th century, and the machine sector maintained its importance even in the times of the communist German Democratic Republic within the old Comecon. Nearly one-fifth of the G.D.R.’s total industrial turnover was accounted for by machine tools. But now, of the 660,000 jobs in east German machine tools at the beginning of the decade, only one-tenth still exist. Without a renaissance in machinery, there is no chance that the urgently necessary reindustrialization of the new states of Germany will succeed. Both of these goals can only be reached if the enforced isolation of the “Reconstruction of the East” program is overcome, and if the long-overdue Marshall Plan for the rest of the devastated East bloc is finally begun.

FIGURE 3

**Employment in eastern German machine-building sector, 1988-98**

(in thousands)



Source: VDMA.