Enterprise Formation and Market Structure in the Five New Bundesländer

Keith Tribe

> Economic policy involves a choice among alternative social institutions, and these are created by the law or are dependent on it. The majority of economists do not see the problem in this way. They paint a picture of an ideal economic system, and then, comparing it with what they observe (or think they observe), they prescribe what is necessary to reach this ideal state without much consideration for how this could be done. (Coase, 1988: p.28)

In 1920 Nikolai Bukharin, a Bolshevik economist who had studied in Vienna with Böhm-Bawerk and von Wieser, published a treatise on the development of the socialist economy under the title *The Economics of the Transition Period*.[1] For Bukharin, the market mechanism which regulated capitalist economic organisation was essentially anarchic - the transformation of capitalism into socialism would therefore follow a path of planful social organisation, placing the productive potential unleashed by capitalism at the service of a new society through the conscious regulation of production and distribution. At first, this regulation was to be effected by factory councils, on the model of the *Betriebsräte* that had appeared in Germany during 1918-19. Once stability had been achieved, however, production and distribution were to be managed by elected technicians and administrators in a decentralised fashion.[2] It was only later that this vision was realised as an apparatus of centralised economic administration, an apparatus not envisaged in the early 1920s.[3]

At first glance, the problem today for the former socialist command economies is to reverse the train of events set in motion in 1917. This conception of a transition - to socialism in 1920, to capitalism in 1990 - is not however a mere rhetorical device, introducing a historical parallel with which to bracket the rise and decline of the socialist command economies. It is introduced to draw attention to a curious and perverse symmetry between the utopianism of Bukharin's conception of the transition to socialism, and that of market enthusiasts celebrating the collapse of communism and the transition to capitalism. The political and economic innocence with which

---

[1] Bukharin (1979). For the background to this see Lewin's account (1975: pp.7-10).

[2] This process is described in Ch.8 of the *Economics of the Transition Period*, "The System of Production Control Under the Dictatorship of the Proletariat".

[3] It is worth emphasising that the Soviet planning mechanism matured no earlier than the early 1950s, and then almost immediately entered a permanent process of reform. This phase therefore fell together with, rather than preceded, the imposition of centralised planning on the Eastern European economies.

Bukharin confronted the transition to socialism is mirrored today by our ignorance of the agenda imposed by this “transition to capitalism”.

This process of transformation in Eastern European economies into functioning market economies has to be understood as an experiment without precedent. There are two principal difficulties here. Firstly, it is not clear how one can *create* a functioning market economy, since the ones in existence assume different forms and none of them were planfully created - as such this could be said to be a minimum definition for a market economy. Secondly, the manner in which modern economists conceive market relations depends on an implicit theoretical ideal which is, as Coase suggests above, ill-suited to shape economic policy-making. This theoretical ideal centres upon the priority of allocative efficiency, and is best represented by the Arrow-Debreu model of general equilibrium encountered in economics textbooks as the model of the market mechanism. This model presupposes that well-functioning markets achieve an efficient allocation of resources; and that, if the market mechanism is able to function as freely as possible, this allocation of resources is Pareto-optimal. This presumption treats the existence of externalities, monopolies and cartels, and the requirement for public supervision of trading, as impediments to the realisation of market efficiency, rather than inherent aspects of market mechanisms themselves (Hare, 1990: p.583). Western economists are of course by and large aware of this, and direct their attention to the reduction of allocative inefficiency, rather than seek its removal altogether. Implicitly, it is recognised that market imperfections and market failure are permanent features of market economies, but this recognition does not get translated into standard expositions of the virtues of the market economy.

This mode of thought can, and does, work within functioning market economies, but it is ill-suited to appraise the problems of, and propose solutions for, economies in which the usual institutional structures do not exist. Moreover, it is apt to mislead Eastern European politicians, managers and administrators seeking to replicate the economic growth generated in their western neighbours since 1950. It is obvious that the socialist command economies have failed, but it is not at all so obvious how these economies can be quickly restructured within a European market economy. This is a very great problem when considering what has become known as the “marketisation” of the formerly-planned Eastern European economies. On the one hand, it is evident that command economies were extremely inefficient in meeting the objectives that they themselves set. The general low level of economic welfare, and the obsolescence of the capital stock throughout Eastern Europe, requires little comment. But in seeking to estimate the real economic base for economic development, a more exact appreciation of structure and functioning of these systems becomes more important.

The German Democratic Republic was widely regarded as the most advanced of the command economies as regards economic development, but there is a general lack of reliable comparative data that would enable us to lend some degree of scale to this assertion. Economic statistics relating to the economic structure of the former GDR are either unavailable, or non-comparable, or, if comparable, unreliable.[4] Such data that would be required for microeconomic investigations of the functioning of the GDR economy - assessment of household consumption, labour supply, production structures, capital stock and output - is unavailable. In contrast to other former socialist command economies, however, this might not be a problem for the new united Germany, since here the process of marketisation involves the wholesale imposition by a leading world economy of robust and successful institutions, with the capital to go with them. This is largely a colonial scenario; and given the advanced state of decay of the political and economic institutions in the East, there was probably little alternative.

It should be recalled that in early 1990 the GDR government was still in power and proposing a transition to a market economy.[5] By the spring of 1990 the five year scenario of convergence between the two economies envisaged in late 1989 had been cut to one year;[6] the signing of the Economic and Monetary Treaty on 18.May 1990 envisaged a currency union to be initiated in less than two month's time; and the introduction of currency union on 2.July 1990 signalled the demise of the GDR economy as an independent entity, removing the buffer of converging currencies and formally converting all wages and prices into strict equivalents with those in the Federal Republic. Unification in October 1990 completed the formal dissolution of the German Democratic Republic and heralded the colonisation of the east by the west, or the *Anschluß*, as it is popularly and accurately termed.

However, the colonial model of economic development has not been an unqualified success when applied to Africa or India; no matter how determined and well-resourced its implementation, this approach to economic development encounters intransigent and enduring institutions and structures. Some of these institutions have in the new Bundesländer been swept away wholesale - most striking here perhaps is the whole apparatus of economic and civil administration. While the mechanisms of the command economy might have gone, the organs of production, distribution and retailing remain, transferred for disposal to the Treuhandanstalt.

---

[4] Estimates of the GDP of the former GDR vary considerably; a document published by the European Parliament in 1990 (European Parliament, Directorate-General for Research (1990) p.90) gave an estimate of DM300 bn. as the 1989 GDP, while the Statistisches Bundesamt has recently estimated the GNP of the former GDR at DM105 bn. (Siebert (1991) p.305). Assuming that there is in effect little difference between GNP and GDP estimators for the GDR, this represents a range from DM18290 to DM6400 per head. This lower figure would give the former GDR an output per head figure of $4000, in the World Bank league table just ahead of Czechoslovakia ($3450) and just behind Portugal ($4250). The former Federal Republic has on this scale a GNP per head of $20,440. World Bank (1991) Table 1 p.205.

[5] In early 1990 Christa Luft, GDR Economics Minister, proposed that the first step would be the reduction of subsidies to producers. Private ownership was to be permitted in all sectors apart from energy, heavy industry and transport; *Kombinate* were to be made independent, with the creation of the two-tier board structure of W.German industry, there was to be a new corporate tax law, and foreign trade was to be freed by the end of 1990. Currency convertibility was to be achieved within five years. D.Goodhart, "East Germany ready to begin transition to market economy", *Financial Times* 15.1.90 p.18.

[6] In March 1990 the FT still considered that formal union would occur in 1991, but not before: D.Marsh, D.Goodhart, "Puzzling out a single Germany", *Financial Times* 10.3.90 p.9.

This is the agency charged with the privatisation of former GDR state enterprises, the implication being that the adaptation of the existing economic structure of the former GDR to that of the Federal Republic requires only the sale of its residual component parts. In fact, success in this limited task has proved distinctly uneven. By mid-1991 75% of restaurants and small stores had been privatised, but only 16% of industrial plants in the Treuhand portfolio had been disposed of at this time (Siebert, 1991: p.299).[7] It can be reasonably assumed that much of the Treuhand industrial portfolio represents liabilities, rather than assets, and that a considerable proportion will prove unsaleable at any price. For the moment, this remains a working conjecture, to which we can return in conclusion. In order to understand the rational foundation of this conjecture, however, some attention needs to be given to the GDR economy of the 1980s. Proper identification of the impediments to a rapid transition to a market economy requires that we understand the nature of the economic legacy of the GDR.

The *Kombinat* and GDR Industrial Structure

It is difficult to arrive at a reliable estimate of the structure and volume of GDR production which can be meaningfully compared with that of the FRG during the 1980s. International comparisons of industrial production are usually made in terms of labour productivity, sales, profitability, and investment. Variations in labour productivity indicate variations in capital investment and utilisation, the latter being in turn an indicator of managerial efficiency. The volume of industrial production in the GDR in 1983 was perhaps 25% of that in the FRG, but with half the level of labour productivity, and a far higher participation rate.[8] Although this indicates a significant difference between the FRG and the GDR in the utilisation of labour and capital, this was not necessarily a problem for the GDR so long as the GDR's currency was non-convertible, since prices for GDR goods were not determined by production costs, or, more precisely, these costs were defined in a different way to that customary in market economies. For all Eastern European economies during the 1980s, it was more important to earn hard currency through exports than to rationalise their production in line with comparable Western enterprises. The industrial sector accounted for around 66% of GDR national product in 1988, compared with 40% of value added in FRG (European Parliament, 1990). However, these figures are not directly comparable; and this is a great deal to do with the organisation of industrial production in large combines which cut across what would, in the FRG, be defined as service and distribution sectors .

The *Kombinat* became a dominating force in the GDR economy in the early 1980s, integrating production vertically and amalgamating enterprises regionally into large units.

---

[7] Erstwhile customers of restaurants and small stores in the GDR will of course welcome this development, but it should also be noted that the number of retail outlets per capita was in any case very small compared with the Federal Republic.

[8] In late 1980s 88% of women of working age were either in work or training, representing the highest recorded female participation rate in world. In 1983 females made up 49.5% of all employed (Jeffries, 1987: p.7).

Kombinate had existed during the 1970s, but grew in importance as a response to the shortcomings of the “New Economic System of Planning and Management” inaugurated in 1963. They gradually displaced the intermediate functions of the *Vereiningungen Volkseigener Betriebe* (VVB) which were supposed to be intermediaries between enterprises and industrial ministries, but which had in fact been administrative authorities charged solely with the planning and management of enterprises in their control. The elimination of this layer of economic management devolved their functions to the new combine level, but also introduced linkages within the combines to related suppliers. In 1970 30 *Kombinate* existed; this number grew to 45 by 1975, 54 by 1978 and 101 by 1979 (Boot, 1983: p.331). By 1990 there were about 130 *Kombinate* under the direct control of ministries, while 95 smaller ones fell under the administrative districts. A number of advantages were anticipated from this industrial reorganisation: foremost was the exploitation of economies of scale and scope, followed by related improvements to the supply and utilisation of raw materials, greater efficiency in the use of new machinery, and improvements to project planning, investment and quality control (Melzer, 1981: p.90). Industrial Ministries were freed from detailed planning, and it was thought that the shift of decision-making towards the enterprise would promote flexibility in production (Bryson, Melzer, 1987: p.54).

Kombinate were formed in a number of ways - bringing together associated enterprises under the supervision of a holding company, or by associating a number of enterprises in a product group with a leading enterprise, or concentrating production in a single enterprise with a divisional structure. This last variant became the dominant form by the early 1980s.[9] Typically, the *Kombinate* consisted of 15-30 enterprises (VEBs) with, on average, 20,000 employees. Taken together, they dominated the GDR economy and contributed greatly to the high level of concentration in the economy. In 1988, for example, there were 3,526 GDR industrial enterprises with an average of 900 employees, compared with 47,826 FRG industrial enterprises with an average of 190 employees. Industrial enterprises with less than 800 employees made up 25% of GDR enterprises, compared with 67% of those in the FRG. This process of concentration was still increasing in the GDR, whereas it was stable, if not falling, in FRG (European Parliament, 1990: p.45).

As already noted, the *Kombinat* grouped enterprises within a small geographical area; but it is important to note that in so doing they tended to absorb the non-production functions of individual enterprises into a headquarters organisation. The basic production unit within the GDR economy became in this way the *Kombinat*, and not its constituent enterprises. It might be

[9] The best available account of the organisation of the *Kombinate* within the GDR economy is that of Granick (1975). His study is based upon fieldwork done in 1970, at the high point of the reformed system and before the decisive shift towards the *Kombinate* as the principal industrial organisational form took place. Granick’s focus on the role of the manager in industrial production does however mean that much of his research retains its usefulness, especially since no work of such detail and quality has been published since.

noted in passing that this concentration of non-production functions within a head office is diametrically inverse to the process by which the modern business corporation developed in the United States. Here the process of vertical integration and internal reorganisation characteristic of DuPont and General Motors during the period 1900-1920 was linked to a dispersal of non-production functions out of the head office and down to the individual lines of production. This occurred precisely because of the need to replace market information displaced by the process of vertical integration with a coherent internal flow of information and decision-making. A centrally-planned economy faces a similar predicament, but in the case of the GDR the adopted solution, the formation of the *Kombinat* as a prime structural element, simply made the problem worse at the enterprise level, not better. Put in a different way, the *Kombinat* was designed in the 1970s as an organisation that would facilitate the central control of the planned economy, and in so doing adopted a model for the organisation of production that had been discarded in the 1920s by the most advanced giant business enterprises.[10] This feature of the *Kombinate* has significant implications for the privatisation of state industrial enterprises in eastern Germany, since individual plants are typically dependent upon a central office for much of their functioning, and lack the management structure that would enable them to function as autonomous units.

In common with other state socialist economies, the allocation of inputs and investment goods in the GDR was calculated in physical terms. Some of these were centrally allocated, but most were "balanced" by the principal national suppliers, who were responsible for regulating supply and demand of individual subgroups of products and for ensuring that the sum of individual contracts was consistent with the national balance (Granick, 1975: p.147). One outcome of the location of decision-making in this way was that their behaviour in determining product mix favoured producing rather than consuming organisations. Furthermore, the manner in which these decisions were concentrated within product groups hindered the efficient distribution of resources towards innovating areas. Within this allocative system, Granick argues,

> enterprises and *Kombinate* are not free to shift their product mix at will. Their prime product-mix task is to "meet economic needs", whether or not these are incorporated in their plan indicators. They are required to obtain the agreement of balancing organs (which are often the product groups) as to their product-mix decisions and as to the contracts which they sign with consuming bodies. If they wish to cease the production of an item, they or their product group must find some other enterprise in the country which will produce either it or a substitute product. Here is a major restriction on the degree to which enterprises and *Kombinate* can respond to economic incentives. (Granick, 1975: pp.149-50)

---

[10] The classic study of modern business organisation is Alfred Chandler's *Strategy and Structure* (1962). For a summary of its formative period see his essay in Chandler and Daems (1980).

Granick's study of resource allocation and the structure of managerial decision-making point up the rigidities in the GDR economy. Many of these rigidities were inherent to the ministerial and regional planning structures within which the *Kombinate* functioned. This entire apparatus has now disappeared, and enterprises are operating within a structure in which the transformation of inputs into manufactured output is the subject of monetary, rather than physical, calculations. Nevertheless, there is a persisting legacy of the GDR economic system in the actual structure of the enterprises themselves, and this has not disappeared with the abolition of the planning system. The persistence of these features of enterprise organisation, primarily associated with the internal organisational characteristics of the *Kombinat*, is a major obstacle to the transformation of the eastern industrial base, but does not seem to have drawn a great deal of academic attention. This problem will be returned to below when dealing with the activities of the Treuhandanstalt.

Almost 85% of industrial production in the GDR was accounted for by 7 industrial sectors, whose characteristics can be summarised as follows:

> a) Mechanical engineering and construction of motor vehicles (21% of production); mainly supplying the USSR and hence the structure of output was dictated by its needs. Emphasis here on the construction of heavy machinery and machine tools, while output of computer-controlled numerical machinery below that typical in Western economies. The technology employed in car production was below that even of other East European producers. Shipyards exported 90% of output, and had extensive repair contracts with USSR.
> b) Electronics, dataprocessing, precision engineering, and optical goods (9%). Uneven with respect to technology and output - considerable ground made up because of investment in microelectronics, but Robotron combine, sole manufacturer of dataprocessing systems in GDR, has to manufacture all its components. Telecommunications very weak, mechanical switching still predominates. 11 telephone lines per 100 inhabitant in GDR against 45 in FRG.
> c) Chemicals (20% of total production). In part outdated, the synthetics plants in Halle/Leipzig area dating back to the 1930s. Majority of output basic plastics that require little processing. Although sections have labour productivity levels better than 50% of FRG, much of output based on use of brown coal.
> d) Steel and non-ferrous metals (9% of production). Steel plants obsolete, with 38% of plants unable to employ high-technology methods of production. By contrast, proportion of continuous casting in FRG is 90% of capacity. 40% of steel produced in GDR uses Siemens-Martin open hearth techniques not used in FRG since 1983. GDR steel industry concentrates on basic steels. Productivity 45% of FRG.
> e) Textiles (6%). Geared to mass production goods, with old plant in prewar enterprises.
> f) Food industry (15%). Foodstuffs of poor quality and limited variety. Productivity 40% of that in FRG.
> g) Construction (2%). Poor quality housing and construction facilities. Productivity 40% of FRG. (European Parliament, 1990: pp.47-51)

An appraisal of the GDR economy by sectoral output would be forced to the conclusion therefore that even those sectors which had enjoyed the highest level of investment, such as electronics and data processing, were of rather uneven quality, and furthermore tied to CMEA markets which have, since Unification, become deeply problematic. The foreign trade of the GDR was typically dominated by exports to and imports from the CMEA economies: in 1989

27.6% of total trade was with Western industrialised countries, 37.5% with the USSR, and 28.9% with other CMEA countries.[11] The USSR was therefore the primary trading partner of the GDR in which imported raw materials were bartered for machine tools, chemicals, and consumer goods (European Parliament, 1990: pp.115-7). Furthermore, the 72.6% of GDR exports in 1989 which went to CMEA economies was almost exactly equivalent in value to the 4.6% of FRG exports to CMEA economies, further underscoring differences in the scale and structure of international trade for the two economies (Siebert, 1991: p.293).

These broad generalisations based on sectoral performance and trade patterns cannot however substitute for an understanding of industrial organisation and the impact of the *Kombinat* upon the GDR economy. First of all, it will be helpful to arrive at some kind of assessment of the actual size of the typical *Kombinate*. These were certainly “large enterprises”; but how large? If size is measured by employment we risk significant overestimation; if we measure by output, then this disregards the question of product quality that occurs in all such East-West economic comparisons. The financial data with which we would evaluate Western companies, data which is generally available because of legal obligations associated with company status, does not of course exist. Some figures have however been published giving the turnover and employment of the largest *Kombinate*, and this enables some comparison to be made with their Western counterparts both in terms of scale and productivity.[12]

11 Figures given in *Financial Times* 14.3.90 p.7.

12 The valuation of a quoted company is derived from multiplying the current share price by the number of shares issued. On this basis no meaningful comparison can be made between former state companies and commercial undertakings in market economies since there exists no comparable indicator of market value. Some comparison can however be made on the basis of turnover and employment. The figures given here for the *Kombinate* are drawn from European Parliament, (1990) Annex III, p.58, in which the source is given as the *Handelsblatt* for March 1990 No.48. Turnover is here quoted in DM, without any indication of whether the Ostmark has been calculated at 1:1, or at the rate of 4.40:1 which is the conversion rate introduced for foreign trade (European Parliament, (1990: p.112). The DM figures quoted have here been converted to the US dollar at the rate of .627 DM for $1; 1bn. is taken to be 1000 million. The statistics for Western companies are drawn from The *Financial Times* European Top 500 Companies, 13.1.92.

Company	Turnover $bn.	Employees
Petrochemische Kom.Schwedt	17.5	30,000
Leuna-Werke Walter Ulbricht	7.5	30,000
Robotron, Dresden	6.9	69,000
Baumwolle, Chemnitz	5	70,000
Mikroelelektronik, Erfurt	4.4	59,000
BP-----	57	118050
ICI-----	22.3	132,100
BMW--	16	65,792
Racal Electronics	3.6	38560
Olivetti	7.1	53679
Thorn EMI	6.3	57930
Cadbury-Schweppes	5.4	35600

Comparison of the turnover of Schwedt with BP, and that of Leuna with ICI, gives some insight into the actual scale of these concerns, although it must be noted that both ICI and BP are longstanding multinational corporations of a kind that could not develop in the GDR. How reliable even these figures for turnover are is, however, another question. On these figures, Schwedt had a turnover of $1714 per employee compared with BP's $2071; Leuna turned over $4000 per employee as compared with ICI's $5934. Robotron turned over $10,000 per employee as compared with Thorn-EMI's $9195 and Racal's $10711. On this showing, the *Kombinate* of the GDR were apparently operating on a par with their opposite numbers in Western Europe. Although the Politburo of the SED might have believed this to be true in the 1980s, it is now evident that these figures for turnover, and hence real scale of production, are seriously distorted. Part of the difficulty is that much of the output of the GDR electronics and chemical industry was exported to the USSR; not only is it difficult to estimate the value of this output in dollars, it is moreover evident that much of it would have been uncompetitive in world markets. This output was therefore either unsaleable in world markets and hence worthless, or saleable at very heavy discounts - a practice which would have been contrary to the rules governing international trade. We can conclude from this that published figures for the turnover of the *Kombinate*, and hence our estimation of their actual size compared with Western companies, are substantial overestimates. In western terms, the *Kombinate* were "giant enterprises" only in waste and inefficiency.

Such information as can be gleaned from the press confirms the depth of the problem. Leuna was one of 15 *Kombinate* in the chemical industry, which was ranked in the 1980s as the eighth biggest chemical industry in world. However, there was at this time a general lack of investment, almost all production equipment being older than 15 years. Little research and development was done, and there were no marketing or accounting departments. The Leuna complex itself was marked by heavy environmental damage that would be extremely costly to correct. Much of this is attributable to the use of lignite as a raw material, which was the original reason for the siting of the plant in 1914. The future of Leuna, together with the entire chemical industry of the former GDR, is in serious doubt.[13]

As part of the CMEA economies the GDR had produced cars and small-to medium trucks - heavy trucks and buses being produced in Hungary and Czechoslovakia. Around 50% the IFA truck output was exported to Eastern Europe and the USSR. The degree of vertical integration was so extreme that IFA made practically all its own parts, down to the manufacture of piston rings. In Mid-1990 the IFA *Kombinat* was still producing Wartburgs in Eisenach and Trabants in Zwickau, despite the absence of markets for these products. Opel had plans to begin assembly of the Vectra in Eisenach in October 1990 at an initial rate of 10,000 per annum. Since the Opel HQ was at Rüsselsheim, this meant that parts for assembly for the Vectra could be diverted to Eisenach - whereas the Opel Kadett, which would be a more suitable product for the emerging eastern market, is on other hand produced at Bochum in the Ruhr, which is too distant to make transfer of materials and parts practical.[14]

The third example that can be introduced here is that of Carl Zeiss Jena, generally held to be one of the more viable concerns in the former GDR. The workforce here stood at 29,000 in December 1990, and was set to be cut to 7,900 by July 1991. This concern employed, directly and indirectly, 70,000 people in the Jena region, with a relatively modest turnover of 4.1bn. East Marks. Unlike other branches of the GDR economy, Carl Zeiss had received substantial research funds, and much effort had been expended on replicating western microelectronic developments. A substantial share of its output however went to the USSR; this market had now been abandoned together with the production of microelectronic components, in which so much had been invested; the concern has shifted its attention back to optical equipment. Zeiss (W.)

---

[13] P.Marsh, "All the elements of an industrial failure", *Financial Times* 13.6.90 p.2. The entire Leuna complex will be replaced by a new refinery financed by Thyssen - H.-G.Kemmer, "Der Mann hinter dem Deal", *Die Zeit* 24.January 1992 p.24.

[14] A.Fisher, "E German car industry's bumpy ride to modernity", *Financial Times* 8.6.90 p.2.

has reached an agreement with Zeiss Jena on trademarks and production, but had no desire to take over Zeiss Jena on account of the debts of nearly 1 bn. DM, accumulated one can assume during the drive to develop its production of microelectronics.[15]

The industrial base of the GDR was clearly in severe difficulties, and these difficulties have become critical in the transition to a market economy. Having drawn attention to the organisational structure and productive resources of this industrial base, we can now turn to the strategy adopted to effect the transition to a market economy.

<u>The Treuhandanstalt as an Agent of Marketisation</u>

The Treuhandanstalt assumed ownership of all GDR state enterprises on 1.March 1990. It was therefore a creation of the government of the former GDR, and was conceived as a giant holding company which could facilitate the process of convergence between the economies of the GDR and the FRG, a transition process which it was envisaged would lead to economic union. The Treuhandanstalt was given three major objectives:

1) to establish DM balance sheets for all state companies based on a realistic asset valuation;
2) to examine the viability of companies in its portfolio and organise their restructuring if worthwhile;
3) to privatise state companies.

The Treuhand is not only responsible for the old *Kombinate*, but also for all publicly-owned agricultural land and forests. Its first task, the establishment of DM balance sheets for all enterprises in its portfolio, is probably not yet complete, but this aspect of its work was given further impetus by a GDR law of 1.July 1990, which endowed all companies with corporate status and directed that opening DM balances, based on valuation of assets and liabilities according to FRG accounting rules, were to be established by the end of February 1991.

The Treuhand is likewise not really in a position to execute the second task assigned to it; even the task of reviewing assets to judge their suitability for restructuring requires greater resources than it has available, quite apart from planning and executing such a strategy. Its activity has therefore concentrated upon the creation of enterprises on a semi-commercial basis, and offering them for sale; it has become the privatisation agency. This is not an easy task for, as indicated above, it confronts an industrial base that has not been organised in such a way as to lend itself to this procedure, given the relation between individual plants and management structures within the *Kombinate*. Furthermore, perception of its role is clouded by a general misunderstanding of the nature of privatisation and deregulation as practised in the USA and Britain during the 1980s.

[15] L.Colitt, “East Germany’s high-flying company comes down to earth”, *Financial Times* 14.12.90 p.2.

First among these problems is a lack of clarity about corporate status. Under English law, shareholders in a company own a right to a share in the company's declared profits, not the company itself; they are entitled to vote in shareholders' meetings on company policy, or for the appointment of directors. The privatisation programme pursued during the 1980s by the Conservative government has taken the form of the issue of shares in going concerns which are either opened to very limited competition (as in British Telecom) or are subject to some limited restructuring (as in electricity generation and supply). In all cases, the significance of the share issue has been exaggerated; in economic terms this is a matter of income distribution, and not one that is of great significance for the management of the enterprises concerned. Far more important in Britain has been the creation of a new regulatory regime for the "privatised" utilities, imposing limits on charges for its products and services that seek to replicate the discipline of a competitive market structure. The chosen form for the introduction of this new regulatory regime, a regime which is not incompatible with nationalised status, was that of selling new shares, rather than for example issuing them to employees or local authorities or pension funds directly.[16] In principle, this could be achieved without issuing shares to the general public, for in any cases such shareholders do not "own" the enterprise itself, nor did the government beforehand - under English corporate law, enterprises in effect own themselves.

German institutional arrangements for commercial enterprises are somewhat different, and a smaller number of companies are listed and traded on the Stock Exchange. The emphasis on share ownership and trading common in the UK is absent, as is the associated preoccupation with mergers and acquisitions as a means of company growth. In fact, in the European context this British preoccupation is more or less unique, since in the EC in 1988 the UK accounted for 73% of all takeovers by value, whereas Germany accounted for just 4% (Woolcock et.al., 1991: p.15). With some significant exceptions, mergers and acquisitions have not played a large role in German industrial development over the last twenty years.

This has now changed. The manner in which the privatisation process is being conducted by the Treuhandanstalt requires that purchasers be found for enterprises in the former GDR, and preference is given to German purchasers. "Privatisation" here means the recruitment of a suitable purchaser with the capital and managerial expertise required to rationalise and reconstruct the fragments of the old *Kombinate*. Distributing or selling shares to the public would not address this problem, no matter how this sale was made. The sophisticated privatisation programme being pursued in Czechoslovakia for example, in which an initial distribution of credits to the public is, via a bidding system, employed to establish a form of company valuation,

[16] Since the bulk of the shares ended up with large shareholders such as the pension funds it would have cost taxpayers considerably less if shares had been issued to such bodies directly, while at the same time giving a premium to those with savings in Building Societies, since this is where the purchasing funds came from, to which they subsequently returned, with windfall gains, some weeks later. This would replicate the actual economic impact of the process, but would not of course have been politically acceptable.

is only the first step in the creation of a viable industrial base - this elaborate process does not after all address the problem of uncompetitiveness directly, it instead shifts attention to the ownership of assets. This is, however, as with Britain, a minor aspect of the problem.

In the case of the former GDR, many of the functions of privatisation had been effected simply through the formation of the Treuhandanstalt. The regulation of enterprises through the central planning system dissolved with the abolition of the structures involved. The direction of inputs, investment and sales, once this apparatus had been removed, could only operate with respect to market mechanisms. The problem is that the economic units concerned are not fully capable of operating in this new environment. Importantly, the production units lack an appropriate management structure, since the management of such enterprises hitherto meant carrying out the commands which came from above. The task of the Treuhandanstalt should be more properly viewed as that of completing a process of privatisation which is already 75% complete. The difficulty is that, without a structured transfer of ownership to partner institutions, many, if not most, of the enterprises concerned will simply collapse. The prime task of the Treuhandanstalt has thus been to reorganise state property into units that resemble commercial enterprises and then find direct purchasers for them. This is in effect the only option open, since these new enterprises generally lack the management structures that would enable them to function in a market economy. The only way to install such management structures is to find suitable partners willing to buy them and introduce an appropriate organisation. Share issue and the associated turnover of holdings on the part of the general public into pension funds, on the British model, is irrelevant. An alternative option, of transferring nominal ownership in the new enterprises from the Treuhandanstalt to local or regional authorities, is not a realistic possibility given the weakness of local administration in the former GDR.[17]

The task of the Treuhandanstalt is therefore delicate enough, without the additional complication of the property claims that currently number some 2 million. These arise under the terms of the Economic and Monetary Treaty, signed between the FRG and the GDR on 18.May 1990, according to which all property expropriated after 1949 can be the subject of a claim for restoration, or compensation where land has been combined or altered in use in such a way that it cannot easily be separated (Siebert, 1991: p.297). Indications are that the majority of such claims will be met by compensation rather than restitution, confirming the view that the Federal Government, in committing itself to this process, simply encouraged large-scale and unproductive transfers to rent-seekers. The current uncertainty over the status of possession and property is nevertheless a major obstacle to new investment, or acquisition.[18]

---

[17] In 1988 84% of total FRG public sector construction investment was made at the level of the Länder and local authorities, the latter accounting for 67.5% of total. Local administration in the GDR never had this degree of control of projects and finance. (United Nations Economic Commission for Europe, 1991: p.101).

[18] See *Financial Times* 25/26.1.92 p.2. Some economists have expressed their bewilderment that the German government would actively promote such rent-seeking activity; the situation is worse than they imagine, since

As noted above, the Treuhandanstalt has been successful in disposing of department stores and other retail outlets. Autobahn service areas and filling stations have likewise been disposed of successfully.[19] The reason for this is that the primary asset sold is a location, which for this kind of business is of primary importance. For much of manufacturing industry, however, location is not so critical. In purchasing an industrial enterprise, a buyer gains plant, land and buildings, a workforce, products and a market. In the former GDR even the land can be a liability; chemical and related undertakings are in this respect major liabilities.[20] Existing buildings are unsuitable, the products are obsolete, and the associated markets gone. All that remains is a workforce, which can be simply recruited by founding new enterprises and recruiting from the ranks of the unemployed.[21]

Many of the enterprises in the Treuhand portfolio will prove to be of zero or negative value. The state property of the former GDR will become the state property of the new united Germany until such time as it has been restored, restructured and made ready for “sale”. The disposal of shipyards and associated enterprises in Rostock and Wismar for example involved just such large-scale subsidies and write-offs, to such an extent that they could not be completed without reference to the EC competition commissioner.[22] Exactly the same pattern had occurred with the disposal of Eko Stahl to Krupp, in which the company’s restructuring plans presuppose a high level of government subsidy.[23]

As noted above, this process of acquisition, which although hitherto atypical for German capitalism is the hallmark of privatisation in the five new Bundesländer, is the only feasible route to a viable reconstructed industrial base, and marks the completion of a privatisation process begun with the disappearance of the administrative apparatus of the old socialist command economy. This is distinct from the privatisation process in other former socialist command economies, in which the privatisation of state property is simply the first stage of industrial reconstruction. In this respect, the economic experience of the former GDR holds no great lessons for its former CMEA partners, except to demonstrate what large amounts of capital and an established legal order can achieve.

---

expropriated owners were in any case offered compensation in the early 1960s, any payment made at that time not being treated as prejudicial to future restitution of the property concerned.

[19] Elf Aquitaine, which is the largest French state undertaking, acquired 930 Minol filling stations in early 1992 - D.H.Lamparter, “Französisches Kraftpaket”, *Die Zeit* 24.January 1992 p.24.

[20] See D.H.Lamparter, “Zurück zum Staat?”, *Die Zeit* 7.February 1992 p.31.

[21] The construction of a new VW production plant next to the old Trabi plant at Zwickau symbolises this process - “Der Osten schreibt rot”, *Die Zeit* 28.February 1992 pp.15-16.

[22] See for the background to the industry and its sale Leslie Colitt, “Baltic shipyards count cost of Treuhand deal”, *Financial Times* 12.March 1992 p.3.

[23] Christopher Parkes, “Treuhand agrees to Krupp plan for east”, *Financial Times* 29.February 1992 p.2.

The unification process can on the other hand be seen as a laboratory for the study of market structures in which the outcome, a functioning market economy, is a foregone conclusion by virtue of the manner in which the GDR was absorbed into the legal and economic structures of the Federal Republic. As noted in the introduction, the conceptualisation of market mechanisms in terms of allocative efficiency is of little use in studying the transition to market economies in Eastern Europe. But this is not the only way in which to conceptualise the dynamics of capitalist market economies. More appropriate is Schumpeter's identification of the innovation process as the motor of growth and competitiveness - industrial development comes from new firm formation and the products that they introduce, and not the development of established firms and products (Schumpeter, 1947: pp.82-3).[24] Granick's own research indicates that the fundamental problem in the economic structure of the GDR was not inefficiency *per se*, but rather the impediment to innovation embedded in the *Kombinat* structure. The manner in which the restructuring of the former GDR economy is proceeding simply sweeps this out of the way, both metaphorically and literally - new plants, new products, new management are developing alongside the existing enterprises.

References

Boot, P. (1983) "Continuity and Change in the Planning System of the German Democratic Republic", *Soviet Studies* Vol.35 pp.331-42.

Bryson P.J., Melzer, M. (1987) "The *Kombinat* in GDR Economic Organisation", in I.Jeffries, M.Melzer (eds.) *The East German Economies*, London: Croom Helm pp.51-68.

Bukharin, N. (1979) *The Economics of the Transition Period*, translated in Bukharin, *The Politics and Economics of the Transition Period*, London: Routledge and Kegan Paul pp.53-184.

Chandler, A.D. (1962) *Strategy and Structure*, Cambridge (Mass.): MIT Press.

Chandler, A.D. (1980) "The United States: Seedbed of Managerial Capitalism", in A.D.Chandler, H.Daems (eds.) *Managerial Hierarchies. Comparative Perspective in the Rise of the Modern Industrial Enterprise*, Cambridge (Mass.): Harvard University Press pp.9-40.

Coase, R.H. (1988) *The Firm, The Market, and the Law*, Chicago: University of Chicago Press.

European Parliament, Directorate-General for Research, (1990) *The Impact of German Unification on the European Community*, Working Document No.1, 6-1990, Luxembourg.

Granick, D. (1975) *Enterprise Guidance in Eastern Europe*, Princeton N.J.: Princeton University Press.

Hare, P. (1990) "From Central Planning to Market Economy: Some Microeconomic Issues", *Economic Journal* Vol.100 pp.

Jeffries, I. (1987) "The GDR in Historical and International Perspective" in I.Jeffries, M.Melzer (eds.) *The East German Economy*, London: Croom Helm pp.0-00.

Lewin, M. (1975) *Political Undercurrents in Soviet Economic Debates*, London: Pluto Press.

M.Melzer, (1981) "Combine Formation in the GDR", *Soviet Studies* Vol.33 pp.88-106.

Murrell, P. (1992) "Evolution in Economics and in the Economic Reform of the Centrally Planned Economies", in C.Clague, G.C.Rausser (eds.) *The Emergence of Market Economies in Eastern Europe*, Oxford: Basil Blackwell pp.35-53.

[24] See this argument extended to Eastern Europe as a whole in Murrell (1992: p.37).

Schumpeter, J.A. (1947) *Capitalism, Socialism and Democracy* (second edition) London: George Allen and Unwin.

Siebert, H. (1991) “German Unification: The Economics of Transition”, *Economic Policy* 13 pp.287-340.

United Nations Economic Commission for Europe, (1991) “The Unification of Germany”, *Economic Bulletin for Europe* Vol.42/90 pp.89-108.

Woolcock, S., Hodges, M., Schreiber, K. (1991) *Britain, Germany and 1992. The Limits of Deregulation*, London: Royal Institute of International Affairs.

World Bank (1991) *World Development Report 1991*, Washington D.C.