

Der Open-Access-Publikationsserver der ZBW – Leibniz-Informationzentrum Wirtschaft
The Open Access Publication Server of the ZBW – Leibniz Information Centre for Economics

Gupta, Asha

Working Paper

Privatization in East Germany: Can the Treuhandanstalt provide a model?

Kiel Working Papers, No. 849

Provided in cooperation with:
Institut für Weltwirtschaft (IfW)

Suggested citation: Gupta, Asha (1998) : Privatization in East Germany: Can the Treuhandanstalt provide a model?, Kiel Working Papers, No. 849, <http://hdl.handle.net/10419/47162>

Nutzungsbedingungen:

Die ZBW räumt Ihnen als Nutzerin/Nutzer das unentgeltliche, räumlich unbeschränkte und zeitlich auf die Dauer des Schutzrechts beschränkte einfache Recht ein, das ausgewählte Werk im Rahmen der unter

→ <http://www.econstor.eu/dspace/Nutzungsbedingungen> nachzulesenden vollständigen Nutzungsbedingungen zu vervielfältigen, mit denen die Nutzerin/der Nutzer sich durch die erste Nutzung einverstanden erklärt.

Terms of use:

The ZBW grants you, the user, the non-exclusive right to use the selected work free of charge, territorially unrestricted and within the time limit of the term of the property rights according to the terms specified at

→ <http://www.econstor.eu/dspace/Nutzungsbedingungen>
By the first use of the selected work the user agrees and declares to comply with these terms of use.

Kieler Arbeitspapiere

Kiel Working Papers

Kiel Working Paper No. 849

**Privatization in East Germany :
Can the Treuhandanstalt Provide a Model?**

by
Asha Gupta

Bharati Mahila College
(University of Delhi)
Link Road, New Delhi-110 052
INDIA.

January 1998



Institut für Weltwirtschaft an der Universität Kiel
The Kiel Institute of World Economics

Institute of World Economics
24100 Kiel
Federal Republic of Germany

Kiel Working Paper No. 849

**Privatization in East Germany :
Can the Treuhandanstalt Provide a Model?**

by
Asha Gupta

Bharati Mahila College
(University of Delhi)
Link Road, New Delhi-110 052
INDIA.

January 1998

809283

The author herself, not the Kiel Institute of World Economics, is solely responsible for the contents and distribution of each Kiel Working Paper.

Since the series involves manuscripts in a preliminary form, interested readers are requested to direct criticisms and suggestions directly to the author and to clear any quotations with her.

Contents

The Context.....	3
A Review	6
The Agency	8
The Structure.....	9
The Functions and Responsibilities	11
Financing.....	15
Supervision.....	17
The Functioning of the THA.....	19
Privatization through MBO/MBI/Management KGs.....	21
An Evaluation	23
Lessons to be Drawn.....	36
Bibliography.....	42

ABSTRACT

The dynamics of privatization in the Eastern Germany can be better understood in terms of the 'economic politics' applied to the 'political markets'. The Treuhandanstalt played a key role in transforming the entire economy of the former GDR into the market economy in the wake of unification of East Germany with West Germany. The present study discusses the agency's structure, functions and responsibilities, on the one hand and financing, functioning and evaluation, on the other. Although the Treuhandanstalt provides a unique example of privatization by the state and the market, it cannot be duplicated or copied in *toto* (P 52).

Acknowledgement¹

I would like to express my deep gratitude to the Friedrich Ebert Stiftung at Bonn and New Delhi for providing me a short term research fellowship for my post-doctoral project on Privatization Experiences in East Germany with especial reference to the Treuhandanstalt, during summer 1996 and allowing me to continue with the project during the summer 1997. I am equally obliged to the Kiel Institute of World Economics for providing me the necessary affiliation, cooperation and administrative support.

I am particularly grateful to Mr. Klaus-Dieter Schmidt, a renowned scholar and an expert on German economy, for taking a keen interest in my project and providing me the necessary support and guidance. Despite his very busy schedule, he gave me an opportunity to discuss my project with him in detail. It provided me an insight into the whole debate. I was deeply impressed with his simplicity and erudite scholarship.

I feel deeply indebted to Mr. Uwe Siegmund for thorough discussions on various aspects of privatization in East Germany — legal, social, historical, economic and political. Mr. Siegmund is pursuing a Ph.D on privatization in East Germany at the Kiel Institute of World Economics. He provided the gist of some of the literature available only in German. I am equally grateful to Dr. Jamuna P. Agarwal for his valuable comments and suggestions.

¹ The present study is the outcome of the short term research fellowship awarded by the Friedrich Ebert Stiftung at Bonn during summer 1996 and 1997. The author is equally grateful to Kiel Institute of World Economics and FES for providing the necessary support. Special thanks to Mr. Klaus-Dieter Schmidt, Professor Dieter Bös, Professor Hans Werner Sinn and Mr. Uwe Siegmund for their valuable comments and suggestions.

I am simply beholden to Professor Dr. Dieter Bös of the University of Bonn and the Editor of Journal of Economics for providing me with the latest data and information on my project in English. I enjoyed my discussions with Dr. Bös, a scholar of international repute and an expert on privatization in theory and practice. I express my sincere thanks to Professor Dr. Hans Werner Sinn, Director, Centre of Economic Studies, University of Munich and the co-author of the popular book 'Jumpstart', for sparing some of his valuable time for discussions on my project both during his short visit to Kiel and at the University of Munich. I also got an opportunity of discussing my project with his younger colleague Mr. Marcel Thun.

I am indeed grateful to Mr. Klaus-Dieter Schmidt for arranging interviews with Mr. Wolf Dieter Plessing at Bundesministerium für Wirtschaft and Dr. Dieter Knoll at Bundesministerium der Finanzen at Bonn. Interactions with them provided me the first hand information on Treuhand and BVS. Interestingly, while Dr. Knoll was in favour of the winding up of the BVS as a true representative of the Ministry of Finance, Dr. Plessing supported its continuance. I also got some official data on my project published in English. Although Mr. Schmidt fixed an appointment with Dr. Wild at BVS at Berlin, I could not make it owing to financial and time constraint on my part.

Last but not the least, I am grateful to Professor Dr. Hartmut Elsenhans of the University of Leipzig for providing me the necessary guidance at the initial stages of the preparation of my research proposal. He has always been a source of inspiration to me. I would like to express my sincere thanks to Dr. Heinz Bongartz, Dr. Horst Büscher, Mr. Gunter Lehrke, Dr. Horst Mund and Ms. Karin Paffenholz of Friedrich-Ebert-

Stiftung, Bonn, for their constant encouragement and support. I am equally grateful to Ms. Sabine Niemann and Ms. Kristina Sander of the Kiel Institute of World Economics for their administrative support.

I am grateful to Dr. C. Ranft and the staff of Klinik Lubinus for their expertise and care. Although I felt handicapped because of the accident, I am grateful to God for sparing my life. The accident, in fact, provided me an opportunity of delving deeper into the German ways of life. I feel obliged to my husband Mr. K. K. Gupta and my daughter Miss Kakli Gupta for providing me physical assistance and moral support. Without their active and positive support, I could not have accomplished my task. The natural beauty of Kiel and the excellent working conditions at the Kiel Institute of World Economics provided the boost. Given an opportunity, I would love to come back again.

July 24, 1997.

ASHA GUPTA

Privatization in East Germany : Can the Treuhandanstalt Provide a Model?

The debate initiated around the neoliberal themes of privatization, deregulation, denationalization and destatization is based on the new political economy — 'economic politics' applied to the 'political markets'. It signifies political action in economic markets with a definite aim to maximize profit and utility — the themes underlying neoclassical economics. In the era of globalization and interdependence, we find a close relationship between political philosophy and attitudes towards economic relations. Although the interaction between the political and economic aspects of the changing role of the state is often assumed, it is rarely studied. In fact, two political legacies of the 1980s have influenced the economic policies of the 1990s — (1) the renewed enthusiasm for private enterprise and market economy and (2) rolling back the frontiers of the state. It is now being held that 'it is none of the business of the government to remain in business'.

The spread of privatization all over the world in less than a decade is a remarkable phenomenon in recent history. The waves of privatization which swept the 'first world', so called 'second world' and 'the third world' alike cannot be explained straightforward either in political or economic terms. It can be seen as a part of the general rehabilitation of the market forces as an intellectual disillusionment with the keynesian approach to economic management and a failure of socialism as a serious intellectual force. The 'ethics' of privatization is based upon the validity of the private as opposed to the state property rights.

Privatization refers to the transfer of various activities from the realm of public to the private sector. It can mean the sale of state owned-enter-

prises either fully or in part. It can also mean a partnership between the government and business through the transfer of responsibilities from the public to the private. It can also imply the simple association of the private with areas hitherto reserved exclusively for the public sector. It covers a wide range of ideas and policies both in economic theory and political practice. As such, it can mean different things to different people.

In fact, the move towards privatization has been so diverse in forms and varied in settings that the causes and consequences are unlikely to be the same everywhere. If public ownership had diverse origins and designs, privatization is bound to have diverse origins and designs too. While faster growth, higher efficiency and wider competition have been cited as the prime objectives of privatization in ideological terms, external pressures and budgetary constraints have been the prime factors responsible for privatization in practical terms. Surprisingly, in the wake of 'de-ideological recasting' of the concept, a variety of measures have sailed through the flag of privatization, ranging from 'divestiture' to 'contract management'.

It is futile to locate the causes and consequences of privatization within a state itself. Nor should it be seen as a simple matter of transferring public assets and services to the private sector. We should not forget the hard fact that the politicians can never afford to be market-dependent. In the process of privatization debate, only the governments decide who would enter or exit the market place and under what circumstances. Prior to privatization, the role of the state was to protect the economy from disruptive external forces. It is now required to adjust the domestic economy to the external exigencies. This has led to 'domesticization of international politics' and 'internationalization of domestic economies'. It

has not only freed the domestic economies from state regulation but also has exposed them to greater vulnerabilities both at the domestic and international level.

The Context

The dynamics of privatization can be better understood in terms of the international context. Although it is difficult to say whether privatization constitutes the 'cause' or 'consequence' of globalization, one thing is certain — it is the process of globalization which has made privatization imperative and desirable in more than a hundred countries in less than a decade. Privatization in East Germany is also to be seen in a special context — not only in the context of the unification of Federal Republic of Germany with former German Democratic Republic, but also in the context of Germany's keen desire to become a driving force in the European unification process. Some look at it as the 'Europeanization of Germany', while others look at it as 'Germanization of Europe'.

The unification of Germany has not been an internal affair. It has certainly affected the unification of Europe as a whole and its economic consequences have affected the rest of the world. The ease with which the German unification swept away the political barriers sharply contrasts with the economic impediments and hardships. Approximately DM 1000 bn of public funds have been channelled to the East Germany till the end of 1996 since unification. In 1989, West Germany had the world's biggest surplus. Since 1991, however, it has been a net importer of resources. It is because of the excessive absorption of public and private resources by the new länders. East German absorption doubled in last six years and currently it is approximately 50% larger than the GDP

of the East Germany. About one-third of excess absorption is met with private capital imports into East German economy and two-third from public transfers in the form of unemployment benefit, pensions and investments in public infra-structure.

The sum of the DM 1000 bn also includes parts of the loss of DM 270 bn incurred by the Treuhandanstalt in the process of privatization (the lion's share was transferred to the Heritage Fund). Instead of raising DM 600 bn, as anticipated prior to privatization, the privatization process led to huge losses. Instead of pursuing the privatization policy on severe economic grounds, the Treuhandanstalt had to rely on a political strategy. It had to pay a heavy price in terms of 'economic efficiency' to make rapid privatization 'politically feasible'.

The Treuhandanstalt, popularly known as 'Troyhand' played a key role in transforming the entire economy of the former GDR into the market economy. During a short period of four and a half years since the German unification and culmination of the Treuhandanstalt (July 1, 1990 to December 31, 1994), the THA was able to privatize fully or partially all but 192 companies out of a total portfolio of 13,815 holdings, reprivatize 1,588 companies and communalize 265 companies. By communalization, was implied the restoration of the SOEs and public assets to various municipalities at the provincial level. At one stage, the THA became the world's biggest holding company.

In the process of privatization of the THA companies, 2,983 'Management Buy-Out' or 'Management Buy-In' contracts were signed out of which 2,081 contracts were administered by the THA branch offices and 902 by its headquarters. The THA was able to secure investment commitments upto DM 211.1 bn and job commitments upto 1,508,000. It was

able to raise proceeds upto DM 66.6 bn and foreign investment to the tune of DM 6.8 bn. The THA was also responsible for the privatization and restitution of 30,000 small shops, restaurants, service firms, 2.3 million hectare of arable land and 1.9 million hectare of forest land and the assets of former GDR political parties, mass organizations, army and security forces.

The THA had to sail between a no man's land between politics and economics. Devoid of a blue print to follow, it became an instrument of industrial policies itself. Since fetching the highest price was not the chief goal of the THA, it had a lot of scope for manoeuvring and subjective judgement which gave it the image of an 'omniscient agency'. It was commonly criticised for being bureaucratic and secretive. Its primary interest was in the continuation of business. There were some instances of favouritism, financial irregularities and miscalculations, but they were unavoidable in the situation of rapid privatization on a massive scale.

The THA is survived by the *Bundesanstalt für Vereinigungsbedingte Sonderaufgaben*, more popularly known as the BVS. Although the BVS wanted to disappear by January 1, 1998, the new länders wanted it to continue for an indefinite period of time. The decision has now been taken towards the continuation of the BVS beyond the year 2000, of course, it is a political decision which cannot be supported in terms of market economy. Despite the weaker economic position in comparison to West Germany, the new länders are able to put political pressure on the coalition government at the federal level. The whole concept of 1:1 conversion rate for current transactions (wages, pensions, interests, etc.) and 2:1 for debts and liabilities has to be understood in terms of federal dynamics.

The BVS is responsible for controlling and re-negotiating the contracts made by the THA. The new länders wanted BVS to continue because of the latter's sound financial condition. By February 1995, the BVS had concluded 2,500 contracts out of a total of 3,000 re-negotiations registered. More and more investors are likely to ask for the re-negotiations on one ground or another. According to a survey conducted in August 1996 on 2,500 manufacturing firms by the *Deutsches Institut für Wirtschaftsforschung* (DIW) at Berlin, 24% East German enterprises wanted to re-negotiate with the BVS on grounds of 'purchase price', 14% on grounds of 'old financial debts', 12% on grounds of 'financial aid', 12% on grounds of contract conditions with regard to 'job commitments' and 12% on grounds of 'investment commitments', 8% on grounds of 'liability for pollution of the soil', 5% on grounds of restitution claims and 29% on miscellaneous other grounds. The privatization in East Germany seems to be an 'unending story'.

A Review

Today, while the West Germans lament the massive costs incurred on privatization in the East Germany in the wake of unification, the East Germans also complain of deindustrialization, mounting unemployment and cutbacks in social welfare. While the entrepreneurs in the West hoped to take advantage of the East Germany's networks and especial position in the COMECON, the East Germans hoped to achieve the matching living standards almost automatically. Even before the unification, the industrial productivity of East Germany was estimated to be just 30–40 percent of that of the West.

It was essential to privatize the whole economy of the East Germany to bail it out of the serious economic crisis. Even the success of the political decisions of the reunification of East Germany with West Germany depended upon the successful transfer of the basic institutions to the market economy and liberal democracy. The government's privatization strategy was based on the assumption that, if given an opportunity, the West German companies, with expertise in management and access to finances, would be willing to buy the East German firms and turn them into competitive enterprises at the global level. The government expected to achieve economic miracles through huge flows of investment from the Western enterprises to the Eastern ones, raising the productivity to high levels, thereby.

It was hoped that the West German companies would commit themselves to major investments in the new länders either in the form of 'greenfield investments' or through the 'purchase of the East German enterprises', in order to reap the benefits of cultural affinity and available skilled workforce at cheaper rates in East Germany and automatic access to Eastern and central European markets through East German networks. East Germany had almost 50% share in the COMECON trading system. However, these hopes could not materialize. With the collapse of COMECON, deep recession in Eastern and Central Europe and disintegration of former USSR, the value of East German contacts was lost.

It affected adversely the Western companies' investment in East Germany. In order to promote investment and privatization in East Germany, the federal government adopted two measures — (1) investment grants and tax allowances were made available to reduce the costs of an investment project upto 50% and (2) subsidies could be provided in con-

junction with the privatization of the SOEs in East Germany by the Treuhandanstalt. The task of privatization was assigned to a fiduciary agency — the Treuhandanstalt. Its job was not only to sell the state owned enterprises and property in East Germany but also to buy investors and secure jobs. Besides economic, it had many social obligations to fulfil. It was 'a challenge impossible'.

The Agency

The term 'Treuhand' in the German language means a 'trustee'. The Treuhandanstalt was a state trustee agency which was responsible for the privatization of the state-owned property of the former GDR. It was founded on March 1, 1990 still under the last communist government of Dr. Hans Modrow. The objective of the Modrow government was to rescue the old economic system rather than to transform it.

The industry in the former GDR was concentrated into 157 *Kombinates* — huge state trusts. Under the Modrow government, the privatization agency was required to play the role of a 'raider'. It was required to break up the *Kombinate* into pieces that could become viable. It could also recombine the units. It was responsible for evaluating what could be privatized and what needed restructuring and liquidating. When the freely elected GDR government came into power under the prime minister Dr. Lothar de Maizière, the coalition agreement went into the detailed legislation on the tasks and working methods of the THA. The law stated that the new THA would continue with the original task of breaking the *Kombinate* and converting them into legal entities. The prime aim was to convert the state property into the property of private persons and well-justified cases into the property of regional authorities.

The Treaty creating 'Monetary, Economic and Social Union' between the East and West Germany took privatization for granted. On May 17, 1990, the Federal Chancellor's office and the Federal Ministry of Economic Affairs presented the 'Bonn plan' for the Treuhand Act. They envisaged three different organizations to deal with commercial assets, residential property and agriculture. The legal form envisaged was an *Aktiengesellschaft (AG)* — a joint stock company on the pattern of AGs in the West Germany. The AGs were found to be more autonomous and flexible for being based on the principles of separation of business and government, on the one hand, and codetermination with equal representation from both sides of the industry, on the other. The Treuhand was not designed to become an entrepreneur itself. As such, its managers did not sit on the Board of Directors of the Companies to be privatized.

A new law defining the tasks and responsibilities of the THA came into force on June 17, 1990. This law emphasised privatization in East Germany. After the unification on July 1, 1990, the THA was subordinated to the FRG Ministry of Finance. The agency was set up in former Hermann Göring's Luftwaffe building at Berlin. It had no blueprint or precedent to follow. The number of employees of the THA increased from a mere 600 in its early days to more than 2,500 by the summer 1991. In August 1990, Detlev Rohwedder became its first president. After he was assassinated in April 1991, Birgit Breuel became the president of Treuhand. She provided able leadership to the THA till December 31, 1994.

The Structure

Although the THA was a statutory body, it functioned more like an investment bank rather than a centralized agency. It was relatively inde-

pendent of Bonn and had an economic and business-like orientation. The agency was allowed within certain limits to run its own debt and its budget. It was not directly controlled by the German parliament but only by the Federal Court of Audit. Although it enjoyed the status of an institution under public law under the Act of Privatization and Reorganization of State Property, yet it was organizationally a separate part of the federal administration within the meaning of Article 86 and 87 of the German constitution — the *Grundgesetz*.

The original THA was headed by a directorate. It was composed of the President and four other members. They were appointed by the Administrative Board for a period of 5 years. They could be dismissed earlier on serious grounds. They were not bound by the instructions given to them. The Executive Board was required to submit annual report and accounts to the Administrative Board. It exercised supervision over the activities of the THA. The president of the THA was supposed to keep the Chairman of the Administrative Board informed of all important business matters. Decisions of particular significance also required the assent of the Administrative Board. It included the preparation of the business plan, drawing of funds from the capital market, establishment of companies, restructuring, privatization and liquidation.

The original THA under the Modrow government was to function on the basis of territorial decentralization. It led to the setting up of the headquarters at Berlin and administrative centres at 14 East German cities, each responsible for a separate region. These were authorized to take decisions on their own with regard to privatization of small and medium-sized companies. The so-called Beiräte advisory boards helped in maintaining contacts with the business, political and social forces within

the region. The THA established excellent networks during the course of its tenure. Without formal and informal networks it could not have succeeded in its mission.

The Treuhand had a matrix organization divided into nine executive boards on the basis of functional responsibilities, such as administration, financing operating responsibilities, etc. The headquarters at Berlin were responsible for the enterprises with more than 1,500 employees and for the firms in the sectors of energy, transport, banking and credit. The rest of the companies were dealt by the regional subsidiaries. In terms of organizational law, the branches were supposed to be subordinate and dependent parts of the institute under public law but, in fact, they proved to be a lower-tier of authority. The THA Executive Board had assigned certain tasks to them to carry out at their own responsibility and there was no possibility of contesting their decisions at the central office. The THA retained the branches as decentralized business divisions by having recourse to the internal organizational power of the Executive Board and its authority to issue orders. It recruited staff for itself and other subsidiaries independently.

The Functions and Responsibilities

The functions and responsibilities of the THA varied from time to time, depending upon the prevailing economic and political situation. The original THA was responsible for converting the state-owned *Kombinates* and other organizations into joint stock companies. Its task was to exercise trusteeship over the public property. It was not the owner of the state property *de jure*. Yet it was the holder of people's property for all practical purposes. It served the purpose of retaining peoples property

as a central agency for the time being. Although it was not directly responsible for privatization, it was authorized to resort to privatization on a limited scale. Some parties from within East Germany were able to acquire shares, buildings or machinery from state-owned companies through the original THA to establish or enlarge private business, having the *mittelstand* character (small to medium size).

The THG (The Act for Privatization and Re-organization of State Property) of June 17, 1990, dissolved the Resolution of Establishment and statutes of the original THA. It also abolished the existing responsibilities of the THA with effect from July 1, 1990. Instead, the statutes of the THA dated July 18, 1990, formulated new tasks and responsibilities for the THA. *The Rules of Procedures* dated September 18, 1990 further supplemented and expanded these responsibilities. The privatization became the main responsibility of the THA under the first sub-clause of the Preamble and Section 1, Sentence 1 of the THG. The responsibility of carrying out privatization was laid on the THA by Article 1, Section B of the THG and Article 25, Section 1, Sentence 1 of the Treaty of Unification. The THA was held responsible for transferring the public assets entrusted to it to private legal entities or natural persons as rapidly as possible and as far as possible. However, 'restitution' and 'communalization' were excluded from the definition of privatization.

On July 1, 1990, the THA had assumed the responsibility for approximately 8,500 state-owned enterprises with a total strength of four million employees. It required a great deal of 'political sagacity' and 'economic expertise' on the part of the THA to resolve the dilemma — it was required to reshape, reform and restructure the entire economy of the for-

mer GDR, on the one hand, and preserve the social market economy and jobs, on the other.

Many of these enterprises operated in various branches which had been 'arbitrarily amalgamated' under the centrally planned economy of the former GDR. For instance, in some cases, production facilities for tools and lemonade, kindergartens, hospitals, hotels and various other social organizations were grouped together in one single holding company. It had a destructive effect as far as any 'potential synergy was concerned'. These *Kombinates* had to be decartelized to enable the new units to survive in the market economy. It was important to introduce market mechanism into the state-owned holdings to make them adapt to the structures of the free market economy. The ultimate objective of privatization was to restructure the obsolete centrally controlled economy of the former GDR into functioning market economy. According to the ex-president of the THA, Dr. Rohwedder, the task of the THA was to privatize rapidly, where that was not possible in the short term, to restructure with determination and liquidate considerably, where neither of these options was available.

The THA worked on the maxim — have as little government as possible and as much government as necessary. It was also responsible for creating small and medium-sized economic units in order to make them saleable and competitive. As such, it got involved in the process of 'creative destruction' of state-owned holding enterprises into smaller units to make them saleable and economically viable and efficient. The challenge before the THA was to create units which were small enough to be saleable and large enough to be able to function independently. It had three objectives in mind before dismantling:

- (i) to make the enterprises competitive
- (ii) to create transparency in order to enable appropriate reviews and inspections to be carried out
- (iii) to change management attitudes of the enterprises.

According to the lady President, Birgit Breuel, the THA's task was not only to sell the state-owned holdings but also to buy investors for the same. The key objective in restructuring companies, both during and after decartelization, was to find the 'right' buyers to make the companies economically viable and competitive. The job of the government through the THA was to create the political, legal and financial framework to support and create the viable economic and industrial units. It required a great deal of time, effort and creativity on the part of the THA. The work of the THA was, in fact, that of 'crisis management'. It is still controversial whether the THA should have given priority to restructuring over privatization. Many economists have argued that restructuring should have been left to the new investors. But it became quite apparent that most of the enterprises could not be sold without prior restructuring.

Prior to privatization, East German industry was dominated by combines (VEBs). 15% of employment was in firms having more than 1,000 people. The THA had to break them into smaller units to make them saleable. It had to recombine them wherever necessary. The sole decision on what to privatize and how to privatize rested upon the THA. The hierarchy comprised the Board of Directors (Aufsichtsrat), Administrative Board (Verwaltungsrat) and Executive Board (Vorstand). The most influential among them was the Administrative Board which was responsible for evaluating the chances of survival of an enterprise in the

competitive market economy. If it found a company not fit for survival, its task was to close it down under 'silent' or 'formal liquidation' or 'bankruptcy proceedings'. It was also responsible for 'creating and preserving jobs'. As such, the THA had conflicting aims and objects since its inception.

Besides these formidable tasks, the THA was required to carry out privatization to the extent to which the assets entrusted to it were affected, although formally this task was allotted to the property offices (*Vermögensämter*) under the Property Act of August 1992. It decided by means of an administrative act, on the sale, letting, leasing of land, buildings, etc. It was also involved in settling the restitution claims on properties under its possession. Under the Treaty of Unification, the assets of political parties and their affiliated organizations, legal entities and mass organizations were to be returned to their 'previous' and 'rightful ownership'. The THA was also responsible for the financing of the Loan Winding-up Fund and the State Insurance of East Germany. The President of the THA was required to certify that the statutory assignment of basic property to joint stock companies were carried out by means of an administrative act.

Financing

When the original THA was set up, it was presumed that it would generate enough funds for itself through privatization proceeds and liquidation of companies entrusted to it. Under Article 21, Section 1, Sentence 2 of the Monetary, Economic and Social Treaty, the THA was authorized to enter into debts upto DM 17 bn during 1990–91. Later, the credit limit was raised to DM 25 bn and these debts were supposed to be paid off

by December 31, 1995. The Federal Ministry of Finance was authorized to prolong the period of loans and/or extend the credit limits in the event of major change in the general conditions. Gradually, the THA was allowed a credit limit of DM 36 bn each financial year and an additional DM 8 bn, with the permission of the Federal Ministry of Finance under the THA Credit Act of July 3, 1992.

The THA Credit Act made it easier for the THA to raise credit on the capital market without any prior audit. It was considered a special asset of the federal government in financial terms. But unlike other special assets, the federal government owed the legal liability for the THA obligations. As such, the THA functioned on the basis of a soft budget. The THA was supposed to raise approximately DM 600 bn from the sale of companies (to be used for the upliftment of East Germans), but it left a debt of DM 270 bn when it closed its doors on December 31, 1994. The Treuhand's reluctance to liquidate companies and subsequent subsidies to keep the loss-making companies afloat in order to preserve jobs for the time being proved to be very costly.

For instance, the THA subsidized investments in shipyards at a rate of DM 1,000,000, more than the cost of sacking a worker. Investment to the Baltic Sea Shipyard totalled more than DM 2 bn. Other examples include DM 800 million for the EKO Stahl steel plant in Brandenburg and approximately DM 2 bn for the Zeiss optical plant in Thuringia. The EKO Stahl had everything going against it. When the Berlin wall fell — the products were of poor quality, the European markets were saturated — it employed 12,000 workers and was losing tons of money. It was a prime candidate for liquidation, but the THA decided that the plant should stay and *Eisenhüttenstadt* should also continue as a steel town.

The THA had the tendency to save the biggest and not necessarily the best companies in order to save jobs. It had conflicting goals to fulfil and had to work under socio-political constraints. The decision to subsidize jobs in EKO Stahl, e.g. was designed to preserve the stability of the region concerned. The role of the BVS is now under question in the case of *Bremer Vulkan* — the largest ship building company in Germany. Its Chairman, Mr. Friedrich Hennemann, was charged of divesting public funds to the tune of DM 716 bn (meant for East German shipyard) to the parent company in West Germany. The THA had sold three East German shipyards to Mr. Hennemann in 1992 despite misgivings by the THA officials and bankers. It is difficult to justify enormous subsidies to companies like which have no chances of a turn-around.

Supervision

We should not forget that the THA had to function under the supervision of not only its own Administrative Board but also under external supervision. It had various internal control mechanisms similar to those within a company in the private sector. The original THA reported to the government. After the THG came into force, the Executive Board of the THA had to report regularly on the progress of privatization to the Council of Ministers. The THA had to take the approval of the Federal Minister of Finance before finalizing the cases for privatization.

As an institute under the public law, the THA was subject to control by the parliament through the monitoring instruments of formal questions and informal requests for information. The Federal Court of Audit also exercised significant control over the activities of the THA. The parliament set up an independent committee on THA with 24 members. The

use of a Committee of Enquiry gave enormous powers to the parliament to investigate special cases. It was possible for the *Bundestag* and the *Bundesrat* to be informed of any matter of public importance any time.

The East German states also exercised considerable influence through their representatives on the Administrative Board of the THA and its Advisory Boards at the regional level. The function of the THA Economic Cabinets was to coordinate the work of the THA and the concerned state government, especially with regard to the labour market. Since the East German states joined the FRG, they became subject to direct control and supervision of the *Bundesrat*. The federal government was under an obligation to report in detail the THA activities every six months to the Commission of the European Community. The Commission could examine individual cases in sensitive areas, such as steel, shipbuilding, automobiles, manufacturing, chemical, etc.

The civil courts are responsible for examining the THA decisions with regard to privatization and dealings in companies in which it held equity. The restructuring programmes come under administrative courts. Parties affected by the THA's decisions on investment priority or assignment of property can also make appeal to the administrative law. The administrative courts can also be approached in the case of disputes among the THA, political parties or mass organizations with regard to public assets under control of the THA. It is still a matter of debate whether the civil courts are competent to examine the decisions made by the THA. Since the THA exercised co-determination and supervisory powers over the companies in which it held equity, it was subject to civil law. As such, it was under the control of civil courts. There are still many cases pending before the civil courts concerning privatization and liquidation carried out by the THA.

The Functioning of the THA

The THA resorted to various instruments and methods depending upon the size of the company and the industry in which it operated. In many cases, it had to opt for a combination of various methods and instruments. It had no fixed criteria or blueprint. It started the process from the scratch and adopted case by case approach. The lady president Birgit Breuel supported flexibility on the part of the THA to avoid unnecessary delay and red tapism during the privatization process. It aimed at finding commercially active business owners as quickly as possible. It had to tailor-make different strategies at different times according to the market conditions prevailing at that particular time. As such, it had to rely on formal and informal networks. It had plenty of scope for manoeuvring needed to carry out its tasks — a complex bundle, ranging from selling the state-owned enterprises and assets, buying investors, preserving and creating jobs to realization of proceeds.

Although there was no hierarchical relationship among the various aims, the THA had set its own guidelines on the basis of experience gained through learning by doing. It gave priority to a privatization that could be carried out quickly. Its endeavour was to sell the company as a whole, if possible. Otherwise, it aimed at partial privatization. It pursued a strategy which not only concentrated on the goals but on the means as well. It tried to preserve as many jobs as possible in order to avoid serious unemployment problems at the regional level. It did not follow the privatization rules strictly and kept its options open. Instead of generating maximum proceeds through privatization, it gave priority to the survival of the company at its location. As such, it gave priority to the investor who was

likely to continue the business operation with a reasonable hope of success to the highest bidder.

Usually, two methods are adopted for selling the companies or part of them — (1) the auction method and (2) the bargaining method. The auction method can lead to rapid privatization on transparent grounds, but does not guarantee sufficient competition among the bidders. The bargaining method, on the other hand, ensures greater degree of freedom and flexibility for both the negotiating parties, but it provides little transparency and is often found to be time consuming. While auction method is recommended for mass privatization, the bargaining method can be more useful when there are only a few bidders or suitable buyers. The bargaining method also helps in finding the 'right buyers' and not simply 'any buyer'.

The THA negotiated with interested parties without following any formal procedure. Although this procedure did not guarantee equality of opportunity to all potential investors, the THA found it useful because it could discuss the various stages of privatization, unbundling, initial restructuring, contract drafting and final sales, simultaneously, quickly and efficiently. The THA resorted to 'limited tender' in the cases of small or medium-sized companies and public tender for mass privatization. The limited tender was a formal procedure in which the THA laid down a number of conditions subject to further negotiations. The THA used public tender only twice — once for the mass privatization of more than 30,000 retail shops in January 1991 and the second time when larger items came for sale later. It did not resort either to public auction or floating of shares.

The THA was actively involved in the preparation, execution and monitoring of the privatization process. During the preparatory stage, it was

concerned with the creation of saleable units by unbundling or merging, valuation of assets and liabilities, assessment of company's suitability for restructuring, exploring the markets and initiating negotiations with the potential buyers. In the second stage, the stress was on the actual sale negotiations. The THA first checked the investors' credit ratings and viability of their corporate strategies. If satisfied, it negotiated in detail on future investments and jobs to be preserved with the individual bidders. It also had to take care of the environmental and other liabilities before finalizing the purchase price. Some of the companies had negative value and some of them were sold just for the token value of DM 1. Even after privatization, the THA's job was not over. It had to supervise and monitor the contracts and re-negotiate whenever necessary.

Privatization through MBO/MBI/Management KGs

Since the East Germans lacked access to finance, management expertise and western markets, they could not participate in the privatization process effectively. They put pressure for privatization from below. The initiative came from the Eastern managers themselves. Initially, the THA had no scheme for Management Buy-Out or Management Buy-In. Only in autumn 1992, the THA established a fund to provide the MBOs access to consultancy advice. The idea had emerged at Berlin regional subsidiary level earlier.

In order to give the East German managers a chance to continue managing their companies under the market economy, the THA set up a policy known as *Initiative Mittelstand*. It aimed at providing the managers of small and medium-sized companies an opportunity to carry out management buy-outs. It also developed a programme to help them finance

the purchases, knowing fully well that the East Germans had no chance of saving money under the communist system. Vouchers did not find favour with the THA mainly because they neither bought fresh money nor new technology. Moreover, because of the high wage costs, lack of markets and bad shape of outdated plants, the East German firms could not yield profits. Nobody would have invested in a company with a negative value.

The *Initiative Mittelstand* proved very successful. Approximately 18% of the medium-sized enterprises were sold to incumbent or external management. It meant that approximately one-fifth of the THA firms were purchased by the East German managers and employees. Nearly 50% of the MBOs were in industry, 25% in service, 13.3% in construction and 11.4% in trade. Approximately 60% of the firms had less than 50 employees, 35% had between 50–250 employees and 5% had more than 250 employees. The average size was approximately 70. Approximately 66% of the firms were purchased by their managers (pure MBOs), 15% by their managers and employees (MEBOs), 15% by East and West German managers jointly (BIMBOs) and 4% by the Management Buy-Ins (MBIs) and 'pure' Employee Buy-Outs (EMBOs).

Through the MBI scheme, the THA tried to attract the individual entrepreneurs to establish business in East Germany. It launched this scheme in 1992. The advertizing campaign elicited 2,800 responses. The applicants were shortlisted on the basis of the following criteria :

- (i) availability of at least two annual salaries as start up finance
- (ii) managerial experience
- (iii) a track record in the industry

(iv) a willingness to resettle in East Germany

The THA selected 400 candidates after a thorough screening and identified approximately 3,000 firms as suitable. The candidates were put in contact with West German and Foreign Venture Capital Funds in order to secure participation by the financial institutions. The *Deutsche Bank*, e.g., established an industrial holding company in 1991 — the *Deutsche Industrial Holding*. Its objective was to secure 100 percent holding of the THA firms. By July 1993, it purchased 13 of the THA firms guaranteeing 3,500 jobs and investment upto DM 150 million. The other private sector investment funds included the *Ermgassen Fund*, *EGIT* and *Robert Flemings of London*.

In spring 1992, the THA launched a new scheme of the Management KGs to introduce market driven incentives into the restructuring and privatization process while retaining the ownership with the THA. This new strategy became necessary when the THA found that even the potentially viable enterprises had failed to attract new buyers. It tried to buy time for these enterprises to prove their viability. The advantage of this approach was that the regional and external effects could be taken into account. The THA was required to monitor the employment and investment contracts and had to maintain contacts with the former enterprises till the full duration of the contracts.

An Evaluation

Any evaluation of the THA can only be made on the basis of a 'comprehensive analysis', covering the basic objectives, processes and results of privatization in East Germany. Although the THA was responsible for 'spontaneous privatization' wherever feasible, making other enterprises

viable after restructuring and liquidating the non-viable enterprises in order to transform the East German economy from the socialist to the market oriented economy, it became clear soon that this programme was 'too demanding' for any privatization agency. Although THA was designed to function in an autonomous manner, it could not be insulated from political pressures, regional politics and bureaucratic red-tapism. It had to function under the circumstances beyond its control.

Right from its inception, it had conflicting goals to perform. It was required not only to transform the ownership patterns, but also to secure jobs. For every privatization, it had at least one more alternative. It could have sold a company to another bidder, or could have kept it for a longer period of time or could have liquidated it straight away. Restructuring of the non-viable enterprises by the THA caused a lot of controversy. Restructuring meant preparing the enterprise from privatization through various activities, such as, breaking up the large conglomerates into viable units, dismissal of former managers lacking entrepreneurial skills, reduction in the work force and making huge investments in the firms to make them more attractive to the private purchasers. While one group of scholars found restructuring by the THA as futile on theoretical grounds, other group supported it on pragmatic grounds.

As a fiduciary, THA had the advantage of having the requisite networks with other government agencies. It could also exert political pressure to modify the laws that inhibited the restructuring of the firms. It could also wait till the necessary infrastructure had been set up. It could enjoy the 'economies of scale' and 'wider scope', on the one hand, and could also pool the risks involved in restructuring such, as restitution claims, environmental damage costs and unforeseen demand developments, on the

other. But in practice, restructuring was often used as a label to disguise subsidization of non-viable firms under political or regional pressures.

Although the THA tried its best to resist political pressures, it had to function under several constraints. It could not resort to liquidation of non-viable enterprises under political or regional pressures. It had no weapons to fight against undue political pressures. It was in a weak position even towards the potential buyers. Once it was known that a particular state-owned enterprise could not be liquidated, potential buyers tried to press for even lower prices. Often the THA had to sell the non-viable enterprises at a negative price in order to ensure job-commitments or investment commitments. Large subsidies had to be provided towards the end of the privatization programme where liquidation was not politically feasible. Large SOEs often found political support against liquidation.

Not adept in public relations, the THA decisions were generally misunderstood by the public. The whole process of privatization was beyond the understanding of an average German citizen. The West Germans were used to seeing their economy always grow without knowing why and the East Germans could not digest the idea of selling a huge enterprise for a token price of DM 1 only. Politicians and trade unions were able to reap benefits out of such precarious situations. In many cases, the THA had to postpone the resolution of liquidation under abrupt political intervention. For instance, in Saxony, the liquidation of the steel manufacturing company in Freital had to be prevented through the intervention of the Prime Minister of Saxony. Similarly, the Chemical Industries in Leuna and the Optical Industries in Jena were saved on political assurance.

Privatization has always been unpopular with the politicians and the voters since they are more concerned with the distributional aspects rather than the macro-economic aspects of economy. In the case of East Germany, privatization gave too high hopes to the public which could not be realised in a short term. Many expectations and calculations went wrong and the THA was made the scapegoat for the recklessly optimistic policies of the West German politicians. They could not anticipate the sudden collapse of the East German economy. There were five factors responsible for it :

- (1) the conversion rate of 1:1 for all current transactions,
- (2) unrealistic wage increases,
- (3) poor quality of goods produced,
- (4) collapse of major export market in Eastern Europe,
- (5) economic recession in western Europe.

Owing to the exchange rates of 1:1 (in lieu of the actual rate of 1:3), the East German firms could not afford supplies from West German or foreign firms, while the East German consumers discarded Eastern goods all of a sudden. In the process of revaluation, the East Germany's capital stock economically halved overnight. Perhaps the biggest blunder was made when wage contracts were signed to match the wage levels in the East with those of the West by 1994 without raising the actual productivity. It was a political and not an economic agreement between the *Gesamtmetall* (the West German Metal Employer's Association) and *IG Metall* (the West German Trade Union of Metal Workers). The wages for the east were *de facto* fixed by the west. Although the wages were about 70% of West German levels in February 1993, the productivity was 50%

below that of West German levels, especially in the area of steel, engineering and electrical sectors.

The lack of correlation between the wages and productivity made the investors more apprehensive. For instance, in November 1992, Daimler-Benz cancelled his plan of building truck factory near Berlin with an investment of DM 1 bn. Krupp, the large German steel manufacturer, abandoned his plan to takeover the EKO Stahl. Besides there was less demand for East German products owing to their poor quality. With the fall of COMECON, the trade with Eastern Europe suffered since these countries were not in a position to pay for East German goods in DM. The East German factories could not compete with the Western markets on technological grounds.

Moreover, Germany was hit by an economic recession — worst since 1974/75. It had significant effect on the privatization efforts by the THA. Many investors backed off and many deals had to be cancelled. It delayed the whole process of privatization. The THA had to keep the loss-making and unviable firms under its fold for longer period of time than anticipated, raising the cost tremendously thereby. The West Germans, used to very good economic and living standards, started questioning the very necessity of complete and rapid privatization in the wake of unification. The East Germans, were also unprepared for price rise, loss of jobs and other socio-cultural problems. All the blame for economic hardships was put on 'unification' in general and 'privatization' in particular. The false promises by the shrewd politicians left many psychological scars on the public mind.

The welfare effects of privatization in East Germany have been high on the political agenda now. It is difficult to evaluate the impact of distribu-

tion of income, knowledge and wealth between the West and East Germany both from theoretical and empirical point of view. In the case of East Germany, the idea of voucher or people's capitalism did not find favour with the politicians. It was difficult to determine the citizenship of East Germany. It was difficult to decide whether vouchers or shares be given to those GDR citizens who left it prior to unification or not. Also, in the Treaty on German Unification, people's property became extinct on the day of unification. As such, there was no legitimate basis for giving shares or vouchers. Provision was made only for the restitution in kind. That also caused a lot of hardships to the Treuhander.

Many cases are still pending before the courts with regard to restitution claims. Many citizens are still claiming compensation for the property confiscated during 1945–49, despite the fact that the role of the courts in Germany has generally been supportive of the Treuhandanstalt and privatization. East German citizens have however been arguing that it was not enough for the original owners to get back their property or monetary compensation. They hoped to be compensated for the opportunities lost during the 40 odd years of communist regime, while the West German citizens were able to prosper under the capitalist economy and liberal democracy.

Nor did the idea of employee's shares found favour with the THA. In many post-communist countries, employees claimed the property or the right to manage public enterprises. In these societies, employees were given a special share free of charge or at a nominal price. To alleviate political pressures from the employee-voters, 'mass privatizations' or 'spontaneous privatizations' were adopted in Hungary and Poland. But it was not found equitable in the case of East Germany. Under employees'

shares scheme, only employees of the privatized firms could hope to reap benefits from the windfall gains, while the diligent civil servants could not claim the same. Secondly, employees in good firms were at an undue advantage in comparison to those working in non-viable firms for no fault of their own.

However, under mounting political criticism for depriving the East Germans of economic opportunities in the wake of deindustrialization as a consequence of privatizations in East Germany, the THA adopted the policy of Managements Buy-Outs (MBOs) and Management Buy-Ins (MBIs) to promote East German ownership and East German entrepreneurship. It saved both the time and cost for the THA over negotiations, and it seemed reasonable to handover small enterprises to former managers or to THA managers who were personally interested in running them. Approximately 20% of all cases of privatization were the cases of MBOs. It comprised a mere 0.6% of all small and medium-sized enterprises (new, reprivatized and small privatization). By September 30, 1990, the THA reported 2,697 MBOs out of a total of 13,781 enterprises which were involved in the process of privatization.

But the importance of the MBOs cannot be judged in terms of number. According to the internal report of the Federal Ministry of Economics published in December 1994, there were 3.2 million jobs in small and medium-sized enterprises in East Germany and MBOs contributed to approximately 6.7% of all the jobs in small and medium-sized enterprises in East Germany. According to a survey conducted by the Bonn Institute of Mittelstandsforschung, approximately 32% of all MBOs were industrial. In 66% of the MBOs, the purchasers were East Germans who bought their own firms. In 14% cases, East German managers from

other firms were brought in. The ownership of East German MBOs was generally shared by two or more entrepreneurs, thereby undermining the importance of employee participation. The purchasers of the firms knew in advance that they would have to dismiss few employees. Hence they avoided extensive participation by the employees.

The MBOs seem to have become the success story in East Germany. By the end of 1994, only 2% of the MBOs declared bankruptcy, compared to the average of 10% in otherwise newly established small and medium-sized enterprises in East Germany. In nearly 25% of the MBOs, profits are more than expected and every sixth MBO has already started increasing the number of the employees they had cut previously. Many give credit to the success of the MBOs to the generous subsidies provided to them by the THA, but it is not true. Till the end of 1994, the MBOs had not received any credits from the consolidation fund of DM 500 million owing to the long time taken by the new länders to evolve the necessary regulations governing the grant of credit from this fund. Perhaps the MBOs became successful because they bought the enterprise at a fairly low price. It gave them a favourable starting point.

However, the Management KGs, have not proved to be as successful as the MBOs/MBIs. MKGs imply private limited partnerships whose general partner is a limited liability company. Under German commercial law, these are termed as GmbH or Co KG. Here the general partner lacks the assets and is only liable to provide financial contributions legally needed to create a limited liability company, the minimum being DM 50,000. A special agency known as *Beteiligungs Management Gesellschaft Berlin* (BMGB) was created on January 1, 1995 as a part of BVS to look after

the MKGs. The THA was a minority partner with 4% shares, while 2–3 managers formed the majority partner with 96% shares.

The MKGs were designed to be the holders of different industrial sub-sectors which required restructuring prior to privatization. What was envisaged was a small number of firms to be quickly prepared for privatization by the MKGs and not to provide huge subsidies to bad firms under political pressures. Various firms were allotted to different MKGs. By September 1995, these MKGs were able to secure 7,110 job guarantees and DM 695.6 million investment guarantees. The budget of the BMGB can provide financial support to the tune of DM 1,243 million for the period of 1995–98. In practice, the MKGs have become the source of political sagacity to deal with the trade unions and East German politicians. It has proved to be a political success, if not economic, by preserving the core industries. But these may face economic crisis in the wake of over-capacity and declining demand or *vice versa*.

In fact, neither restructuring nor privatization by the THA guaranteed economic efficiency, wider choice or more competition. The THA's main target was the continuation of business rather than the generation of cash. Even the ex-President Birgit Breuel admitted many lapses on the part of the THA but she also made it clear that the THA had to start the process from a scratch, with no examples or blueprint to follow. It had to function under very uncertain economic and political circumstances. While some argued that there was too little support by the THA, others argued that there was too much support. While many criticised the THA for its 'kafka like image', some complained of the THA being too generous in divulging information. The Achilles heel of the THA was not a conflict between efficiency and equity but also between privatization and

restructuring. The THA was always criticised for giving priority to privatization over restructuring by one set of economists, while others criticised it for making tremendous losses by keeping the non-viable companies afloat.

Verkauft und Verraten, sold and betrayed, was the basic content of the criticisms of the THA from various quarters within Germany and outside Germany. Since it preferred bargaining over tender, it could not be as transparent as desired in a parliamentary democracy with a federal set up. It was often criticised for showing favouritism towards West German entrepreneurs and firms to the neglect of East Germans and foreigners. Some criticised the THA for the rapid privatization. To them, it was always in super haste to privatize and did not invest enough time, money or efforts into reviving the business enterprises in East Germany. It was held responsible for deindustrialization and massive unemployment causing social unrest among the people in East Germany.

To many East Germans, it paid a lip service to job security. It is surprising to note that the THA did not participate in wage-negotiations, although it was directly responsible for 4 million jobs under its control. The THA was under the obligation to create and preserve jobs. Although it had contracted with 70,000 investors who promised approximately 1.5 million jobs and DM 187 bn investments, nearly 1,400 investors failed to meet their employment targets significantly. To Horst Siebert, economic development in East Germany was characterised by different 'time paths'. We find a 'J-curve' of adjustment in capital stock, a 'V-curve' of adjustment in production and an 'L-curve' of adjustment in employment. The employment dropped dramatically from 10 million at the beginning of 1990 to 6.4 million at the end of 1992. It has not passed the

turning point until now. The social, economic and political costs of privatization proved to be much more than anticipated.

In fact, the Treuhand had to sail between a no man's land between politics and economics. It was neither an official body nor a holding company in the strict legal terms. It could at best be compared to the Deutsche Bundesbank in many ways. It had very limited authority at its disposal. It was financed by the Federal Ministry of Finance, co-administered by the Management Trust whose members represented various political parties, guided by numerous advisory committees and controlled by the parliament through the Ministry of Finance. Under these circumstances, it could not achieve the optimum results.

In an 'endogenous equilibrium', it had to calculate the decisions of other political actors and players as well. It had to calculate the likely constraints to be imposed by the affected parties and political lobbies. It had to choose between 'high costs of rapid privatization' and 'high costs of subsidization' for an indefinite period of time. It preferred 'low and negative selling' to 'permanent subsidies'. In this respect it proved to be a great success.

The major goal of the THA was to create efficient property rights through 'negotiated privatization' and not through auctions or direct sales. Even restitution to former owners was conditional on the THA's assessment of their entrepreneurial capabilities. Under the Investment Priority Act, the THA could allocate property rights to competent investors authoritatively if it found the former owners unwilling or unable to invest in appropriate business plans in lieu of compensation. In this sense, The THA did not really sell the firms, but it bought the buyers. It functioned on the West German model of 'collective bargaining', 'autonomy', 'cooperative interest

group politics', 'monetary stability', 'free trade', 'consensus on industrial competitiveness' and 'welfare state provisions including codetermination in industry and social security'. The transition from the socialist to capitalist economy in East Germany occurred according to the functional conditions, institutional and legal provisions and 'customary patterns of problem solving' prevailing in West German politics. It turned out to be a risky but a promising endeavour.

In the process of transition, the THA evolved from a central economic agency of transformation to the most important instrument of industrial and political policy and an important link between the federal and the new länders. It functioned as a 'third level of cooperation' in Germany's inter-governmental system. As such, both the Federal and Länder governments were represented on its governing body and numerous coordinating committees. It also had various representatives from industry and trade unions. Much of the Treuhand's success depended upon this network. It provided the Treuhand a plenty of scope for manoeuvring and coping with its excessive responsibilities.

The 'interlocking' of the decision makers in the transformation process lessened the problems of legitimacy in the case of the Treuhand. Although there was a danger of being captured by the vested interests, the cooption with the business and political groups contributed to the requisite checks and balances among the various political, economic and social actors, on the one hand, and provided better coordination of conflicting objectives, on the other. The THA provides a classical example of coordination and control. It linked much of the process of transformation by relying upon the common interests of all the participations either on the basis of the principles of rapid economic recovery or agreements

with the trade unions or through internal guidelines. In this way it was able to generate widest possible support for its various activities.

The THA could avoid the danger of conflict inherent in its 'dual role' as an employer and agent of transformation only by restoring to compromise, otherwise it would have been quickly torn due to the clash between the competitive forces of the federal government and new *länder*, on the one hand, and the vested economic and political interest groups, on the other. The Treuhand could survive only through the process of mutual accommodation. The path from 'planned economy' to the 'market economy' could not be meticulously planned itself. The Treuhand needed a lot of autonomy and flexibility in dealing with the investors and its networks paid rich dividends.

It was wise on the part of the Treuhand to invoke political compromise at a time when governance through the markets or hierarchies was neither feasible nor desirable. In the severe economic and political crisis, it was not possible to privatize the East German firms strictly on the principles of market economy. The Treuhand took advantage of its semi-autonomous, semi-bureaucratic and informal procedures. Instead of selling the firms in the open market, it bought the concepts of private investors and subsidized their rescue operations to the extent of negative prices.

As such, the THA came to act as a 'development agency'. The federal structure also helped in balancing the political interests through negotiations. The THA under former GDR could not have survived in the bargaining democracy prevailing in the FGR. The THA also provided a model for 'project-oriented administration' by operating in an informal, flexible and network-like structures which go beyond the dichotomy of public-private boundaries. The functioning of the Treuhand revealed the

tremendous adaptative capacities of the German political and administrative system in the wake of rapid economic and political transformation.

Lessons to be Drawn

The Treuhandanstalt provides a unique example of privatization by the state and the market. While many western countries pursued privatization through market (auction, vouchers, mutual funds, stock market floatations), the East German experience appears to be an exception. Usually, state is considered an impediment, but in East Germany, the THA, a state agency, was responsible for the restructuring of the entire economy of the GDR within a short time. It took restructuring and privatization in a situation when East Germany was undergoing a lot of problems — social, economic and political, in the wake of reunification. It was a public agency with an Advisory Board consisting of representatives from the federal government, state governments, commercial banks, trade unions and major West German firms to signify the importance on non-Germans in the privatization process. They helped in harmonizing the various political, business, administrative and social interests.

While many marvel at the speed with which the THA was able to carry out the privatization business in East Germany, there is no dearth of scholars who look at the whole exercise as a simple contradiction in terms. While some experts on privatization have argued that it would have been better had the THA managers spent more time on each transaction, others have suggested that some concerted efforts by the THA towards 'de-mystifying' the agency would have smoothed the political process, accelerating the speed thereby. The THA was also blamed for the de-industrialization of East Germany. Perhaps it could

have exchanged properties in West Germany for assets in East Germany! Many East German nourish the feeling of being 'deprived' in their own country. The East Germans could invest only in 6% of privatization deals. Some have even argued that the cost of German unification would have been less if financed by the taxes rather than borrowing. According to Dr. Heinrich Hornef, the former agency's Financial Director, it would take another generation to pay off the THA deficit.

The questions arise: can the Treuhandanstalt provide a model to other East European or developing economies, on the threshold of active privatization? What lessons can we learn or unlearn from the East German experiences in privatization? Is it advisable to entrust the privatization job to a centralized agency or should it be left to the market? Is it good to follow a top down approach or a bottom up approach in transitional economies? Can the shift in ownership lead to economic efficiency? Could the THA succeed without access to West German markets, managerial expertise, legal framework and financial support? Can the East German model be adopted elsewhere?

Estonia provides a rare example in Eastern Europe where a privatization strategy similar to that of the Treuhand was adopted. In Estonia, pre-privatization focused on the splitting of the large enterprises into single plant enterprises. Yet sales with more than 500 employees have been rare and only two firms with more than 1000 employees could be privatized. In the absence of well functioning state agencies, domestic and foreign firms, the speed of restructuring is likely to be restricted in Eastern Europe. East Germany was lucky to have a 'big brother' to solve most of its problems in the wake of privatization which is lacked by East European and developing countries. Although report cards are still

pouring on the East German experiences in privatization, some important practical lessons can be drawn :

- (1) Privatization in East Germany provides a unique example of the transformation of the entire economy. But we should not forget that East German economy comprised only one-sixth of the West German economy. Prior to the unification (taking the 1988 figures), East German employees counted for just 22% of the total work force of East and West Germany together and East Germany's disposable income accounted for just 11% of the total German disposable income. As such, it was not the entire economy, but only a large part of unified German economy which had to be privatized. In contrast to East Germany, Czechoslovakia, Hungary and Poland were in a more precarious condition.
- (2) The new länders enjoyed the privileged position of being the part of unified Germany. They had the advantage of having a 'big brother' to guide them and support them while other post-communist societies had to adopt the policies of 'learning by doing' or 'help yourself'. East Germany almost overnight merged into the West German economic and political system. It got ready-made legal and political institutions. The instant currency convertibility with long standing stability insulated it from hyperinflation. It had access to West German human resources and know-how and direct access to EC markets. The West German investors, banks and insurance companies were also available to it for starting new business or redeveloping the old ones. It also had the advantage of West German social security to fall back upon. Privatization in East Germany occurred in unique historical circumstances. As such, it just cannot be duplicated or

copied in *toto*. Treuhandanstalt too was an outcome of the historic development rather than the outcome of a well-thought out plan or industrial policy.

- (3) It is always better to have an independent institution responsible for privatization. It can provide the necessary force, lead, speed and credibility to the whole exercise. But every care should be taken to insulate it from political interferences to be able to achieve the best economic dividends. The East German experiences in privatization clearly depict that the privatization agency could not be kept free from the political and regional pressures now and then. It also explains the slow liquidation process in the case of non-viable enterprises. Liquidation makes the effects of privatization more visible than what the politicians can actually afford.
- (4) It is advisable to fix the targets of privatization in clear terms to avoid ambiguity, delays and political controversies. A multiple target system should have multiple means. The economic and social goals should be clearly specified and entrusted to separate institutions as far as possible. It can help in gaining the necessary public support and legitimacy in a democratic framework. Conscious and systematic efforts must also be made to educate the public about the pros and cons of privatization in a given socio-economic structure. Back-door entry can prove to be counter-productive.
- (5) It would be futile to locate the causes of privatization within the state itself. The dynamics of privatization can be better understood in the international context. Different countries may react to different problems in different ways and the policy outcomes may have a common appearance only by chance. There may be certain com-

mon factors responsible for certain economic and political changes but various countries may not interact with, learn from or induce change in other countries. Or different countries may or may not face similar problems yet they may try to emulate certain policies through interactions with one another.

- (6) Primarily because of the media focus and high attention paid to privatization as an instrument of economic and political management in advanced economies, the emerging economies may also try to emulate privatization despite having an altogether different socio-cultural milieu. But if privatization is seen merely as a matter of growth, economic efficiency and earning foreign exchange, to the neglect of socio-cultural dimension, it may backfire. There is no short cut to success. One must be prepared for hardships at present to be able to reap benefits in future or be prepared to pay the cost later.
- (7) Undoubtedly, the scope of privatization in a given country is set by socio-economic conditions, political culture and management expertise available therein. It may be easier for those countries to reduce the role of the state in public sector which have accorded considerable legitimacy to the private sector, but it may not be easy to reduce state intervention in those countries which have been emphasising the redistributive role of the state in the name of social justice.
- (8) Like all economic reforms, privatization too has distributional consequences. It may favour certain groups at the cost of others. As such, it may end up shifting the 'concentration of economic power' *per se*. In all societies, we find a nexus among power, wealth and politics. It constitutes the political culture of a given society and the prospects

of privatization depends substantially on this nexus. No privatization movement is free from complacency, growth of bureaucracy and desperate pursuit of power and control. Privatization entails not only an economic device but also a political strategy.

- (9) Privatization not only helps in generating money but it also costs money. The East German model provides the best example. Instead of raising DM 600 bn from the sale of public assets as expected, the Treuhandanstalt incurred the deficit of DM 270 bn to the exchequer. A solidarity tax of 7.5% had to be launched on January 1, 1995. It is likely to continue in near future. The burden of the THA deficit will have to be borne by all the taxpayers, while the gainers have been the few. It would take another decade to bridge the gap.
- (10) As such, privatization has no intrinsic value of its own. It is neither good nor bad in itself. It is neither a 'quick fix' nor a 'panacea'. Nor can it lead to economic growth and development *ipso facto*. On the contrary, its 'success' or 'failure' depends upon many other factors. At the most it can be seen as an important economic device, a political strategy or an administrative tool, but certainly not an end in itself.

Bibliography

- Blum, U. (1992). Recent Experiences with Privatizing State Enterprises in the former GDR: The Case of Treuhandanstalt. A paper presented at SOG Conference on *Regime Transition, Elites and Bureaucracy*. April 23–25, (mimeo).
- Bös, D. (1992). Privatization in East Germany: A Survey of Current Issues. IMF Working Paper, 8. January.
- (1995). The Impact of Privatization on Distributional Equity with Special Reference to East Germany. In V. V. Ramanadham (ed.), *Privatization and Equity*. London: Routledge: 49–67.
- (1996). The Treuhand: A Never Ending Story. Bonn Discussion Paper. Sonderforschungsbereich 303 "Information und die Koordination wirtschaftlicher Aktivitäten". Rheinische Friedrich-Wilhelms-Universität.
- (1997). Privatization and Development. *Review of Development Economics*, 1(3): 337–354.
- Bös, D. and G. Kayser (1995). Management Buy-Out as an Instrument of Privatization in East Germany. In IMF, 119, *THA: Head or Tail?*: 1–20.
- (1995). The Last Days of the Treuhandanstalt. In P. Cook and C. Kirkpatrick (eds.), *Privatization Policy and Performance*. New York: Prentice Hall. Harvester Wheatsheaf: 84–100.

- Brücker, H. (1995). Selling Eastern Germany: On the Economic Rationale of the Treuhandanstalt's Privatization and Restructuring Strategy. In W. Quaisser et. al. (eds.), *Privatization in Poland and East Germany: A Comparison*. Vol. I. Working Papers No. 180/181. Munich: Osteuropa Institute. September.
- Carlin, W. (1994). Privatization and Deindustrialization in East Germany. In S. Estrin (ed.), *Privatization in Central and Eastern Europe: Key Issues in the Realignment of Central and Eastern Europe*. London: Longman.
- Carlin, W. and C. Mayer (1994). The THA: Privatization by State and Market. In O. J. Blanchard, A. Kenneth and J. D. Sach (eds.), *The Transition in Eastern Europe*. Vol. 2. Chicago: The University of Chicago Press.
- (1995). Structure and Ownership of East German Enterprises. *Journal of the Japanese and International Economies*, 9(4): 426–53.
- Cassell, M. K. (1996). The Treuhandanstalt, Privatization and the Role of the Courts. *Financial Studies*. Discussion Paper ISSN Nr. 1011–9523.
- Comisso, E. (1997). Is the Glass Half Full or Half Empty? *Communist and Post-Communist Studies*, 30(1): 1–21.
- Cox, H. (1996). Effects of Organizational Reforms, Competition and Privatization on the Performances of Public Enterprises: The German Case. Duisburg: University of Duisburg.
- Czada, R. (1996). The Treuhandanstalt and the Transition from Socialism to Capitalism. In A. Benz and K. H. Goetz (eds.), *A New German Public Sector? Reform, Adaptation and Stability*. Brookfield, USA: Dartmouth Publishing Company.

- Dechant, U. (1995). Management Buy-Outs in East Germany: An Empirical Study of Key Success Factors in the Industrial Sector. In W. Quaisser et al. (eds.), *Privatization in Poland and East Germany: A Comparison*. Vol. I. Working Paper No. 180/181. Munich: Osteuropa Institute. September.
- Dempsey, J. (1993). A High Price to Pay for High Wages in the East. *The Financial Times*. February 22.
- Disinvestment Commission Report 1997*. New Delhi, February.
- Engfer, U. (1996). The Impact of Privatization and Change of Social Security Systems upon Living Conditions of East German Households. In *Innovation: The European Journal of Social Sciences*, 9(3): 279–314.
- Estrin, S. (ed.) (1994). *Privatization in Central and Eastern Europe: Key Issues in the Realignment of Central and Eastern Europe*. London: Longman.
- Evans, G. (1992). Treuhand's Tricks of the Trade. *Euromoney*. September.
- Fischer, W., H. Hax and C. H. Schneider (eds.) (1996). *Treuhandanstalt — The Impossible Challenge*. Berlin: Akademie-Verlag.
- Grosfeld, I. and G. Ronald (1995). Defensive and Strategic Restructuring in Central European Enterprises. CEPR Discussion Paper 1135.
- Gupta, A. (1992). Socio-Cultural Dimension of Privatization. *Financial Express*. April 22. New Delhi.
- (1993). Will Privatization Lead to Debureaucratization? *Janata*. June. Bombay.

- Gupta, A. (1993). Pitfalls on the Road to Privatization. *Financial Express*. January 7. New Delhi.
- (1994). Structural Adjustment, Privatization and Public Bureaucracy. In R. B. Jain and H. Bongartz (eds.), *Structural Adjustment, Public Policy and Bureaucracy in Developing Societies*. New Delhi: Friedrich Ebert Stiftung — Har Anand Publications: 396–407.
- (1994). Privatization in Canada : Lessons for India. In M. P. Singh and Chandramohan (eds.), *Regionalism and National Identity*. New Delhi: Pragati Publications.
- (1994). *Changing Perspectives of the Welfare State: The Issue of Privatization*. New Delhi: Pragati Publications.
- (1995). Will Disinvestment Lead to Privatization? *Financial Express*. March 18. New Delhi.
- (1995). Whose Job Is It Anyway? *Financial Express*. June 1. New Delhi.
- (1996). Why Privatization?. *Janata*. April. Bombay.
- (1996). Privatization: An Economic Device or a Political Strategy? *Journal of the Institute of Public Enterprise*. Vol. I. Hyderabad.
- (1997). *Road to Privatization: A Global Perspective*. London: Macmillan (forthcoming).
- (1997). Looking Beyond Privatization: Blurring of Public-Private Sector Dichotomy. UK: Policy for Centre Research. Sheffield (forthcoming).
- Hau, H. (1995). *Privatization under Political Interference: Evidence from Eastern Germany*. Paris: ESSFC.

- Heyden, E. von der (1995). Privatization in East Germany: The Delivery of an Economy. *The Columbia Journal of World Business*, 30: 42–54.
- Hyvärinen, J. (1996). *A Survey of Corporate Governance: Which Model for Transition Countries?* Helsinki.
- International Management* (1994). Treuhand's Closing Down State. 6 September.
- Kaser, M. (1996). *Post-Communist Privatization: Flaws in the Treuhand Model*. Birmingham.
- Kloepfer, M. with assistance of J. F. von Unger (1996). The Treuhandanstalt under Public Law. In W. Fischer et al. (eds.), *Treuhandanstalt — The Impossible Challenge*. Berlin: Akademie-Verlag.
- Koch, A. (1992). Employees in Privatization Process. Proceedings of the Workshop on *Main Aspects and Objectives of Privatization*. Köln: Deutscher Instituts-Verlag.
- Kokalz, L. and P. Hüfner (1994). Management Buy-Out/Management Buy-In. Working Paper No. 54:25. Stuttgart: Institut für Mittelstands-forschung, Schaeffer, Poeschel.
- Lehmbruck, G. (1994). The Process of Regime Change in East Germany: An Institutional Scenario for German Unification. *Journal of European Public Policy*. June. Routledge.
- Nellis, J. (1994). Successful Privatization in Estonia: Unusual Features. *Transition*, 5: 5.
- Rao, N. V., S. M. Dunphy and C. B. Rao (1996). International Perspectives in Privatization of State Owner Enterprises. *Journal of Business and Economic Perspectives*, 22(1): 97–106.

- Rosa, J.-J. (1996). Public Choice Aspects of Privatization Policies: Driving Forces and Obstacles. A paper presented at Egon Sohmen Symposium on *Privatization at the Turn of the Century*. September 6–7. Budapest.
- Sander, B. (1995). Foreign Investors' Activities in the Context of East German Privatization: Motivations and Strategies. *MOCT–MOST*, 5: 109–132.
- Schmidt, K.-D. (1995). Treuhandanstalt and Investment Acquisitions: How to Ensure that Contracts are Kept? In Grup d'Anàlisi de la Transició Econòmica (ed.), *Joint Ventures in Transformation Countries in the Context of Overall Investment Strategies of their Partners*, Barcelona: 143–178.
- (1995). Requirement for Successful Privatization — Lessons from the Treuhandanstalt's Approach. In W. Quaisser et al. (eds.), *Privatization in Poland and East Germany: A Comparison*. Vol. I. Working Paper No. 180/181. Munich: Osteuropa Institute. September: 141–161.
- (1996). German Unification: A Progress Report. Kiel Working Paper No. 722. February. Kiel Institute of World Economics.
- Schmidt, K.-D. in collaboration with U. Siegmund (1996). Privatization Strategies. In W. Fischer et al. (eds.), *Treuhandanstalt — The Impossible Challenge*. Berlin: Akademie-Verlag.
- Schmidt, K.-D. and K. Gerling (1997). On the Competitive Position of Eastern German Manufacturing: Why is the Catching Up So Slow? Kiel Working Paper No. 825. Kiel Institute of World Economics.

- Schmidt, K. M. and M. Schnitzer (1996). *Methods of Privatization: Auctions, Bargaining and Give-Aways*. A paper presented at the Eugen-Sohmen Symposium. September 6–7. Budapest.
- Sinn, G. and H. W. Sinn (1992). *Jumpstart: The Economic Unification of Germany*. Cambridge, Mass.: The MIT Press.
- Sinn, H. W. (1996). International Implications of German Unification. Discussion Paper No. 1508. *Financial Economics*. November.
- Thanner, B. (1993). The "Simple" Micro Approach in East German Privatization — The Inevitability of Macro Contradiction. *Economic Problems of National Unification*, Seoul: 167–186.
- Treuhandanstalt (1994). The Final Report. December 31.
- Waish, M. W. (1995). Going Private — The Profit and the Pain. World Report. *Los Angeles Times*. January 10.
- Wall Street Journal* (1992). How the Treuhand Lends a Helping Hand and a Leaden Boot. March 21.