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1. Initial Situation

Until the peaceful revolution of late 1989 and the changes in the political and economic system enacted thereafter, the population of the GDR had lived in a typical Soviet-type economy[1]. Political and economic decision-making was centralized at the top, the major means of production including all firms in industry were owned by the state, a rigid plan guided the allocation of inputs and the distribution of outputs, investible funds were collected by the one-tier system of state banks and - under the control of the planning authorities - channelled to the firms according to rather arbitrary priorities. Furthermore, the fixed prices did not convey any reliable and relevant information about true economic scarcities. To firms, these prices were little else than mere bookkeeping entries.

Industries were organized as state monopolies, with almost all of the roughly 3400 industrial firms being grouped together into 231 vertically and horizontally integrated combines ("Kombinate"), of which 126 were directly controlled by the respective central branch ministries and the remaining 95 by regional authorities[2]. Between the combines, the markets were clearly segmented; any disputes on the delineation of the markets for specific industries had to be settled by government decision. For instance, a GDR publisher of children's books was not allowed to print an economics text. If he had wanted to publish an economics text for children, a government decision would have been necessary.

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1) The term has been coined by Winiecki (1988).

2) Statistisches Jahrbuch der DDR (1989), p. 138.

Externally, foreign trade was conducted by a government monopoly. The exchange of goods with other socialist countries mostly took the form of outright bilateral barter; firms exporting to the West were not confronted with a uniform exchange rate but with a system of product and firm specific rates ("Richtungskoeffizienten") supposed to equate the production costs in local currency to the world market price. Because of both the state monopoly on foreign trade and these differential exchange rates, there was no direct link between the GDR's comparative advantage and its export structure.

In the absence of competition and private ownership, managers of firms were not driven by self interest to make profits in an economically meaningful sense; they merely strove to fulfill (or to successfully pretend to fulfill) the prescribed targets. As the firms could not go bankrupt, they had little endogenous incentive to improve their efficiency. Instead, they faced what Janos Kornai has christened the "soft budget constraint" (1980). If the financial situation became precarious, the state-owned firms could rely on the state banks to supply them with the needed funds to pay their bills; if the price competitiveness of exporters to the West was endangered, they had the easy option of asking for a simple adjustment of the "Richtungskoeffizient" instead of keeping costs in check or of restructuring their output mix. The better the managers of a firm were at influencing political decision making, the easier the life they and the workers in their factory could lead.

Except for some minor allowances for tourists, the GDR currency was completely inconvertible into foreign money, at least officially. In fact, even the "internal convertibility", i.e. the opportunity to exchange the money for goods at home, was rather limited. Many important goods, including essential inputs for industrial firms, were not available in sufficient quantities through the official channels. In any case, deliveries could hardly be stepped up if - due to unforeseen circumstances - a producer needed more than the pre-planned quantity of a specific input to meet his own production plan. Hence, firms frequently had to resort to barter trade or to payments in hard currency DM to get hold of these inputs.

As a consequence, the GDR industry exhibited four major weaknesses:

(1) Firms tended to keep huge inventories of raw materials and intermediate goods as buffers against unexpected and unplanned developments. In a similar vein, industrial efficiency was severely impaired by a tendency towards self-production of inputs, with firms forfeiting both the benefits from an inter-firm division of labour according to their specific comparative advantages and from economies of scale. Moreover, each of the combines attempted to be almost autarchic with regard to those services that are normally contracted out in the West. The combines - and in many cases even the firms within the combines - usually had their own departments for the construction of firm buildings and the self-production of capital goods, for maintenance work and repairs, for transport and even for child care. The inherent bias against a rational division of labour between firms was even fostered by deliberate policy: The combines in the investment goods industries were required to produce consumer goods worth at least 5 per cent of their total output. For example, a Dresden firm specialising on x-ray equipment and transformers had to devote some of its skills and resources to the production of raclette sets for GDR consumers.

(2) The tendency towards underspecialisation showed up in foreign trade as well. Under market conditions, the GDR with a population of merely 16.7 million should have had a signicantly higher share of imports and exports in GNP than the much larger West Germany (62 million people). Nevertheless, the export quota of the GDR (roughly 25 per cent) was far below the West German one (35 per cent) and less than half the Dutch one (54 per cent), although the Netherlands are - in terms of population - a country of almost comparable size.

[3] According to one calculation, the metal processing industry of the GDR covered 65 per cent of the range of goods that exist in this category in the world, its much more specialized counterpart in the much larger Federal Republic only 17 per cent[4]. Once again, the bias against a rational division of labour was in part the consequence of a deliberate policy aimed at a high degree of self-sufficiency in most products. Furthermore, the major part of exports (between 46 and 70 per cent, depending on the exchange rates chosen to compare deliveries to socialist countries to those to the world market) went to the European members of the Council for Mutual Economic Assistance (CMEA) and were hence not subject to noticeable competition from other suppliers. To make matters worse, the structure of specialization within the CMEA was determined by a political bargaining process, not by a market-based assessment of economic viability.

(3) As the behaviour of firms was neither controlled by private owners nor by a capital market, managers had no pronounced incentive to keep the physical capital stock intact. In a market economy, a systematic neglect of the physical assets would show up in a declining stock market value of the firm; under the conditions of central planning, state ownership of the means of production and a soft budget constraint, neither managers nor workers have a well defined interest in safeguarding and augmenting the future productive potential of the firm. For similar reasons, new technologies were introduced only slowly and reluctantly in the GDR industry.

(4) The centralization of the major investment decisions at the top resulted in a significant bias towards a few large scale projects. To reduce the dependency on oil imports from the USSR after the oil shocks of 1973/74 and 1979/80, the GDR had embarked upon an economically wasteful and ecologically desastrous

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3) Siebert (1990a), pp. 5, 16; Siebert (1990c).

4) Institut für angewandte Wirtschaftsforschung (1990a), p. 33.

programme of extracting and burning domestic lignite for the generation of electricity and for heating[5]; to overcome the GDR's technological backwardness, resources were channeled on a grand scale into microelectronics without proper consideration of opportunity costs.

As a consequence of these shortcomings, the existing capital stock of the GDR industry is mostly technologically outdated, to a considerable extent physically run down and largely economically and ecologically obsolete. Only 27 per cent of the equipment in industry is not older than five years, 50.6 per cent is older than 10 years and 21.1 per cent older than 20 years. In comparison, 39.3 per cent of all industrial equipment in West Germany has been installed in the last five years, 69.7 per cent in the last 10 years.[6]

Unsurprisingly, labour productivity in the GDR industry is far below the West German level. According to a frequently cited calculation by the Deutsches Institut für Wirtschaftsforschung (DIW) which is based on 1983 data, East German workers are roughly half as productive as West German ones (52 per cent).[7] Meanwhile DIW estimates that the gap is somewhat larger than 50 per cent.[8] However, while the physical productivity is comparatively easy to measure, the estimates cited above are marred by the difficulty of guessing the appropriate world market prices for GDR goods. These prices are needed to compare the value productivity in both parts of Germany. Guesstimates

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5) For example, the emission of sulphur dioxides per square kilometre in the GDR is almost four times as high as in West Germany (Institut für angewandte Wirtschaftsforschung (1990a), p. 56) although the population density in the GDR is almost 40 per cent below the West German level.

6) Institut für Internationale Politik und Wirtschaft (1990), Table 7.

7) Deutsches Institut für Wirtschaftsforschung (1987), p. 390.

8) Deutsches Institut für Wirtschaftsforschung (1990a), p. 9.

employing the actual export prices for GDR goods to calculate the true value of the GDR industrial output indicate that the value productivity reaches at best one third of the West German level.[9)] The virtual disappearance of many GDR goods from the shelves of East German shops after the introduction of the German Economic, Monetary and Social Union (GEMU) on July 1, 1990 corroborates the hypothesis that GDR retailers and consumers - given a choice - do not attach much value to these goods.

2. The Dimensions of the Task

Because of both the traditional emphasis which planners in socialist countries put on the secondary sector and the wasteful underspecialization of Soviet-type economies, the manufacturing sector in the GDR is in general somewhat overblown. 40.9 per cent of the East German labour force is employed in manufacturing as opposed to 33.6 per cent in West Germany.[10)] Furthermore, GDR employment is heavily concentrated in sunset sectors and branches that have been declining rapidly in the West in the last decades. Taken together, agriculture, forestry and fishery, energy and mining, and the clothing, leather goods and textiles branches of manufacturing account for 17.3 per cent of the GDR labour force as opposed to merely 8.8 per cent in West Germany.[11)]

A comparison between the present employment structure in the GDR and in the Federal Republic may serve as a very rough estimate of the structural change which the GDR economy will have to undergo to catch up with the West. In order to attain the same pattern of employment which prevailed in 1989 in West Germany, East German employment in agriculture, forestry and fishery would have to go down by 56.3 per cent, in energy and mining by 50 per cent, in

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9) See for instance Schmieding (1990a).

10) Including crafts; Siebert (1990a), p. 15.

11) Calculations by the Kiel Institute of World Economics.

transport by 26.9 per cent and in manufacturing[12] by 24.1 per cent. On the other hand, employment in commerce (retail and wholesale trade) would increase by 61.9 per cent. All in all, the net loss of 1.2 million jobs would come about as the result of the declining sectors shedding 2.8 million employees while the labour force in the expanding sectors would increase by 1.6 million. In other words, even in the process of an otherwise smooth and successful transition to the West German pattern of employment, 28.9 per cent of the GDR workforce would have to (or want to) leave their present jobs in the branches that are bound to decline. Sure enough, this number is but a very rough guesstimate of the long-run changes in employment which the restructuring of the GDR economy will entail. On the one hand, the differences between the East and the West German pattern of employment may to some extent reflect genuine differences in the comparative advantages of the two locations and will thus not need to be corrected; on the other hand, however, the obsolescence of a large part of the present GDR capital stock and the uncompetitiveness of many GDR goods imply that there has be a reshuffling of labour even within the various branches of manufacturing from uncompetitive to competitive firms on a grand scale. Hence, it is likely that even more than one third of the workforce in GDR manufacturing will have to leave its present job over the course of the adjustment process.

Unfortunately, the pronounced concentration of the GDR industry is likely to considerably impair the adjustment flexibility. The observation that the GDR industry is heavily concentrated holds true even if not the combines but their constituent firms are analyzed. In the GDR, only 4.4 per cent of all industrial workers are employed in small firms with less than 100 employees (West Germany: 17.6), 10.6 per cent in medium-sized firms with 100 to 499 employees (29.4) and 11.8 per cent in large firms with 500 to

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12) The numbers include the effect of a decline of the GDR participation rate to the lower West German level; calculations by the Kiel Institute of World Economics.

1000 employees (13.2). The bulk of industrial employment (73.2 per cent) is in very large and hence typically rather inflexible firms with more than 1000 employees (West Germany: 39.8).[13]

With the introduction of the GEMU, the GDR producers have lost their well protected and clearly segmented outlets. Instead, they have to compete directly with Western suppliers. By necessity, the imminent restructuring of the GDR industry will have a variety of dimensions. It will

- be part of a general structural change away from the secondary (and primary sector) towards modern services, with many of the business-related and the social services that are presently being inefficiently rendered within firms being contracted out in the future;
- imply a pronounced shift of resources within manufacturing from sunset to sunrise branches;
- have to go along with a change in the product mix of firms and with considerable improvements in the quality of products;
- give rise to a higher degree of inter-firm and international specialization to reap the benefits of economies of scale and of an extended division of labour;
- compel firms to make more efficient use of resources, in particular of natural resources and energy, and to drastically reduce the emission of pollutants;
- neccessitate a considerable reduction in the average size of the firms to make the economy more flexible;
- entail both the reorganization and privatization of existing firms and, given the dismal state of many firms at present, the large scale establishment of new producers; and

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13) Institut für angewandte Wirtschaftsforschung (1990b), p. 8. Taking West Germany's business sector as a whole, the importance of small and medium sized firms becomes even more obvious. 79 per cent of all jobs in the business sector (i.e. the entire economy excluding the state, private households and non-profit organizations) are in firms with less than 500 employees; Schmidt (1990), p. 12.

- go along with a sizeable inflow of capital from abroad.

While the GEMU has exposed GDR producers to external competition and hence made the need for a thorough shake up of the existing structure of production obvious, it has at the same time created favourable macro- and microeconomic conditions for a successful process of catching up of the GDR vis-à-vis the West. Most prices can move freely to reflect relative scarcities, the system of central planning has been abolished, the state monopoly of foreign trade is gone (although the issue of the existing obligations vis-a-vis the other CMEA countries, most notably the USSR, has not yet been resolved), inputs are readily available and the almost useless GDR currency has been replaced by the trustworthy and fully convertible DM. Moreover, a modern West-German-style banking system is being established rapidly. In short, the most important devices are already there which, in a market economy based on private ownership of the major means of production, serve to direct resources into their most productive uses and to equate the domestic costs of production with the international opportunity costs of the resources employed. The major task of the coming years is to disassemble the almost completely state-owned and monopolized GDR supply side into privately owned and commercially viable units which are compelled by the self-interest of their owners, managers and workers to heed the market signals and to safeguard and augment the value of the firm's assets.

Broadly speaking, the restructuring of the GDR industry can be divided into three logically distinct issues and processes, namely (i) the reorganization and privatization of existing firms, (ii) the establishment of new firms and (iii) the structural changes that will occur during the adjustment crisis and the subsequent process of catching up. As the existing industrial firms are owned by the state, the first issue neccessitates active state interventions. Once the state has created the respective favourable conditions, the two other issues could and should be left to private initiative and hence the market.

3. Outline of a Rational Privatization Programme

With regard to the restructuring and privatization of existing firms, the task can be divided into three aspects, namely the definition of viable units, the transformation of these units into joint stock or limited liability companies initially still owned by the state and ultimately the sale of these firms to private bidders. By now, i.e. by the end of July 1990, the first two processes are already under way, although progress is rather slow in some cases. Most of the combines have either been dissolved into their constituent firms or at least been transformed into mere holding companies with limited practical say in the affairs of the firms; in some instances, the maintenance, transport and construction departments of industrial firms have already turned into independent spin-off units. This process is likely to go on, it can and should be linked to the privatization itself (see below). Furthermore, in compliance with the deadline set for the end of June 1990, the legal switch from people's ownership ("Volkseigentum") to joint stock or limited liability companies owned by a state agency has already taken place, at least on paper; although most of the roughly 8000 firms emerging in this way have still not completed the required formalities.[14)]

Before we analyze the privatization programme that is to be implemented in the GDR it is useful to establish a reference system. A rational privatization scheme ought to meet a variety of economic and political criteria. It should

- lay the basis for an efficient allocation of capital,
- be rapidly and easily implementable;
- provide an incentive for an effective management of the firms in the meantime,

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14) They ought to do so by the end of October 1990 at latest; presently, they are named joint stock or limited liability companies "im Aufbau" (in the process of being established); Treuhandgesetz §20.

- broaden political support for the privatization programme, and
- enable citizens with little savings of their own to acquire shares if they wanted to do so.

A programme which has been proposed in a slightly different form for Poland in late 1989 by Kostrzewa (1989) and adapted to the situation in the GDR at that time by Kostrzewa and Schmieding (1990) meets these requirements.[15] It has the following main elements: (1) When the state-owned firms are transformed into joint stock or limited liability companies, they are given property titles to the land on which they are built. (2) Initially, all these firms are put into the hands of a number of, say ten, independent and competing privatization agencies. Unfortunately, it is almost impossible to know in advance wich firms will ultimately be profitable and which will incur permanent losses. Although this uncertainty might be reduced by extensively screening all firms beforehand, this would take a considerable amount of a very scarce resource, namely time. Hence, the firms should be allocated to the various privatization agencies (or holdings) by a simple lottery. Firms that will turn out to be profitable eventually and those that will not are thus likely to be distributed roughly evenly between the various agencies. An allocation of firms to the agencies on a sectoral basis only would revive the old planning structure and networks. (3) The agencies are compelled by law to sell all the firms that are in their portfolio within a fixed period of time, say five years, and to dissolve themselves afterwards. (4) The agencies are themselves incorporated as joint stock companies. A sizeable part of the shares in every agency, say 60 per cent, is distributed to the domestic population for free, the rest may remain with the state. Initially, every adult citizen would thus own an equal amount of shares in all ten privatization agencies.

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15) Similar proposals have been advanced by various authors, including Blanchard and Layard in a recent article in the Financial Times (July 11, 1990).

However, the privately owned shares can be traded freely on the stock market. (5) Every six months, the revenues which every agency has already collected by the sale of some of its firms are distributed to the agency's shareholders (privatization dividend). The market value of the shares in the agencies would hence reflect the efficiency with which they run and sell their respective bits of the GDR industry. Incidentally, the agencies' managers should be paid according to the stock market value of their agency to give them a direct personal interest in doing a good job.

The scheme has various advantages. As the agencies are to be run as independent and competing institutions whose performance is permanently evaluated by the stock market, they will strive to maximize the value of their portfolio, i.e. the privatization proceeds. Hence, they have a strong incentive to establish efficient management of these firms immediately and to waste no money on keeping clearly unviable firms in business. For the same reason, these agencies could be entrusted with the task of identifying the optimal size of the subunits to be offered for sale. At the same time, they could decide whether it is more profitable to streamline and restructure the firms before they are privatized or to sell the ownership titles in these firms immediately at a heavy discount and to leave the painful reorganization - which is bound to entail large scale lay-offs in most cases - to the new private owners. Because of the free distribution of shares in the agencies to the population, every adult citizen would indirectly own a part of every enterprise, of the promising and the ultimately untenable ones. If shares of individual enterprises were given instead to selected segments of the population, say the employees of a firm, the recipients of the shares of firms that will go bankrupt would - without any fault of their own - end up with a worthless portfolio. As a major part of the privatization proceeds are to be handed out directly to the population, the citizens - at least those which have not yet sold all their shares in the holdings - will have a direct stake in a swift and efficient privatization in general and in the participation of badly needed foreign capital in this process in particular. The presence of foreign bidders will raise the price for which the firms could be sold off and hence increase the privatisation revenue. Furthermore, the bi-annual distribution of these proceeds implies that even citizens without major savings of their own would have the means to become shareholders in the new private enterprises. The frequently cited lack of domestic capital would cease to be an obstacle to a rapid, successful and politically feasible privatization. Naturally, the revenues accruing to the state could serve to keep the budget deficit in check, to augment the infrastructure, to repair ecological damages and to reduce business taxes.

4. The Present GDR Approach

The details of the way in which the GDR industry is to be privatized have not yet been determined. Major decisions have already been taken, though. In early March 1990, the interim government of Hans Modrow established the "Treuhandanstalt" (trust agency) as a mega-holding for the state owned firms ("Volkseigene Betriebe", VEBs) of all sectors of the economy. In accordance with the broad guidelines of the GEMU treaty between East and West Germany, the Treuhandanstalt has been revamped by the democratically elected new GDR parliament in mid-June 1990. The clear task of the new Treuhand is to privatize the VEBs as rapidly as possible, in combination with a deconcentration. Furthermore, the Treuhand should promote the structural adjustment process. The agency will be headed by two senior top managers from West Germany; it will act under the supervision of the GDR prime minister. As far as the internal organization is concerned, the Treuhand will be a mere holding company for a variety of sub-agencies which are to be incorporated as joint stock companies. These "Treuhand-Aktiengesellschaften" owned exclusively by the Treuhand will carry out the actual operations.

Although this scheme does have some similarities with the concept presented above, in has a few noticeable drawbacks:

1. No time frame has been set within which the Treuhand must have completed its task. Hence, it can not be excluded that the self-interest of the employees in a permanent job will turn the agency into a self-perpetuating and expanding institution, reluctant to make itself obsolete by privatizing all firms. Instead, it may try to become a permanent body for the assistance of ailing industries.

2. The individual firms will be allocated to the various sub-agencies (Treuhand-AGs) by the end of August 1990 according to "considerations of expediency"[16)], i.e. along sectoral lines. While this organizational set up has the advantage that it makes a pooling of sector-specific expertise possible, it is uncomfortably reminiscent of the old socialist branch ministries. The major hazard is that these sub-agencies may be rather prone to rent-seeking by sectoral lobbies. Fortunately, the number of Treuhand-AGs will probably be limited to six; three in industry for the producer goods, the investment goods and the consumer goods branches respectively plus one each for agriculture, commerce (wholesale and retail trade) and for other services.[17)] This may help to prevent that the various Treuhand-AGs identify themselves too closely with individual branches.

3. As the shares in the Treuhand-AGs are not transferable, the performance of these agencies will not be constantly evaluated by the capital market.

4. The eventual privatization proceeds are to be used primarily for the structural adjustment of the state owned firms and, secondly, for the consolidation of the state budget. As none of the revenue will be distributed directly to the population, the citizens will not enjoy any direct personal gain.

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16) §7(3) Treuhandgesetz.

17) Frankfurter Allgemeine Zeitung, (19.09.1990), p. 11.

5. The most important flaw is that the Treuhand has to deal with two tasks, namely (i) the privatization of firms and (ii) the promotion of the structural adjustment process. This combination may not neccessarily be harmful if the tasks were to be carried out by an independent agency run like a private company and hence compelled to be exclusively efficiency-oriented. However, the set up envisaged for the GDR implies that a state institution subject to political pressure will try to single out the potentially competetive firms and to determine which firms will get what kind of adjustment assistance. Given the size of the adjustment problem and the uncertainties involved in the transition to a market economy, it is highly unlikely that a state agency could successfully pick the winners and invest its revenues efficiently. In this respect, the example of developing countries is quite instructive. While open and export-oriented countries have fared spectacularly well, others which have relied on an import-substitution strategy based on external protection and the subsidization of selected sectors have fallen far behind.

Furthermore, there is a major moral hazard involved in the present GDR approach. As managers and workers of firms know that the Treuhand is authorized to spend the privatization proceeds on subsidies for firms, they may find it much easier to clamour for additional support out of this potentially large fund than to adapt to the pressure of competition (or go bankrupt). Hence, it may well happen that almost the entire privatization proceeds will merely serve to prolong the life of ultimately unviable firms (Schmieding 1990b). This would lock in resources which could be employed more productively elsewhere. The adjustment process would be considerably delayed and made much more expensive at the same time.

Two further regulations which the GDR has adopted recently are likely to considerably hinder the process of privatization and industrial restructuring: (i) The purchaser of a GDR firm has to take over all employment contracts (§ 613a of West Germany's civil law code BGB), even if the firm in question is part of a larger unit that has gone bankrupt. (ii) The GDR parliament has copied West Germany's rather restrictive dismissal rules, including the obligation to pay compensation to employees in the case of large-scale redundancies ("Sozialplanpflicht"). As the restructuring of existing firms is likely to necessitate a noticeable slimming of the labour force in the vast majority of cases, prospective investors will probably be quite reluctant to take over these burdens by buying existing firms. In any case, the price for which the shares of these firms can eventually be sold will be reduced by the expected dismissal costs (including a premium for the legal risks and the unpleasantness involved).

In addition, the first collective bargaining agreements concluded in the GDR after the GEMU have raised further hurdles for investors. Besides wage increases in the range of 20-30 per cent that seem to be way out of line with what is warranted by the value productivity of labour in the GDR, employers and employees in the metal-processing industry have agreed upon a one-year ban on dismissals.[18] If this is copied by other sectors and if the Treuhand is compelled by political pressure to prevent large-scale bankruptcies of firms, the desparately needed adjustment process in the GDR may - in the worst case - not start in earnest prior to mid-1991.

These regulations and agreements seem to be based on the presumption that the costs can be shifted onto somebody else. In short: the decision makers sometimes seem to behave as if the entire GDR economy is facing a kind of soft budget constraint, perhaps in expectation of additional assistance from West Germany. While West Germany will clearly supply considerable funds to help the GDR economy and to increase living standards in East Germany, the present arrangements for the restructuring of the GDR economy imply the hazard that a large amount of capital will be wasted on keeping unprofitable firms in business. Instead, it would make much more sense to improve the

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18) Frankfurter Allgemeine Zeitung, 14.07.1990, p. 9.

attractiveness of East Germany as a location of production for instance by quickly shaping up the transport and telecommunications infrastructure.

5. What Is to Be Done?

Clearly, the main hazard is that the process of privatization and restructuring will be delayed and perhaps even be given a wrong direction by discretionary political interference (Siebert 1990d). Therefore, the two general guidelines to be recommended are to keep politics and rent-seeking out of the privatization process and to leave the allocation of investible funds to old and new firms alike to the capital market. The role of politics should be restricted to setting appropriate rules for the Treuhand and to creating favourable conditions for the restructuring of old and the growth of new businesses. In practice, this means the following:

(1) The Treuhand should be granted an independent status similar to that of the German Bundesbank and should be obliged to sell off all its assets within a fixed period of time.

(2) The privatization proceeds should be distributed in part to the GDR population, the remainder being handed over to the state.

(3) The statute of the Treuhand should state that the initiative to privatize a specific firm at a certain point of time might be taken by any interested party, i.e. by the Treuhand itself or by any prospective buyer. As soon as any investor, including the management of the firm, has notified the Treuhand of his interest in purchasing a majority stake in the firm, the Treuhand automatically would have to publish the envisaged contract, invite alternative bids during a period of say three months and then sell to the highest bidder. This rule would minimize the danger of insider-deals. At the same time, it would make it unlikely that profitable firms would remain with the Treuhand for a long time. Sure enough, the Treuhand would still face the task of closing down the lastingly uncompetitive firms. In many cases,

a formal bankruptcy may give firms, or at least part of the firms, the opportunity for a fresh start unburdened by their previous debt.[19]

(4) The same procedure as described above should be made applicable to any subunit of the legal entities which are presently defined as firms. Hence, every interested party could initiate the dismantling of firms into smaller units and thus contribute to a less concentrated organizational structure of the GDR industry. Management buy-outs and, in the case of small and medium sized units, even worker buy-outs are likely to play a considerable role in this process.

(5) Especially the roughly 12.000 small- and medium-sized firms which fell into the hands of the state in the last major wave of nationalizations in 1972 and are now part of larger units should be returned quickly to their previous owners. This would greatly contribute to the process of deconcentration of the GDR economy. In more than 50 per cent of the cases, the former owners had already filed the respective applications by the end of June 1990.[20] All in all, only about 100.000 people in the GDR are self-employed (excluding agriculture); taking the much more balanced employment structure of West Germany as a norm, one should expect the number of self-employed to rise roughly sevenfold.[21] Hence, there should be considerable scope for the establishment of small and medium-sized businesses in the GDR.

(6) The state should cushion the adverse social consequences that will initially arise during a swift adjustment process by direct personal transfers and by supporting requalification programmes. If their is to be further adjustment assistance to the firms, it

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19) Siebert (1990b).

20) Süddeutsche Zeitung, 30.06.1990.

21) Siebert (1990b).

should be granted on a non-discriminatory basis, for instance in the form of a general tax relief for all firms.

(7) According to present plans, GDR firms will have access to special liquidity credits in the first three months of GEMU to pay for wages and non-labour inputs. Within certain limits (a provisional ceiling has been set at 10 bn. DM) these credits will be guaranteed by the Treuhand. As the requests for these credits amounted to 24 bn. DM by mid-July already,[22] the Treuhand will have the discretion to decide which applications should be entertained and which not. Given the precarious economic and political situation in the GDR, it may be perhaps argued that some kind of special state assistance for firms may be needed to cushion the immediate impact of the introduction of the GEMU. Nevertheless, the decisions on the allocation of funds to firms should not be taken by the Treuhand itself but by banks. For instance, the Treuhand could initially offer to guarantee a certain share of each credit which a bank grants to a GDR firm. Over the course of time, this per centage should be progressively reduced according to a prefixed schedule. After a certain time, say six months, this risk-sharing arrangement would be phased out completely. This scheme has the advantage that all credit requests would be scrutinized by banks who, putting i.a. their own money at risk, would directly suffer from any default.

(8) Given the dismal state of many existing firms in the GDR, the extent to which the necessary structural changes can take place within and between established firms is limited. New firms will have to provide a major part of the future jobs in the GDR. Therefore, the remaining impediments to the establishment of new firms need to be removed. For instance, the insufficient provision of land and of shop and office space has turned out to

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22) Handelsblatt, 19.07.1990. 24 bn. DM for three months would be roughly equal to 40 per cent of the East German GNP in this period. Standard estimates put the annual GNP of the GDR in the range of 225 to 272 bn. DM per year (Siebert 1990a, p. 9; Deutsches Institut für Wirtschaftsforschung 1990b, p. 354).

be a major obstacle in this respect. Greater efforts by the GDR authorities may be quite helpful. In the last analysis, however, the lack of adequate facilities is attributable to the fact that the GDR does not yet have a proper market in land and office space. In a similar vein, the housing shortage caused by the absurdly low rents is a major constraint on the mobility of workers within the GDR. Hence, a liberalization of these markets, socially cushioned by rent subsidies for people with low incomes, should not be delayed any longer. This could make it much easier for new firms to develop in the GDR and for workers to move from unfavourable locations to those places were they can find a better job.

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