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REFORM IN THE GERMAN DEMOCRATIC REPUBLIC (GDR): WHAT SHOULD THE U.S. DO?

BY

COLONEL HASKO K. W. ECKEL

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Socialist command economies have relied on centrally planned rigid economic systems which have performed poorly and need the introduction of market mechanisms. While the GDR command economy has been manipulated to achieve the highest standard of living among the Warsaw Pact (WP) countries, living conditions trail those in the industrialized free-market countries by a hugh margin. Economic stagnation frustrates large segments of the population. These conditions and historic socio-political events in the WP nations, initiated

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USAWC MILITARY STUDIES PROGRAM PAPER

REFORM IN THE GERMAN DEMOCRATIC REPUBLIC (GDR): WHAT SHOULD THE U.S. DO?

AN INDIVIDUAL STUDY PROJECT

by

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ABSTRACT

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TABLE OF CONTENTS

REFORM IN THE GERMAN DEMOCRATIC REPUBLIC (GDR):
WHAT SHOULD THE UNITED STATES DO?

CHAPTER I

INTRODUCTION

The command economies of communist countries have relied on central planning systems, dominated by government bureaucracies and inefficiencies, resulting in living standards far below those of the Western free-market industrialized nations. These circumstances, together with the effects of glasnost and perestroika introduced by the Soviet Union in the mid-1980s, contributed to widespread popular unrest and demands for democratization and economic reform in all Warsaw Pact (WP) nations during 1989 - initiating historic changes in these countries.

The German Democratic Republic (GDR) has been one of the WP countries most dedicated to a "centrally planned economy based on the Stalinist politico-economic framework." Only slight modifications were undertaken in the late 1970s, early 1980s "towards a more sophisticated system of central control, emphasizing efficiency gains and profit maximization over rapid industrialization and quantity output."[1] Until 9 November 1989, when the wall separating East from West Germany opened, the GDR had been vocal in "rejecting glasnost, democratization and market orientation ...."[2] In spite of this strict adherence to the principles of a command economy, "... it is difficult not to conclude (however) that the GDR economy in recent years has registered real but limited success."[3] It should also be noted that "the East German economy continue(d) to function at a higher level of efficiency than those of its East European competitors."[4]

While the GDR thus unquestionably has been the economic front-runner in the WP, her economic performance and living standard have trailed those of the Federal Republic of Germany (FRG) and the other advanced market economy countries by huge proportions. These conditions, together with the socio-political events focused on political democratization and market-oriented reform in the entire WP during the final months of 1989, have intensified the GDR's dilemma. This has led to large-scale demonstrations by dissatisfied citizens, resulting in forced changes in the government top leadership, promises for free multi-party elections in 1990, and requirements for major reform of the economy.

On 9 December 1989, the current GDR Premier, Hans Modrow, declared: "The upcoming economic reform in the GDR is the hard core of the renewal of socialism in the country,"[5] and, "... the break with the command economy should indeed be radical, but

... decoupling from the old system should not, however, lead to chaos,..."[6] Both statements, as well as subsequent actions by the GDR provisional government and many demonstrations by citizens demanding change, indicate the near certainty that major political and economic reform in the GDR is inevitable. In addition, numerous meetings and dialogue between the GDR and the FRG, and other Western nations and institutions, have occured since the day "the wall came down." These novel events further manifest the apparent inevitability of democratization, economic reform toward a social market system, and increased economic relations with non-communist countries.[7-10]

These developments in the GDR and similar events in the other WP countries, as well as progress toward arms/force reductions in Europe and confederation or reunification of the two Germanies, have reduced the military threat from the East. The unacceptable economic conditions in all WP nations will quickly force substantive economic reform, political democratization, and reductions in defense expenditures. Increased economic and political interface between Western and Eastern Europe will follow. Then economic and, by necessity, political ties between Central and Western European countries will become more dominant elements of national concerns, while the military aspect of national power will be of lesser importance during the next decade or two. A strategy of containment will no longer be the most desired or feasible; one of increased trade relations and economic interdependence will emerge with or without U.S. participation. - The U.S. Government should, therefore, become pro-actively involved (together with its NATO allies) in attempts to positively influence changes in the GDR and the entire Eastern European region, to assist in maintaining European peace and inter-state stability, to protect U.S. interests, and to get a fair share of future economic trade with the GDR and other WP countries.

This paper will highlight economic conditions in the GDR which have catapulted the population into political action. It will also address the economic reforms to be accomplished and challenges facing the GDR in view of the unavoidable requirement to introduce market mechanisms. Several actions the U.S. should pursue will be outlined in the final chapter.

ENDNOTES

1. U.S. Congress, Joint Economic Committee, Pressures for Reform in the East European Economies, Vol. II, p. X.

2. Ibid.

3. Ibid., p. 248.

4. Ibid., p. XXVII.

5. Foreign Broadcast Information Service, Daily Report: East Europe, FBIS-EEU-89-236, p. 62 (hereafter referred to as FBIS with respective number).

6. Ibid., p. 63.

7. FBIS-EEU-89-240, pp. 37-39, 41, 46, 49.

8. FBIS-EEU-90-002, pp. 47-48.

9. FBIS-EEU-90-003, pp. 54-55.

10. FBIS-EEU-90-004, pp. 41-44.

CHAPTER II

ECONOMIC CONDITIONS IN THE GDR

The GDR economy has operated under a state-controlled central planning system. Ninety-five percent of the agricultural land is collectivized (in Cooperatives) and the state owns financial institutions, transportation, and industrial and foreign trade enterprises. About sixty-five percent of foreign trade (primarily manufactured goods) is with the USSR and, to a lesser degree with other WP countries. West Germany has been the most important trading partner among the non-communist nations and has "provide(d) the GDR with interest-free credit under a special trade arrangement." Overall, economic growth has slowed during the 1980s to 1.5%, the external debt has risen to $20.4 billion (1987), the inflation rate of state controlled consumer prices has (as can be expected in a government subsidized system) been negligible (0.9% in 1987), and unemployment is non-existent - as in most communist command economies.[1]

"The GDR must overcome many economic problems including low hard currency earnings; stagnating living standards; shortages of energy (imported from the Soviet Union); labor shortages (aggravated by recent emigration of several hundred thousands of young people to the FRG); and ...an inadequate level of capital investment."[2] Unrest of large segments of the population, demanding immediate democratization and rapid improvement of living conditions, continues and must be overcome. Millions of GDR citizens traveling to the FRG since the "opening of the wall," observing vastly superior economic conditions, will accelerate these demands for drastic changes in the GDR ("5.2 million crossed the FRG border 30-31 December 1989" alone[2]).

The GDR party-apparatus controlled economic system has, in past years, been able to manipulate the economy to consistently outperform that of the other WP countries and achieve the highest standard of living among these nations. Negative economic results or trends have been successfully addressed to restore performance to at least minimally acceptable levels. Considerable percentages of the national income have been channeled into, sometimes ill-conceived or ineffectual, investments and research and development. Also, some decision authority has been decentralized to the Directors of Combines in recent years, when the industrial sector was reorganized into the so-called KOMBINATE (giant trusts). These latter changes were implemented to gain more efficient use of all factors of production and to produce new products through introduction of an incentive system.

In spite of all these efforts, productivity gains have continued to trail those achieved in the West by a wide margin. For example, one study concludes: "GDR labor productivity was estimated overall at only slightly more than 50 percent of the West German level...,"[4] while another source puts plant productivity "20% to 30% below comparable West German companies."[5] In addition, industrial product quality has been poor by Western standards, technology is lagging, much of the plant equipment is inferior or obsolete, and the GDR is becoming ever less competitive on the world market. In this regard, increasing competition from newly industrializing countries (NICs) has added to the GDR's problems.[6,7] One can conclude here that the GDR's economic performance has been optimized to the extent possible under its centrally planned command economic system. Market-oriented reform and democratization, as well as massive help from the Western countries, are essential to achieve further gains relative to the Western market economies and living standards - namely to avoid status quo or worsening economic conditions. These reforms are also unavoidable in view of the impatient popular demands for real change and to stem further loss of urgently needed labor resources to West Germany through emigration.

ENDNOTES

1. U.S. Central Intelligence Agency, The World Fact Book, 1989, pp. 107-108.

2. Ibid.

3. Foreign Broadcast Information Service, Daily Report: East Europe, FBIS-EEU-90-006, p. 46.

4. U.S. Congress, Pressures for Reform in the East European Economies, Vol. II, p. 247.

5. John Templeman, Thane Peterson, Gail E. Schares, and Jonathan Kapstein, "A New Economic Miracle? Falling Barriers and the Spirit of Free Enterprise are Priming Eastern Europe for a Dynamic Era of Growth - The Shape of Europe to Come," Business Week, 27 November 1989, p. 64.

6. *Ibid*., Vol. I, p. XVI.

7. *Ibid*., Vol. II, pp. 246-255.

CHAPTER III

REFORM OF THE ECONOMIC SYSTEM

As alluded to in the previous chapters, radical reform of the GDR's command economy, already initiated by the current interim government, is for all practical purposes irreversible. Major changes to the political and economic systems are required to provide the opportunity for eventual success, but will impose significant hardships on the entire population during the transition period. The FRG is also affected. As a result of the large number of immigrants from the GDR, self interests, and prospects of confederation or reunification, the FRG is practically forced to assist East Germany. With the primary focus on economic aspects, this chapter will address several major reform actions the GDR must pursue and some of the challenges that country will face in the early 1990s.

Immediate democratization is crucial, as a first step, to minimize growing popular dissatisfaction with the political system and to avoid further disruptions of the economy through frequent strikes, mass demonstrations, and additional large scale emigration of workers. Democratization is, in fact, a prerequisite for actions to change the centrally controlled command economy. In terms of the political system, this means free multi-party elections scheduled for 18 March 1990; initially to take place on 6 May 1990. In terms of the economy, this means decentralization, privatization, and introduction of market mechanisms.

One action that the GDR interim government should implement immediately is reform toward more democratic management of the existing Cooperatives and Combines. This could include participative management regarding investments, structure, production, cooperative ownership, profit sharing, etc., and could be accomplished quickly with minimal start up time or change to existing structures. Complete, but phased abolition of the state controlled, state administered economy must follow as soon as possible. This will require numerous additional reform actions, some of which are presented in the remainder of this chapter. No attempt has been made to prioritize these actions; however, all have to be pursued with deliberate speed in view of the rapidly deteriorating political and economic conditions.

Revisions of law, regulations and past government practices are essential (1) to authorize and encourage private ownership of enterprises, to create a small business infrastructure and provide incentives for them (such as tax advantages), (2) to allow privatization of state owned enterprises, (3) to assure reduction and eventual elimination of price controls and subsidies (subsidies have totaled "more than M50 billion a year ... for basic consumer goods, rates and services."[1]), and (4) to foster introduction of competitive market forces. During the implementation of these changes it will be necessary to control large increases in consumer good prices to avoid excessive consumer dissatisfaction and emigration of workers. Significant inflationary pressures are likely to result from opening of the previously protected market and the GDR full employment situation. A private and central banking system will have to be established also, and appropriate monetary and fiscal actions will be necessary to provide some means of control. Incentives will have to be found to quickly slow further emigration of workers, as the latter would severely aggravate the labor shortage already existing in the GDR ("...343,000 GDR citizens settled in the FRG in 1989;"[2] and emigration of approximately 2,000 per day has continued in 1990.[3]).

Reduction in the defense establishment and government bureaucracy is unavoidable and will free monetary resources that can be used for necessary investments to improve, for example, the deteriorated transportation infrastructure system. A reduction of the Army by 10,000 and a 10% defense expenditure cut has already been decided in the final weeks of 1989,...[4] and, the dissolution of the National Security Office and discharge of State Security Service (Stasi) employees is underway.[5] Integration of these newly unemployed into the workforce and capital investments of monetary savings obtained in this way must be orchestrated efficiently. Critical jobs vacated by the many previous emigrants must be filled quickly to minimize disruption of production and services. Necessary retraining and schooling of workers displaced as a result of reforms will also be a problem and will cause further slow down in economic output. (On 3 January 1990, the GDR Economic Minister, Christa Luft, mentioned problems of 250,000 vacant jobs to be filled by 50,000 state employees.[6]). Further reduction of the GDR's defense establishment can be anticipated as the West German "enemy" becomes more and more a "friend" in the on-going reform, as more soldiers will be needed to prop up the economy by filling vacancies created by emigrants, and as recent desertions from the Army to West Germany will continue or increase. Harmonizing enlightened workers in factories in their relationships with jobless "previously hard-core communists" joining their ranks will be another transition problem to be mastered by those in charge.

Immediate decentralization of authority for foreign trade relations is essential to reduce bureaucratic delays and to introduce competitive market forces. According to Prime Minister Modrow, the GDR plans to link foreign trade enterprises with "more independent" Combines. This will allow development of immediate and direct foreign trade relations without the central control previously exercised by the Foreign Trade Ministry. These changes are also required for future interface with the Council for Economic Mutual Assistance (CEMA) trading partners (six WP nation trading bloc), because of similar economic reforms in these countries.[7]

Change of the Constitution to permit, encourage and protect foreign investments and joint ventures is another urgent reform requirement to create the legal environment for a market economy. Foreign capital and joint enterprises would provide much needed modern capital facilities and equipment, advanced technology, and management know-how. - As an example of the currently inadequate manufacturing capability, it is instructive to note that car production and quality has been dismal. In 1989 only 217,000 cars were built of which approximately one quarter were exported, largely as a result of the demand pull from the Soviet Union and other CEMA trading partners, as well as requirements to pay for imports from these countries. The waiting period for new cars in the GDR has been about 15 years, obviously causing dire consumer frustrations.[8]

Involvement by foreign companies and insertion of foreign capital are sorely needed to improve the economy. "Estimates of what it will cost to bring East Germany up to West German standards range from 500 billion to 1.1 trillion Deutsche marks ($300 billion to $650 billion)."[9] This has been realized by the interim GDR government and interface with several Western nations has already begun, as illustrated by the following events. On 7 November 1989 expansion of economic, industrial and technical cooperation was discussed between the GDR and Italy.[10] After a 14 December 1989 meeting between the GDR Premier and the FRG Economic Minister, the formation of a joint economic commission and a cooperation (investment protection) agreement was announced. The GDR's priority project areas were said to be construction of housing, infrastructure, environmental protection, and the manufacture of cars and machine tools.[11] Additional meetings have since taken place between government officials of the GDR and the FRG, up to and including the Premier and Chancellor level, and other West European countries and Japan, to discuss economic cooperation. Also, one should note that only three months after the historic 9 November 1989 event at the inter-German wall, literally hundreds of businessmen from West Germany and other Western countries have been congregating in East Berlin's Grand Hotel, "wheeling and dealing" in pursuit of joint business ventures.[12]

Other critical actions to be pursued are negotiations through CEMA and/or independently with the International Monetary Fund (IMF), the World Bank, and Western nations, to achieve convertibility of the GDR currency and adaptation of the economy to world market prices. Also, efforts should be made to obtain additional low cost loans from other countries for capital investments. - Several events related to these issues are noteworthy. During a Council for Mutual Economic Assistance (COMECON) meeting on 8 January 1990, the Soviet Premier proposed "putting COMECON trade on a dollar basis."[13] In early December 1989 the GDR held discussions with the IMF to obtain information and assistance, which was agreed to.[14] A GDR-FRG agreement in December 1989 set the currency exchange rate at DM1 to 3 GDR marks for travel to be effective 1 January 1990.[15] And, "West German Chancellor Helmut Kohl has promised 'massive aid' if East Germany holds free elections and starts dismantling its rigid command economy."[16] - All these actions and events point to readiness of the GDR's interim government to pursue increased trade relations with the West and to convert the economic system.

Adaptation to world market prices is essential, even though it would lower GDR purchasing power. Monetary reform and agreement to appropriate exchange rates with hard currencies would reduce the value of savings, but cannot be avoided. Incentives and reasonable compensation alternatives will have to be developed for savers in that case. One possible initiative would be authorization for private citizens to purchase shares in enterprises and providing the opportunity for sharing profits. As a by-product, this could assist in efforts to increase labor productivity and improve product quality because of self interest. The need for more investment money and the idea of shared ownership could also lead to the establishment of a stock market so useful in generating funds for business firms.

International support will be required to stabilize the market value of the GDR currency and to assure the success of economic reform. West Germany appears to be capable and willing to do a lot in this regard. Obvious reasons for the FRG interest include the potential for future economic gain, national and cultural ties, the rapidly increasing currency exchange between the two countries since the lifting of travel restrictions, as well as the opportunity of confederation or reunification of the two Germanies in the foreseeable future. In fact, West German overtures toward East Germany have become bolder with incredible speed. In early February 1990, FRG Chancellor Kohl proposed establishment of the West German mark (DM) as the currency for East Germany.[17,18] He also has been active suggesting establishment of a European Development and Recovery Bank for the purpose of West European monetary assistance for the East European countries. - Following these and other prior FRG proposals regarding reunification and assistance for the GDR, the

U.S. government reacted in slow fashion by finally declaring that it will "...back (the) Bonn unification plan"[19]...and support West German attempts to positively influence developments in East Germany. Such declarations were made by Secretary of State Baker during the 12 February 1990 "Ottawa Conference" attended by NATO and WP nations[20], after a somewhat "aloof approach (by the Bush administration) to the drama unfolding in East Europe," leading to a perception by many that "the U.S. has a cheap seat in the bleachers."[21]

Change of economic data gathering methods and reporting formats to parallel the model of Western nations is another important reform requirement. Currently East European statistics are inadequate and are based on incompatible criteria. Western estimates are often uncertain. These changes are necessary to improve credibility with Western governments, creditors, investors, and international organizations. The GDR should attempt to have all CEMA countries follow this course of action, so that dual bookkeeping requirements may be avoided during the reform period and trading with the CEMA and Western countries is based on the same cost, performance and pricing data.

Additional initiatives to strengthen economic ties with the FRG, which has the financial capability and technical know-how to provide significant assistance quickly, are in the best interest of the GDR. The FRG, in turn, is interested in quickly supporting the GDR for reasons mentioned earlier and to reduce the excessive inflow of immigrants (a critical FRG political issue in view of inadequate housing, substantial unemployment and a stretched out social system[22]); to help ensure improvements to the GDR's severe environmental problems, which are spilling over into the FRG (another critical FRG people concern); to take advantage of investment opportunities, utilizing the well-educated, cheaper GDR labor; to expand export markets; and a forty-year history of political policy aimed at eventual reunification. One should note here that under Bonn's chairmanship, "formal relations between COMECON and the European Community (EC) was established in early 1988...,"[23] and, the FRG's Foreign Minister Genscher for years has "...made no secret of its (Bonn's) enthusiasm for the evolution of detente into east-west entente as soon as possible."[24] Also, the leader of the FRG Chancellor's Christian Democratic Party (CDU) said in early January 1990: "Kohl (FRG Chancellor) will proceed with West Germany's program to aid the East in order to prevent another massive wave of immigration."[25]

It is clear to this writer that the GDR (and the other CEMA nations) need to expand economic relations with Western nations from which economic benefit can be derived to help solve their massive problems. It also appears certain that most, if not all EC countries, will in fact seek expanded trade with the GDR and other CEMA countries as soon as democratization and marketization of the economy has progressed. "Eastern Europe has traditionally had close trade relations with the Western European nations...."[26] The GDR (and other CEMA countries) may also seek trade relations with Japan in the future and the reverse appears equally likely. In this regard, the current GDR Deputy

Premier and Economic Minister, Christa Luft, stated in a recent interview with DIE WELT in response to the question what the future GDR economic system might look like: "There is the Japanese model, which, I would say, comes very close to our ideas."[27] It is also revealing that Japan has already made offers for substantive investments to several Non-Soviet Warsaw Pact (NSWP) nations in late 1989 and early 1990.

Many other aspects of the GDR's economic system require reform to achieve effective introduction of market mechanisms, to eventually reap the benefits of a market economy, and to reach substantial improvements of the standard of living for the general public. The required actions and challenges outlined in this chapter are only the most significant ones and have been discussed to highlight the complexity of the tasks at hand and to lead us into some conclusions, as well as several recommended actions for the U.S. to pursue.

ENDNOTES

1. Foreign Broadcast Information Service, Daily Report: East Europe, FBIS-EEU-89-219, p. 51 (hereafter referred to as FBIS with respective number).

2. FBIS-EEU-90-008, p. 48.

3. Robin Knight, "The Arithmetic of Unifying Germany," U.S. News, 5 March 1990, p. 42.

4. FBIS-EEU-90-007, p. 48.

5. FBIS-EEU-90-006, p. 46.

6. FBIS-EEU-90-003, p. 55.

7. FBIS-EEU-90-008, p. 47.

8. FBIS-EEU-89-219, p. 54.

9. Russel Watson, et al., "The New Superpower," Newsweek, 26 February 1990, p. 19.

10. FBIS-EEU-89-219, p. 55.

11. FBIS-EEU-89-240, pp. 37-38.

12. Marc Fisher, "Wheeling and Dealing at the Grand: West's Capitalists Set Up Shop in Posh E. Berlin Hotel Lobby," Washington Post, 22 February 1990, pp. A1 & A27.

13. "Breaking up the Old Gang," Wall Street Journal, 10 January 1990, p. A10.

14. FBIS-EEU-89-240, p. 41.

15. FBIS-EEU-89-249, pp. 50-51.

16. John Templeman, Thane Peterson, Gail E. Schares, and Jonathan Kapstein, "A New Economic Miracle? Falling Barriers and the Spirit of Free Enterprise are Priming Eastern Europe for a Dynamic Era of Growth - The Shape of Europe to Come," Business Week, 27 November 1989, p. 64.

17. Hobart Rowen, "Europe on fast track: U.S. foreign policy fails to keep pace with rapid developments in Germany, U.S.S.R.," Patriot, 15 February 1990, p. A15.

18. Marc Fisher, "Kohl to Open German Unity Talks with Modrow," Washington Post, 12 February 1990, p. A26.

19. Al Kamen, "Baker Said to Back Bonn Unification Plan," Washington Post, 7 February 1990, p. A19.

20. Tom Wicker, "The Score at Ottawa," New York Times, 15 February 1990, p. A31.

21. Bill Javetski, "Europe's Grand Drama: Waiting for Bush to Make His Entrance," 7, Business Week, 27 February 1990, p. 66.

22. "'Da brennt die Sicherung durch'," Der Spiegel, 1990, Issue 4, pp. 28-35.

23. Edwina S. Campbell, Germany's Past & Europe's Future: The Challenges of West German Foreign Policy, p. XXV.

24. Ibid., p. XXVI.

25. Marc Fisher, "E. German Opposition Halts Talks," Washington Post, 9 January 1990, p. A1.

26. U.S. Congress, Pressures for Reform in the East European Economies, Vol. II, p. 52.

27. FBIS-EEU-90-004, p. 42.

CHAPTER IV

SOME CONCLUSIONS

In the GDR rapid reform and improvement of the the economic system, as well as political democratization, have become the most critical issues for the population and the government. In fact, these changes have become a matter of survival. A transition from the current economic system to a social form of capitalism, such as practiced in West Germany, France, or Japan, would appear to be the most achievable and appropriate in view of the current frame of mind and past social experiences of the GDR's population. Pressures for a completely free market system should be avoided to reduce the possibility of failure of the reform movement and to enhance inter-German compatibility.

West Germany is vitally interested in speedy and successful democratization and market orientation of the GDR. Because of the "collapse of the wall" and related problems of overwhelming numbers of East German immigrants, cross-border environmental concerns, national ties, future economic opportunities, etc., the FRG has been forced into quick action to assist the GDR and plan for confederation or unification of the two Germanies. The situation in the two countries will mandate intensified cooperation in the weeks and months to come, and, the FRG will out of necessity carry the lion share of the huge financial burden of curing the East German economic problem. In view of these circumstances, the Bonn government has been extremely pro-active from the beginning of the historic developments east of its borders, has embarked on a course of providing massive assistance to the GDR, and is planning for reunification.

Interface between the U.S. and the GDR has been minimal and inconsequential during the first several months following the elimination of the "iron curtain" on 9 November 1989. In fact, while preoccupied with superpower relations, the U.S. has "contributed little politically to bringing the post-Communist order into being...." One has to conclude that "Washington's continuing low-key response to this great change (namely the dramatic reform movements in the WP countries) compounds the sense of passivity."[1]

During the economic reform/transition period, the GDR will face many problems. Examples are: (1) Layoffs and displaced workers ("...restructuring the East German economy will leave some 1.4 million people unemployed initially...,"[2] many of whom will have to be relocated and retrained); (2) introduction of income inequalities, an unfamiliar phenomenon for the vast majority of the GDR population; (3) inflationary pressures, likely when subsidies of goods are terminated; (4) loss of purchasing power, after conversion of the currency exchange rate and commencement of inflationary trends; (5) further deterioration in the balance of payments during the early period of reform; (6) future import competition and bankruptcies caused by non-competitiveness; and (7) further austerity. These hardships will tax the patience of the East German population to the limit, but are unavoidable during the transition to a market economy and until productivity, product quality and exports respond to competitive pressures.

As other WP/CEMA countries become integrated into the global economy and East German citizens emigrate by the thousands because of unsatisfactory living conditions, it will no longer suffice for the GDR to be one of the best producers (or even the best producer) among these countries. Better quality products will be demanded by all trading partners, including the Soviet Union and the other CEMA nations. Supply gaps will initially develop and cancellations of previous orders can be expected from the other East European nations, as they are undergoing political and economic reform. Also, East German consumers will quickly demand greater quantities of better quality products at competitive prices.

Much internal will and external help, combined with unwavering, but phased economic reform will be required to succeed in eventually increasing productivity, product quality and exports. These improvements will be crucial so that the economy will become self-sustaining, the standard of living can be sufficiently improved, and foreign debt can be reduced or eliminated eventually. Political reform, i. e. democratization, is an essential ingredient for the economic reform to succeed and both, political and economic changes, are necessary to reestablish internal stability in the GDR. Extremely quick action is required to avoid complete break down of the economy during this period of mass exodus of East German workers and political/economic instability.

If the FRG provides a substantial amount of assistance to the GDR, as appears probable, the reform/transition period will be shorter than that for the other CEMA countries. If the United States gets involved and provides some support, then the U.S. will be considered a friend in the future, will enhance its position to influence actions and keep a united Germany in the Western fold, and will create opportunities for future political cooperation and market access. The U.S. must be pro-active and innovative during this time of diminishing emphasis on military strength and containment, as economic and political elements of power will undoubtedly have overriding importance in Europe during the 1990s and probably beyond the year 2000.

ENDNOTES

1. Jim Hoagland, "In Eastern Europe, Our Diplomacy is Weak," Washington Post, 6 February 1990, p. A25.

2. Watson, p. 19.

CHAPTER V

ACTIONS THE U.S. SHOULD PURSUE

The United States, because of its position as one of the two superpowers and its political and economic influence, as well as national interests in the European region, must become more pro-actively involved in the events in the GDR and Eastern Europe during this historic period of reform. All plausible actions should be pursued to the extent that they are possible and ensure a role for the U.S. in the future in the changing environment in that region of the world.

Continuing U.S. leadership in the on-going mutual arms/force reduction negotiations and future-oriented refocusing of NATO are essential elements in efforts to assure continued inter-state stability in Europe and to keep the U.S. involved. U.S. involvement in this arena is especially important in view of the likelihood that European organizations, such as the European Community (EC), the West European Union (WEU), the European Parliament, the Independent European Programs Group, or other European bodies and institutions will gain more importance in shaping events in Europe in the future. Formation of the European Community 1992 (EC92) and perceptions of a reduced threat from the East will add to a diminishing role of NATO. In fact, the European nations will be inclined to chart future courses of action with less reliance on the traditional U.S. leadership and dominance. - Any actual reductions in military expenditures achieved for or by the GDR as a result of the on-going arms/force reduction negotiations or due to unilateral decisions, will allow that much more emphasis on investment and expansion of commercial/consumer good production and will help the reform process in East Germany. Such changes would be equally beneficial to other CEMA countries, and all references to the GDR in the remaining paragraphs are also applicable to the other East European countries.

If possible, it would also be desirable for the U.S. to provide massive foreign aid to the GDR and other Eastern European countries (similar to that provided the West European nations via the Marshall Plan after World War II), and to help rebuild the defunct economies of the GDR and other WP countries. This would give the U.S. the best chance to positively influence events and develop long-term political and economic relationships with the East European nations. However, the U.S. is not able to pursue such a course of action in view of the limited foreign aid currently available, the massive requirements to undo damages caused by the 20 December 1989 invasion of Panama, the huge national deficit and negative foreign trade balance, many urgent domestic needs, and the reluctance of Congress to appropriate additional foreign aid money. (Most likely the FRG and possibly Japan will be players in providing sorely needed foreign aid moneys). - Therefore, the U.S. must be active and demonstrate good will through other means. Several initiatives which could and should be pursued by the U.S. are highlighted below.

The U.S. should exert its influence with international organizations (such as the IMF, the World Bank, etc.) and important free-market countries, to speed along a process of convertibility of the GDR's currency or the setting of interim exchange rates. Another action that may be required is the purchase of sufficient quantities of East German marks to hold that currency at a workable exchange rate. The U.S. should encourage the FRG, other European allies, and Japan to pursue such actions, including establishment of the European Development and Recovery Bank, and participate to the extent possible. Visible political support should be provided as a minimum. FRG intentions to set an exchange rate of "one for one" between the West German Deutsche mark (DM) and the East mark were being considered by the Bonn government at the time this paper was finalized. Such a decision would certainly assist the government and population of the GDR. A negative consequence would unfortunately be worldwide inflationary pressures.

The U.S. should also pursue actions to facilitate trade with the GDR, contingent upon further liberalization of economic and political policies in that country. - Specifically, the Export Administration Act of 1979 and other pertinent laws and restrictions (including conservative COCOM rules retained in response to the conservative U.S. position in the past) should be modified to allow expanded trade between the East and West. A reduction of restricted items (generally high technology items) on COCOM's control list to a reasonable level based on the new developments in Eastern Europe should be considered.[1] (The

Coordinating Commitee on Export Controls (COCOM) is a Western alliance group making lists, which stipulate materials to be kept from communist nations.). The West European approach of quantitative restrictions, rather than complete elimination from the restricted list, could be used during an interim period, until further liberalization has taken place and complete adaptation to world market prices occurs in the GDR.[2] Furthermore, the U.S. should liberalize its current anti-dumping and trade laws, which assess anti-dumping charges on a number of East European products, essentially amounting to non-tariff barriers.

Negotiations with the GDR to reach an agreement for investments by and joint ventures with U.S. firms, subsequent encouragement of U.S. firms to get involved, "resumption of government loan insurance and guarantees, and help (to) finance commercial projects that are managed by private groups in the GDR..."[3] would also be appropriate. Emphasis should be placed on encouraging many small entrepreneurs to invest to help build a private enterprise infrastructure currently non-existent and so vitally important to a market economy. - In early December 1989, during discussions between a delegation of the U.S. House of Representatives and Prof. Dr. Gerlach, acting chairman of the GDR State Council, the latter spoke "in favor of the United States, along with other Western countries, having a presence in the GDR and providing economic and other kinds of cooperation."[4]

Another form of U.S. involvement could be low cost or non-reimbursable shipments of surplus agricultural products. This would assist the GDR in maintaining relatively stable food prices during the transition period, while subsidies are reduced and eventually eliminated. In addition, the U.S. could offer education and management assistance pertaining to the operation of a market economy, provide modern farm or production equipment, and assist with know-how to improve productivity.

Quick, positive economic and political reform in the GDR is crucial to capitalize on current opportunities to democratize the government, introduce market mechanisms into the economy, and avoid possible destabilization or chaos. The developments in the GDR will, without doubt, have a major affect on West Germany, our staunchest ally on the European continent for the past forty plus years. Emigration from the GDR to the FRG is likely to continue until substantive political and economic reforms have taken place and a new order, acceptable to the majority of the GDR's population, is evident and appears permanent. Under these circumstances, the FRG socio-political system, which is already burdened by many immigrants each year (over 720,000 in 1989,[5] nearly equalling the immigration rate of the U.S.), will be taxed to the limit. Lack of a stable and sufficient labor force, excessive political turmoil, and lack of assistance from Western countries would doom successful reform in the GDR. Turmoil could result in both countries (the GDR and the FRG) and reach undesirable levels, possibly spilling over into other European nations. It could even lure the Soviet Union into actions contrary to U.S. interests.

These eventualities require responsive actions, which assist in achievement of successful reform in the GDR, until the likely confederation or reunification of East and West Germany. Timely U.S. involvement (and that of other Western nations) is necessary and desirable, lest we take a chance on losing the achievements of Western policies of the past forty-five years and risk the extensive investment in Europe already made by the U.S. and NATO allies. Many West European countries are already steps ahead of the U.S. It is time to change past conservative practices, develop a new paradigm befitting the changed situation, and give the fledgling reform movements in the GDR and other WP countries a chance to succeed, while preventing unnecessary loss of future U.S. influence and economic opportunities in that region of the world.

ENDNOTES

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3. Ibid., p. XV.

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5. "'Da brennt die Sicherung durch'," Der Spiegel, 1990, Issue 4, p. 29.

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