

Honecker's debt legacy set to blow up German economy

by William Engdahl

A hidden debt bomb inherited from a dead communist regime is about to explode over Germany.

For the past half-year, huge amounts of political energy have been expended in the Bundestag, Germany's parliament, to securing a broad all-party and state austerity deal, called a Solidarity Pact. The mystery in this hubbub is that the pact, which has just been signed, is slated to take effect only in 1995, after national elections in 1994. Why the unusual delay?

The argument that it would depress a weak German economy to impose new tax burdens now, is political subterfuge. The new austerity package takes effect in 1995 because that is the year when the debt bomb of the old East German economy, the "hereditary burden" as it is called, must, by law, come into the daylight, and the German government—i.e., the taxpayers—must begin servicing this debt.

Much is bizarre about this so-called debt which German citizens must begin to repay in January 1995. First, no one has revealed precisely how large the debt from the old East German collective farms, state corporations, and other entities of the communist regime actually is. If Finance Minister Theodore Waigel knows, the ruling coalition presided by Chancellor Helmut Kohl refuses to reveal it. Opposition Social Democratic Party (SPD) members have chosen to accede to the Solidarity Pact without uttering a dissenting word about the legitimacy of the old East German debts.

Best estimates from sources in the thrift institutions put the total debt at 400-600 billion deutschemarks (\$250-375 billion). Of this sum, the German taxpayer, starting in 1995, must pay annual debt service of an estimated DM 40 billion, perhaps even DM 60 billion if the DM 600 billion figure is accurate. For what?

The strange dealings in July 1990

It is important to recall the fast pace of events during the dramatic weeks after the November 1989 opening of the

Berlin Wall. Already in March 1990, the Bonn government was close to agreeing on a parity of 1 ostmark (the East German currency) to 1 deutschemark (the West Germany currency), after the proposed monetary union the coming July. On Feb. 6, Karl-Otto Poehl, the president of the Bundesbank, West Germany's central bank, was in East Berlin meeting the president of the East German Staatsbank and the East German economics minister to discuss terms of monetary union. The same day, in the same city, and reportedly without prior warning to Poehl, Chancellor Kohl made a surprise public announcement that Bonn was offering full economic and political union to East Germany—not merely a step to currency convertibility.

Perhaps under pressures of large street demonstrations in Leipzig, Dresden, and other cities of East Germany, perhaps alarmed by the growing stream of East Germans moving west, the Bonn government reacted politically, without consulting its colleagues in the Bundesbank. This, in the crucible of a unique historic moment, is understandable. What is not understandable, are the terms on which Bonn agreed to incorporate the entire monetary and economic system of East Germany—debts and all—that July.

A situation has been set up by the Kohl coalition, with the tacit acquiescence of the SPD opposition, which, if not corrected now, threatens to bring down not merely the present German government, but, Italian-style, all the political institutions of the postwar Federal Republic. The issue of the East German "hereditary debt" is programmed to become the dominating issue of European financial politics at least for the rest of this decade.

There are as yet many unanswered questions surrounding the dramatic events leading to the July 1, 1990 Monetary Economic and Social Union Treaty. Was the chancellor blackmailed by Soviet party boss Gorbachov and the Stasi (the dreaded East German secret police) with the threat of

losing the historic chance to reunite Germany, were he not to agree to their draconian financial terms? Was the attempted assassination of the government's top negotiator in the Union talks, Wolfgang Schaeuble, meant to deliver Bonn a message? Was the chancellor euphorically over-confident of the power of the mighty West German economy to solve all problems, once pressures of national elections were past in December 1990?

According to informed accounts in Bonn, the elite of the old regime in East Berlin, already by the mid-1980s or thereabouts, realized that it was a matter of months before the Warsaw Pact and their regime would crumble. Much like the Nazi elite after the defeat at Stalingrad, these Stasi and SED (the Socialist Unity Party or communist party) circles began quietly preparing for the good life after communism. Alexander Schalck-Golodkowski, a major-general in the Stasi, was responsible for all "hard currency" affairs of the Erich Honecker regime from his commissariat in the Foreign Trade Ministry. SED party boss Honecker, Stasi chief Markus Wolf, Schalck, and the other communist bigwigs began an elaborate process of looting the East German economy in the several years before the Berlin Wall cracked open in late 1989. Secret bank havens were set up in Switzerland, Gibraltar, Luxembourg, and elsewhere by Schalck and the Stasi-SED elite. Schalck alone had a network of 148 firms worldwide. A Jan. 30, 1990 report in the daily *Bild Zeitung* revealed that the SED was secretly selling its gold reserves to get hard currency in value of DM 2.1 billion.

The 'hereditary debts'

What Honecker and his accomplices left behind in East Germany was a rotted infrastructure, outmoded industry, polluted streams, broken machinery—and one of the most precious reserves of skilled labor in the world today. Plus the "hereditary burden." What constitutes this huge new debt burden?

We are not disputing the legitimacy of the DM 30 billion in foreign debt of the East German government. This was, for the most part, contracted to western banks and should be paid. We ignore here approximately DM 10 billion in costs agreed to cover East German obligations after July 1, 1990 denominated in transfer rubles, though much could be said about it. We also do not take up the issue of the approximately DM 90 billion in debts for so-called settlement compensations for the currency conversion.

Rather we focus on what the Bonn Finance Ministry as of October 1992 calculated to be around DM 250 billion in inherited debts from the companies and collective farms now under the Treuhand, the economic agency which united Germany inherited from the communist German Democratic Republic. If we take the higher figure for total inherited debts of DM 600 billion as closer to the truth, then the Treuhand component of this debt by January 1995, when by law the remaining debts of the Treuhand are directly assumed as part of the federal budget and no longer "off-balance sheet," will

total not DM 250 billion, but closer to DM 450 billion. This is the albatross which threatens to sink the fiscal integrity and solvency of the Federal Republic.

In the final terms agreed between Bonn and East Berlin for the July 1990 union, Bonn assumed the book debts of East German industry and agriculture at a parity of 2 ostmarks = 1 deutschemark. Private household savings, after much political agitation, were finally accepted by Bonn at 1:1. The private savings sums involved are not burdensome. The 2:1 conversion, however, is.

The problem lies with the old industry debt owed by the state-controlled factories and collective farms to the Staatsbank in East Berlin. By assuming a 2:1 ratio of valuation, the Federal Republic assumed responsibility on July 1, 1990 for some DM 130 billion of "old debts." But, as the Treuhand was the umbrella set up some weeks before unification by the still-communist Modrow government of East Germany, to control all state-owned industry and agro-enterprises, this DM 130 billion was then legally assumed by the Treuhand.

Cancerous growth of the debt

In a little-noted last act of the communist People's Chamber in East Berlin, a law was passed which allowed East German banking institutions (in reality the Staatsbank and subsidiaries) the option of charging "western" market interest rates, rather than the typical extremely low 0.5% rate charged by East Germany to its own state-owned farm cooperatives and collective farms for their "debts." Hours before the July 1, 1990 monetary union took effect, interest rates on the "debts" of state firms in the East Germany increased by 8 to 20 fold!

At the same time, the relative burden to the old East German collectivized farms of their East German "debt" carryover, besides bearing as much as a 20-fold higher interest burden, was now payable in West German currency at a ratio of 2:1, while the structure of East German industry and agriculture depended on export to the ruble-zone economies of the Warsaw Pact region, which had no hard currency reserves with which to pay. Exports from the vertically integrated agricultural collectives, the *Kombinate*, during the course of 1990, collapsed almost totally as a consequence.

But not the debt on the books of the East German farm combines, which, after July 1, 1990 were now a part of the Treuhandanstalt—itsself placed under the German Finance Ministry of Theo Waigel. This debt began to grow cancerously, hidden from public view.

On what basis were the "debts" of these old firms pegged at 2:1? Then-Bundesbank president Poehl rightly protested, insofar as his public role permitted, when the parity of 1:1 for the collective farms' debt was being mooted. But even were one to assume legitimate nominal debt, which was not the case as we shall see, a value of 2:1 was absurd. The Berlin black market some months before July 1990 sold ostmarks for deutschemarks at 10:1. If we take the per-man output of average East German industry *in toto*, the comparison with

West German economic productivity would have suggested a ratio closer to 13:1—in any case, not 2:1. Were a more realistic ratio for debt of firms used, the total state-controlled factory debts at union would have been on the order of DM 20 billion, rather than DM 130 billion—though even this would be bogus, as we shall see.

One case to illustrate: An agriculture collective in former East Germany had 150 members, and, prior to unification, had annual sales of about 15 million ostmarks, as well as a so-called state debt obligation on which they paid an average of 1% annually, or a yearly debt cost of 28,000 ostmarks, or some 0.2% of total sales. After unification, now with 30% fewer people, and an annual sales of DM 5 million, the collective must pay annual interest costs of 10%, or DM 140,000!

If west German modern industry and agribusiness firms were forced to operate under such financial pressures as were imposed on the east German firms under the conditions after July 1, 1990, it can safely be said that no concern would survive. That is precisely what has happened to east German industry and agribusinesses since July 1990. Real unemployment levels, among those wanting to work full time across the five new states of the east, today exceed 40%. Most state-controlled factories have been “privatized” in a manner which has amounted to a deindustrialization of eastern Germany.

But Honecker’s stand-in Comrade Modrow and friends succeeded in pressing Bonn for 2:1. With a stroke of the pen on July 1, 1990, Bonn took over the Treuhand, and with it a combined old debt of farm collectives and state-controlled factories valued at DM 130 billion, and for the most part now payable at western interest rates of some 9-10% annually. But how do we arrive at a figure of DM 450 billion in 1995 for the combined debts, including interest, of the Treuhand?

Reorganization of the Treuhand

Helmut Kohl’s choice as first Treuhand chief, Carsten Detlev Rohwedder, was a manager with deep experience in transforming the steel industry at Hoesch, as well as years in Bonn under former Economics Minister Karl Schiller and others. Shortly before his assassination in April 1991, Rohwedder had realized that the policy of Treuhand had to change. He met with Kohl shortly before the German elections in 1990 and Kohl agreed to a policy of “modernization rather than privatization,” as priority for Treuhand. This meant that Treuhand would serve as ultimate guardian overseeing investment into east German industry, its effective reorganization, but above all, its modernization, even were this to mean that many east German companies must remain state-owned for ten or even more years before they were ready for the pressures of western markets. Under Rohwedder’s concept, east German steel should be used to rebuild collapsing east German railways, or to build new ports, for example.

But after Rohwedder’s murder, this mandate was re-

versed. An Anglophile Hamburg banker’s daughter with decades-long intimate ties to leading circles of City of London and Wall Street finance, Birgit Breuel, was named to the most demanding and difficult job in the entire German economy. Breuel proceeded to reverse the firmly established policy almost from her first day. Treuhand, according to numerous first-hand accounts of businessmen who have dealt with it, operates under the worst Anglo-Saxon “free market” ideology. The investment bank of her family, Schroeder, Munchmeyer, Hengst, now owned by Lloyd’s Bank (of London), was even hired as one adviser in the Treuhand privatization under Breuel.

Beginning in the summer of 1991, with Breuel at the helm, American and British management consultants were brought in to advise Treuhand, company by company, on privatization. According to a study by the Düsseldorf Institute for Economics of the DGB, the German trade union confederation, made public in October 1992, the Treuhand has deliberately hidden this policy shift by accounting tricks. Money, not preservation of valuable industry groups, rules Treuhand under Breuel.

In their official report for 1991, under the heading, “Outlays for Modernization, Privatization, and Shutdowns,” Treuhand claims an impressive expenditure of DM 77.5 billion. But according to the DGB examination of the fine print, Treuhand only spent DM 5 billion for what rigorously must be called “modernization” or rebuilding of the productive plant equipment and management structure of former East German firms! The remainder mostly was spent to keep companies operating with the same decrepit equipment, losing billions of deutschemarks monthly, while Berlin refused to pay out a pfennig for new investment in those firms. As a result, the total Treuhand debt is ballooning month by month. This is believed to be the real basis of the estimated growth from an original DM 130 billion in Treuhand “debt” in July 1990 to an estimated DM 450 billion by 1995.

The Treuhand does not list “modernization,” except in combination, “Modernization *and* Loss Settlements,” or “Loans for Investments *and* for Loss Settlements.” Through such tricks, Breuel’s Treuhand is apparently fulfilling the policy of Rohwedder’s Treuhand, but in reality building the biggest fiscal crisis in modern German history, set to erupt in public in 1995. No one knows, outside perhaps an inner circle of people advising Breuel, how much this Treuhand debt is mushrooming, because of the false policy since April 1991.

The phony debt

But the most absurd of all in this tale of folly and fraud, is the fact that the entire debt is illegitimate.

How can a state which, under the East German system owned all means of production, owe itself? The so-called debts of the East German firms and agriculture complexes were, pure and simple, political fiction. The “creditor” and the “debtor” under the East German law were one and the same legal personage, the five SED states. Under the old

East German system, state-owned manufacturing company "debts" were carried as loans on the balance sheet of the state-owned Deutsche Kreditbank, which in turn was wholly owned by the East Berlin Staatsbank. After July 1, 1990, Treuhandanstalt in Berlin became the legal successor to the Staatsbank.

There was no credit system in the communist regime. Rather, the bookkeeping entries termed "debts" were a political planning and control mechanism of a communist state over state-owned industry. Because the SED Central Committee arbitrarily determined the prices the farm collectives could ask, firms were deliberately loaded down with "debts" from the Credit Bank, the difference between artificially low state prices for products and state plan demands for company "tax" revenue to the state. As the Warsaw Pact economies fell deeper into economic chaos in the late 1980s, these fictive accounting devices termed company "debts" mounted rapidly. But they were not "credit" in the West German legal sense of loans to buy real equipment or improve facilities. There was virtually no net new investment as we today know. Nor were they credits in the sense that the "loans" were drawn from national savings. They were merely arbitrary sums used to cover the collapse of the central planning process, or to allocate resources inside the planned economy. There existed

no legal form of debt. It was "debt" of the people—to communist Honecker.

Since July 1990, however, the Federal Republic of Germany has implicitly recognized this fiction as legitimate and given the "full faith and credit" of Germany as guarantee for its repayment. This error, while understandable under the extraordinary political pressures of 1989-90, will bring Germany and its entire economy to ruin as sure as night follows day, if it is not judiciously corrected—whether by determination of the proper legal courts as to the juridical legality of the inherited debts, particularly that of Treuhand.

Solutions are certainly possible if the problem is squarely faced. Replacement of the present debt entry in the books of creditor banks with new state bonds, call them, say, "reconstruction bonds," in some agreed ratio, but earmarked for direct investment in east German states for infrastructure rebuilding and industry reinvestment, would turn every billion deutschemarks now being lost in a bottomless barrel of debt payment and unemployment costs, into a genuine "eastern economic miracle." To regain the trust of the disillusioned citizens of the east, a truly impartial German national commission, named by all parliamentary parties, must conduct a full audit of the Treuhand under Birgit Breuel's tenure as well.

E. German housing firms need a debt moratorium

The much-propagandized "Bonn Solidarity Pact" is worthless, as it leaves the old debt untouched. The swindle behind the German government's alleged success story of having found "a sound way of keeping financial flows under control" is most obvious in the case of the heavily indebted east German housing sector.

The eastern municipalities are expected to shoulder an old debt ratio of DM 150 per each square meter of inhabitable space—which means that the total old debt of DM 36 billion (in late 1990) is not reduced much, as this square meter trick adds up to a sum of DM 31 billion. The accumulated interest on the old debt, another DM 18 billion by the end of 1993, remains unchanged as well.

The only "concession" of the government now is to grant a two-year grace period to the east German municipalities, and to pay their due interests during this period. They are obliged to begin paying their share from July 1995 on, however.

The slightly reduced principal of DM 31 billion is meanwhile "parked" in the special government fund of "debt inherited" (from former East Germany), but it is to

be paid back in installments by the eastern municipalities through, among other measures, the sale of at least 15% of their property (land, buildings, etc.) to private owners starting in 1995.

The municipal housing agencies will have to invest in the restoration of an estimated 2.3 million apartments, however, which, as an average ratio of DM 60,000 is needed per apartment according to Bonn government calculations, will require a total of DM 138 billion over the next ten years. Hence, the eastern housing sector will not be in a much-improved position to pay the old debt which it cannot pay now, in 1995 either.

Rostock, the eastern German port which was targeted for neo-Nazi riots a few months ago, announced in February that it could not pay its 6,100 employees their monthly wages, due to a budget shortfall of DM 78 million. Only a special mobilization of funds allowed the city to scrape together enough money to cover February and March expenses. The official jobless rate in Rostock is 11.8%, but the real figure is more like 25-30%. Due to tax breaks granted to new businesses under the federal "Upswing East" program, there is no relief in sight for municipal revenues. The debt-burdened municipalities in the five eastern states have no options except to raise parking fees or to drastically cut the city payroll, as in Rostock, where 1,700 employees will be laid off, but even that measure won't close the budget gap.—*Rainer Apel*