INTRODUCTION

The well-known factor that compelled both the erstwhile GDR and India to liberalize their economies was the collapse of communism. The autarkic statism having been discredited with the collapse of the Soviet Union, this appeared to be the only option available to them. Also, in the fast changing global environment and world development, liberalization of the economy has become inevitable owing to globalization of the production process and increasing international competitiveness in particular and economic strength in general.\(^1\) As a result, in both eastern Germany and India, a convergence in approach towards integration with the global economy was adopted through trade, investment and technology flows, for ensuring steady growth. Broadly, they aimed at reducing the extent of government controls over various aspects of domestic economy, increasing the role of the private sectors, redirecting scarce public resources to areas where the private sector was unlikely to enter, and opening up the economy to trade and foreign investment. They were expected to bring about socio-economic changes affecting several sectors of economy. At the same time, there was divergence in the approach of the two economies keeping in view the divergent nature and response of their respective economies. India's mixed economy - "a third way between a planned and market

economy"\textsuperscript{2} - did not see a total politico-economic transformation, as that of eastern Germany did, because the assistance of mixed economy had already facilitated the role of private entrepreneurship. Also, the reforms were not introduced against the background of a prolonged economic crisis or system collapse. Speaking of the beneficent effects of the State-directed economy in India John Adams, a well-known American economist acknowledged:

This period of the "socialist pattern of society" generated respectable rates of economic growth ... Agricultural output expanded by almost 3 per cent per year on average after independence. In the late 1970s, annual industrial growth was 4.5 per cent per year, while exports grew at 5.9 per cent. GDP climbed at a 3.4 per cent annual rate and GDP capita rose by 1.2 per cent a year. These are respectable numbers for a large, very poor economy.\textsuperscript{3}

Also, in former GDR, there was a widespread desire for and willingness to accept radical economic as well as political restructuring. In India, the need for such a thoroughgoing change was not keenly felt at the popular level. Rather as "statism" collapse in the Soviet Union, India felt its most grievous effect in that it desperately \textit{HAD} to leap-frog into the free market economy. Already, India's economy in early 1991 had reached its lowest ebb, and to salvage its imports, it had to tranship gold to London and Zurich. Where was then any alternative option available to India. The Indian Prime Minister had to rush to Bonn to convince Germany about its decision to go the whole-hog for free market economy. In the case of Eastern Germany the


booming economy and engendered by the DM provided the raison d'etre for their speedy integration with FRG. With India, there was no such option. India had to moved out of its "mixed" or "mixed up economy", which had failed to deliver the much expected goals in the form of higher economic and social development.

CONVERGENCE OF ECONOMIC EXPERIENCE

The economic reforms in GDR witnessed a total transformation from a centralized socialist system to a social market economy. Under the motto "as little government as possible, as much government as necessary" the State began to play regulatory role in the market economy. As such, the liberalization process in eastern Germany was regulated by the government and the Treuhandanstalt to absorb and finance inefficient enterprises. Since the coming into affect of GEMSU (July 1990) and the Unification Treaty (October 1990), the goal has been to transform eastern Germany rapidly into a social market economy:

It shall be determined particularly by private ownership, competition, free pricing, and as a basic principle, complete freedom of movement of labour, capital, goods and services ... It shall take into account the requirements of environment protection. It shall be characterized in particular by a system of labour law that corresponds to the social market economy and a comprehensive system of social security based on merit and social justice.  

In order to harmonize with the social market system of western Germany, various steps were taken in the areas of economic and financial policy, foreign trade and payments, structural adjustment of enterprises, agricultural and food industry, protection of environment, labour and social welfare, etc. Efforts were also made for price stabilization, a high level of employment and foreign trade equilibrium.

---

4 The Treaty of 18 May 1990, between FRG and GDR establishing German Economic, Monetary and Social Union (GEMSU).
As a first step, former GDR, as a process of politico-economic reform, accepted the West German market-economy package virtually in its entirety. This included: private ownership of means of production, freedom to choose a profession and to exercise economic activity, the liberalization of trade and capital movements, the introduction of well-defined property rights, and the encouragement of wide variety of small and medium-sized businesses. In addition, the rapid implementation of West German environmental standards and regulations was decided upon. The Bundesbank was empowered to act as the bank of issue of the common currency area. The liabilities and claims expressed in East German Mark were converted into Deutsche Mark. Wages, salaries, rents and pensions were converted at parity. The basis of conversion of wages and salaries was the level of payment as of May 1990. Pensions were raised to 70 per cent of West German levels. As for savings, a conversion rate at parity was allowed for up to 4,000 GDR marks per person for GDR citizens aged 15 to 59, and up to 2,000 marks for young people under 15. Citizens aged 60 and over were allowed this rate for amounts up to 6,000 marks. Financial assets and liabilities were generally converted at a rate of 2M:1DM. This put a heavy debt-services burden on the State-owned enterprises. The high level of debts of 260 billion GDR marks arose primarily from practices in the planning systems, which made it difficult for enterprises to generate funds for investment on plant and equipment. In brief, introducing the Deutsches Mark into GDR was much

---


more than simply a change of currency. It was the lever with which the economic
and political system in GDR switched over to a market economy.\footnote{Hans Willgerodt, "German Economic Integration in a European Perspective", \textit{Aussenpolitik} (Hamburg), vol.41, no.4, 1990, pp.326-38.}

As a part of the financial sector reform, arrangements were made for the
Laender and communes. The communes were granted an annual share of at least 20
per cent of the land share of total revenue from joint taxes and 40 per cent of the
land share of the German Unity Fund. The new Laender were granted an average
share of turnover tax per inhabitant and fixed proportion of the average share per
inhabitant in the old Laender, rising from 55 per cent in 1991 to 70 per cent in 1994.
These arrangements were restricted to a transitional period in order to avoid making
the West German financial system needlessly complex. Accordingly, tax revenues
were distributed among various levels of government (vertical financial equalization),
and the richer Laender were obliged to contribute to the revenue of the poorer
Laender (horizontal financial equalization). In addition, the Federal government paid
grant-in-aid to the financially weaker Laneder.

Fiscal deficits were to be reduced by the abolition of subsidies, particularly
in the short term for industrial goods, agricultural products and food, autonomous
price supports being permissible for the latter in line with the regulations of the
European Commission. Subsidies were also to be progressively reduced for
transport, energy for private households and housing, making allowance for the
general development of income. Sustained reduction of public expenditure in the
government service was to be another means of reducing fiscal deficit.\footnote{Jorg Hesse, in Ghanie Ghussy and Wolf Schäfer, eds., \textit{The Economics of Unification} (London: Routledge, 1993), pp.26-40.}
Measures were also taken to facilitate a swift structural adjustment of enterprises to the new market condition and to strengthen their competitiveness in a social market economy. A diversified, modern economic structure was to be built up in eastern Germany through private initiative, with emphasis on small and medium enterprises. In foreign trade, eastern Germany would adhere to the principles of free world trade as per the provisions of GATT, benefiting from experience of West Germany. Agriculture in eastern Germany would adopt EC standards, including the introduction of market regulations. A price support and external protection scheme in line with the EC market regime was also introduced in order to adjust with those of Western Germany. Restructuring in agriculture and food industry was intended to improve the competitiveness of enterprises to achieve environmentally acceptable and quality-based production and to avoid surpluses, etc.9

One finds an echo of the structural reorientation taken up in eastern Germany in the economic measures adopted in India towards liberalization of the economy. The new policy, announced in mid-1991, set the pace of India’s switch over to a free market economy, ending the phase of the public sector at commanding heights.10 Industrial licensing was abolished, with the exception of a small list of industries on account of environmental considerations. The operation of MRTP (Monopolies and Restricted Trade Practices) and FERA (Foreign Exchange Regulation Act) were reviewed allowing, industrial mergers, take-overs and further expansion of industrial

---


10 R.N. Molhotra, "Recent Change in India" in K.N.Malik and Peter Robb, eds., *India and Britain: Recent Past and Present Challenges* (New Delhi: Allied, 1994), pp.130-53.
capacity if it did necessitate new capital investment. Foreign investments up to 51 per cent of foreign equity, in 34 specific industries was allowed. Automatic permission would be given for foreign technology agreements in high priority industries subject to specified limitations. For proposals involving foreign equity beyond 51 per cent, a Foreign Investment Promotion Board (FIPB) was set up to facilitate speedy clearance. No official approval would be required for hiring foreign technical experts or for foreign testing of indigenously created technology. As in eastern Germany, small and medium units were encouraged for export promotion. In areas reserved for small-scale units having substantial export potential, for example, toys and garments, medium-scale units were allowed to enter provided they exported at least 50 per cent of production. In addition, the items mentioned in the negative list of exports were reduced drastically.\(^\text{11}\)

The EXIM policy (March 1992) adopted by India substantially reduced the list of restricted items of import or export. As in eastern Germany, the objective was to facilitate imports of capital goods and technology needed for industrial manufactures, and to stimulate exports by simplifying procedures. Quantitative restrictions were lifted, particularly in imports, and the tariffs were reduced from 87 per cent of import values in 1991 to 25 per cent in 1995. The exchange rate policy too underwent a total transformation through a series of transitional regimes and in August 1994 achieved full convertibility on current account.\(^\text{12}\) Fiscal reforms were adopted to enable banking institutions to discharge their functions more effectively and efficiently. The regulation of interest rates in the banking system by the Reserve

\(^{11}\) Beginning April 1995, items such as coffee, audio-tapes, personal computers, sport goods, etc. no longer required official approval.

Bank of India was reduced and rationalized, private shareholders were inducted into State-owned banks, private banks were encouraged and a Debt Recovery Tribunal was set up for recovery by banks from defaulting borrowers, etc.\textsuperscript{13}

By Indian standards, both the change in the economic frame work and liberalization of economic policy are tantamount to a revolution.\textsuperscript{14} The measures announced gave clear signals to the international business community that India charted out on a new course, with a clean break with inward-looking policies of the past and preparing the Indian economy for integration with the rest of the world.

**DIVERGENCE IN ECONOMIC REFORMS**

For eastern Germany, the replacement of a socialist social and political system with a free democratic federal and social system based on the rule of law, has implied the introduction of the right to freedom of contract, freedom to exercise a trade, freedom to establishment and occupation, freedom of movement in the entire German currency area, freedom to form association, to safeguard and enhance working and economic conditions, and freedom to ownership of land and means of production. In India, these fundamental rights existed since the enforcement of the constitution in 1950.

In eastern Germany an aggressive policy of privatization was adopted as part of liberalization. The Treuhandanstalt was entrusted with the task of rapid privatization, resolute redevelopment and cautious closure. The central objective was to reduce the entrepreneurial activity of the State by introducing privatization, and


\textsuperscript{14} Fasbender, n.2, pp.58-9.
closing enterprises that could not be restructured to form competitive companies.\textsuperscript{15} In its privatization exercise, during its tenure 1990-94, the Treuhand privatized more than 14,000 enterprises, out of which 4,000 enterprises were re-privatized, that is, returned to their former dispossessed owners; 3,700 firms were closed down and around 66 enterprises remained to be privatized. The few remaining enterprises were transferred to entrepreneurial federal property but the aim of redevelopment and privatization remained unchanged.\textsuperscript{16}

In implementing its privatization programme, the Treuhand considered three types of purchases: the complete firm, individual subsidiaries or plants and parts of fixed assets and liquid assets. The negotiations on a sale considered the opening balance of the firms in terms of the Deutsche Mark. The buyer or investor were exempted from clean-up expenses under the Environment Protection Act. The Treuhand assumed 60 per cent of the clean-up costs, and 40 per cent by the relevant state government.\textsuperscript{17} It also assumed responsibility for old debts of these companies and the social welfare costs. Redundancy pay was granted to compensate retrenched workers. In practice, the labour and social services policy of FRG was introduced.\textsuperscript{18} Management buy-outs (MBOs) and management buy-ins (MBIs) were neglected by the Treuhand at first but later, these became an important form

\textsuperscript{15} "The Treuhand and Privatization in Eastern Germany", \textit{Inter Nationes} (Bonn), 1993, p.16.

\textsuperscript{16} Karl Zawadzky, "From a Planned to a Market Economy", \textit{Inter Nationes} (Bonn), 1995, p.9.

\textsuperscript{17} In the case of large-scale projects, for example, in lignite mining and chemical works, which have often damaged the environment to an extreme degree the Treuhand assumed 75 per cent responsibility and the relevant state government 25 per cent.

\textsuperscript{18} "Modern vision" \textit{The Economist} (London), 21 May 1994.
of privatization for small companies. MBOs occurred when German managers took on the task of privatization and MBIs when a West German foreign management undertook to make a firm independent. The usual practice was for a bank to take an equity stake in the MBOs and the managers were given the first option on buying out the bank's equity within a few years at an agreed value. For consumer and retail outlets, more often, a spontaneous privatization was introduced.

The public sector reform in India was greatly influenced, in breaking the psychological resistance to change, by the sweeping changes in the communist regimes including GDR. No clear strategy emerged, however, on privatizing the public sector enterprises. In some cases, privatization was pursued as an option. The focus was rather on general liberalization of controls or "marketization" and de-bureaucratization. Unlike eastern Germany, this was based more on pragmatic than ideological grounds. A compelling situation had been created by the inability of the State to continue to subsidize the public sector through budgetary support. The emphasis therefore was on distancing the government from the actual running of public enterprises. Institutions had, therefore, to be created, which were distinct from a government department and operated as separate entities enabling a commercial approach to the activities of the public sector. A method of "greenfield privatization" was adopted with the purpose of promoting private enterprises to venture into areas earlier reserved for the public sector.

To decide the fate of loss-making sick public enterprises, the Bureau of Industrial and Financial Reconstruction (BIFR) took matters in hand. The Board would consider whether a consensus could be reached among the existing

---

19 Davis, n.5, pp.128-9.
management, that is, government, creditors, and labour for a viable restructuring package which might involve some voluntary burden-sharing by all parties. The Board was also empowered to consider revival packages involving induction of new managers, with a fresh injection of capital. If no consensus could be reached on a revival package, the BIFR was authorized to close a unit and to liquidate its assets. This process, though somewhat lengthy, did provide an objective means of exploring ways of reviving sick public sector units, with closure as a credible ultimate threat in extreme cases.

A feature different from the liberalizing economies of the former communist world was the reform of the private sector in India. India never remained a closed economy. In fact, big business in India made a small contribution to export and faced little import competition. It has raised little capital overseas and its exposure to MNCs was within the highly constrained environment of officially sanctioned joint ventures and technology collaboration agreements. In the protected environment, Indian private sector showed some strengths, facing world prices for its inputs (including capital) and output, and more competition at home and in export markets. One of the beneficial factors was the numerous and diversified enterprises. Apropos, the following observation is worth mentioning:

The perception of India as a hopelessly poor society no longer reflects reality. Major economic progress especially in the last ten years, has brought not only economic growth but also increased diversification and reduced vulnerability to bad weather and other shocks.

---

21 For example, banks could offer to reschedule loans, workers to accept partial retrenchment or wage freezes, government might have to give up taxes due.

22 Ahluwalia, n.1, pp.21-2.

In addition, Indian business had a sophisticated underpinning of trained managers and professionals, primary and secondary markets, specialist services such as advertising and audit. In contrast, GDR had virtually private sector. Decision-making was highly centralized and hierarchically organized, enervating innovation and individual action and responsibility.

In India's experiment of privatization, the private sector expanded into areas hitherto reserved and dominated by the State, including the sale of State unit shares. Unlike eastern Germany, the privatization programme in India lacked political and people's support. The Indian government ought to have built a support platform of privatization by selling shares in profitable public sector units directly to the public or to the work-force, like the practice of Management Buy-outs (MBOs) in eastern Germany. Also, in India, unlike eastern Germany, a two-tier labour market exists. The lack of job security in the private sector indirectly affects the privatization process. In contrast, in eastern Germany, the labour and social policy of FRG are applicable which is based on the following principle:

Germany is hard to beat for the unquantifiable benefits. If you are ill, the treatment of the country's social-insurance system, is among the best in the world; if you are unemployed, the benefits are among the most generous. If you are employed, the benefits are even better: high wages, long holidays and often lifetime employment.

A divergence in the liberalizing process of the two economies was also influenced by the difference in the *modus operandi* of their central banks. The

---


Deutsche Bundesbank is next to parliament and the Federal government - the third pillar of economic policy-making in Germany. It is responsible for monetary policy and acts independently of government and parliament. Its foremost task is to secure monetary stability and the value of currency. It supports the economic policy of the Federal government within this framework in promoting economic growth, maintain price stability, securing full employment, and reducing business cycle fluctuations. It is from its success as the guardian of the Deutsche Mark that it derives its popularity in Germany - "not every German believes in God, but they all believe in Bundesbank". The bank's autonomy in monetary policy and interest rates has proved entirely compatible with a flourishing democracy. A number of countries, for example Ukraine, have now set up an independent central bank. A greater openness in the relationship between the British Chancellor of Exchequer and the Bank of England is an indication of the influence of the German model. Interestingly, the banking sector reforms in many former communist regimes have adopted the German model of the banking system.

The Bundesbank derives its considerable economic power from its control over interest rates which are decided by its Central Council - "by law, the Bundesbank, not the government, decides on the level of interest rates". Theoretically, the government could delay changes in interest rates for two weeks, but in practice, this veto has never been used. This is because of the ever


29 Radice, Ibid., p.135.
growing importance of the Central Council. The following description succinctly sums up the reality:

On every second Thursday, the 16 members of the Central Bank Council meet to decide the monetary policy. Their decisions are eagerly awaited not only in Germany but across Europe... The Bundesbank has become in Germany, best-known and most-feared institution.  

In contrast, the Reserve Bank of India did not enjoy the power to check the creation of money beyond a "justified level". As such, every new Finance Ministry resorted to deficit financing when it had to spend more than available revenue.

LESSONS FROM GERMANY

A main explanation for Germany's economic miracle lies in that country's distinctive institutional arrangements. The most striking is Ordnungspolitik, that is, the free play of market forces within a secure, unobtrusive, and well-institutional and financial framework. Ordnungspolitik is defined as;

...a system of measures and institutions which impart to competition the framework, rules and machinery of impartial supervision which a competition needs as much as any game or match if it is not to degenerate into a vulgar

32 Ibid.
brawl. This presupposes mature discernment on the part of all responsible bodies and individuals and a strong impartial state.\textsuperscript{35}

At the heart of Germany's social market economy is the system of Mitbestimmung, or co-determination, which gives workers extensive powers. In a company, the boss may have the casting vote, but, by law, unions have half the seats on the supervisory board and all of them on the workers' council, which must be consulted on most decisions.\textsuperscript{36} In fact, the German firms are closer to parliamentary democracies, run by company boards, specialists on those boards and trade unions. This gives the unions a stake in ensuring that the demands of their members do not put their firms in jeopardy. It turns workers and managers from opponents into partners and accounts to a considerable degree for the German economic success.\textsuperscript{37} The employers belong to industry associations, employees to trade unions, and they negotiate wages between them. The wages are determined not at company level but across whole industries. It is because of these reasons that the labour of Germany is equated with the medieval guild system in which craftsmen ran closed shops that set wages, defended quality standards and discouraged outside competition. In India, on the other hand, wages in the private sector are determined by the owners of industries and not by the workers. In fact, workers compete for jobs in the labour market rather as goods compete for customers in the shops. Also, the competition amongst firms in India is on the basis of lower wages costs. But the German model provides for competition on the basis of the same cost. Regarding

\begin{itemize}
\item \textsuperscript{35} Wilhelm Ropake, quoted in \textit{Germany in Transition} (Cambridge: Daedalus, 1994), p.56.
\item \textsuperscript{36} \textsuperscript{36} Parker, Ibid.,
\item \textsuperscript{37} W.B.Smyser, \textit{Germany at the Crossroads} (London: Hurst, 1992), p.261.
\end{itemize}
its merits, the following observation has been made by Rudiger Soltwedel of the Institute for World Economy, Kiel:

This is not ridiculous as it sounds. By blocking lower wages, it tends to force wages up in an economy in which the government, by and large, does not intervene to stop firms going bankrupt. This means that, if firms are to survive, they must shift to higher value goods like luxury cars and top-of-the-line refrigerators or machine tools—products for which Germany has for years led the market.38

Besides, the consensus-based system produces continuity and stability. It is less at the whim of politicians which restricts government tinkering. As mentioned earlier, monetary policy has been handed over to an independent central bank, the Bundesbank, which is subject to little parliamentary scrutiny. The government has room to conduct experiments, making it easier to see which policies are useful and which do not work. Although labour and capital markets are rigid, companies compete with each other as fiercely as anywhere in production markets. And the rigidities of the capital and labour markets are connected to one of the fundamental economic principles of Germany: the stability of relations among the economic actors—banks and borrowers, purchasers and suppliers, and unions and managers. This ensures in the German economy stability of employment, and the commitment of workers and firms to each other encourages firms to invest in skills and training which they might not do if workers moved jobs frequently.

In contrast, the labour laws in India are complicated even by Indian standards. They are incorporated in the "concurrent list" of the India constitution, that is, both the centre and the state can make laws on it. As such, there are 45 separate laws, dealing with every conceivable aspect of employment, for example, wages, job security, safety at work, industrial disputes, collective bargaining, etc. The rules are

38 Rudiger Soltwedel, in Parker, n.33, p.58.
applicable to private firms in India once employers hire more than ten people and they are officially noticed by the government. The rules oblige companies to offer benefits such as pension funds, health insurance, subsided canteens and clinics. If firms are bigger the requirements are more demanding. The rules also go to great lengths to protect existing jobs. For instance, permission to sack workers in firms employing more than 100 persons must be obtained directly from the state governments, which is granted rarely. The government itself provides many of the mandated benefits: health care through its own hospitals and dispensaries, pensions through its own schemes. Furthermore, firms with more than 25 workers have to inform official labour exchanges of any vacancies, and fill them from that source. The government also regulates job specifications. For example, firms of certain size (the minimum size includes 10 workers) must notify the authority of changes in job content or employee status. Some states even forbid any such changes unless every worker consents to them.

Expectedly, the enforcement of these laws poses great difficulties. Certain terms, such as workers, employees, workmen, working non-employees and employed persons, vary from law to law. "Wage" is defined in 11 different ways in all different statutes. In India protection for workers goes beyond what rich-country governments would ever think of requiring of their own big companies. Apropos, the following observation has been made:

If firms are trying to cut back on labour, it is often because they are in financial trouble. Denied permission to retrench, they face the possibility of closure. But the government has thought of that as well. Closing a company is forbidden too. India has many thousand "sick companies" that in most other countries would go bankrupt and disappear. India's system keeps them struggling on for years with subsidies, tax breaks, debt forgiveness and other life-support instruments. Altogether, India's labour laws are a parody of
excessive regulation, each bizarre dictum making sense only if you accept all the others as given.39

AN ASSESSMENT

After discussing the reformatory measures adopted by the economies of eastern Germany and India and the convergence/divergence of their economic experiments towards global integration, we may consider how these economies have fared since the adoption of their economic exercise.

In Germany, the consensus-based system is under threat since unification. The concept of a welfare state poses problem to the German model. As predicted, the share of GDP devoted to social spending could rise from 33 percent (1994) to 50 per cent by 2030. Critics have pointed out that Germany's welfare state benefits are generous, sometimes ridiculously so, which no country could afford for a long period. As a part of cutting expenditure, health-service reforms in 1993, mainly restrictions on doctors' limitless ability to prescribe, yielded successful results by cutting spending by 2.7 percent in the first six months of the year. But, there is little sign of radical overhaul of the welfare state, as the government has announced plans to introduce a new nursing care scheme for the elderly.40

The second long-term trend affecting the German model is a change in international trade and competitiveness, which will affect Germany more than almost any other country because it has the largest share of the world's manufactured exports. International capital markets, dominated by Anglo-American financial standards, are becoming more influential. This will make German firms less


40 Parker, n.33, p.56.
secretive with their books and force changes in the close relationship between firms and their bankers.\textsuperscript{41} For this reason, the Bundesbank reported that the prospects for growth depended partly on a cyclical revival in major partner countries such as the United States and the United Kingdom and partly upon domestic factors such as the acceleration of economic development in eastern Germany.\textsuperscript{42}

Next, the change in the balance of power between unions and managers threatens Germany's centralized wage-bargaining system. Many east German firms are ignoring the wage bargaining system altogether by paying less than the negotiated wage. These firms mainly from eastern Germany not confined to it. The Mittelstand firms are against the traditional wage bargaining system, which they say discriminates against them, forcing small firms to be as big ones. As such, they ousted the representatives of big firms who usually take the lead in wage negotiations. Furthermore, in eastern Germany unions and workers demanded that wages in the two parts of Germany should be equalized by 1994. Having failed to achieve this, the two sides agreed that the aim could not be achieved, and allowed struggling firms to opt out of their contracts and reduce wages in circumstances agreed to in advance with the unions.\textsuperscript{43}

As such, Edmund Fawcet has argued that it is time to redefine what counts as success integrating the two economies.

It is becoming increasingly unrealistic to treat success as bringing the average east German living standards up to west German levels within the next ten or

\textsuperscript{41} Ibid.


\textsuperscript{43} Parker, n.33, pp.60-1.
even twenty years. Bonn should make it clear once and for all that even if this was once a policy goal, then it must be revised, even dispelled. 44

Above all, "even the most rock-solid and successful parts of the German model", the Deutsche Bundesbank, cannot escape the pressure of change. Since unification, the Bundesbank's monetary policy has to cope at the same time with the inflationary shock of unification, past cost-push pressures from wages and benefits, and growing government debt. In response it has forced short-term interest rates above long-term ones to squeeze inflation, and in effect to attract foreign capital. So, the DM has become ever more dependent on the confidence of the foreign investor. As such, the former German Chancellor, Helmut Schmidt and his party SPD have been in favour of greater parliamentary scrutiny over the Bundesbank.

In the final analysis, Chancellor Kohl's prediction of equalization of living standards between the eastern and western parts of Germany to be achieved five years after unification has become illusory, just like the promises made to the people by the SED in former GDR. 45 The magnitude of the task of restructuring eastern Germany was underestimated by western Germans. It was around DM 180 billion a year, equal to half the total tax revenues. The real cost of unification became even more clear to the people in the east, where increasing unemployment and socio-economic insecurity have generated strikes, protests in the streets, and various signs of personal insecurity from suicide to sterilization by worried young female workers. 46


45 Quentin Peel, "The Deal They were Condemned to do". Financial Times (London), 18 January 1993, p.2.

46 Bill Berentsen, in Bennett, ed., n.25, p.217.
The spectre of permanent unemployment has been haunting eastern Germany, which has become a major threat to social market economy. Abrupt restructuring that followed unification led to unparalleled industrial collapse (industrial output fell by 65 per cent in 1990-91) and the loss of nearly 3 million jobs. For example, manufacturing employment fell from 3.2 million in 1989 to 1.2 million in 1993; jobs in farming fell from 2,50,000. The number of unemployed rose from 4 million (1994) to 6 million in 1995. The official unemployment rate it may be noted, does not include the so-called "second labour market" of short-time jobs, early retirement pensions, and government job creation schemes and retraining programmes. When the actual number of persons without employment is counted, the rate of unemployment comes to approximately 28 per cent for 1995. The employment situation varies widely among different sectors, with some branches of industry cutting 80 per cent of jobs.

Many east German firms are still struggling to survive. At the top of their list of troubles is a lack of the capital resources needed for investments in modernization, increased production and new product development. Small and medium firms are especially handicapped by the dearth of capital that hinders their chances for the future. East German firms also face increasing competition from west German and foreign firms. Only a handful of industrial firms have been able to gain supra-regional markets. They lack the necessary marketing know-how and the capital to

48 Radice, n.28, p.151.

159
invest in marketing efforts. The rising wages and the persistent wage-productivity gap represent further problem for east German firms. With the move to bring eastern wages in line with western wages, many employers, especially small business owners, fear they will not be able to carry their rising personnel costs. As a result, some firms are leaving their industrial organizations and may be tempted to pay lower wages than those set in the wage agreements. A large portion of employees is willing to consider waiving a raise in salary if it means being able to keep their jobs.\textsuperscript{50} The OECD, too, has expressed anxiety over the developments in eastern Germany:\textsuperscript{51}

If wage levels do not reflect the surplus of labour in eastern Germany, prospective level of profitability for new investment will be lower, reducing the incentives to invest; the viability of existing plant is also affected reducing output and employment, with consequent burdens on social security budget, and diminishing the ability of the eastern German economy to generate domestically some of the funds for investment.

The Federal Ministry of Economics itself has acknowledged:

This substantial gap between wage levels and productivity must have considerably increased the number of jobs lost and appreciably hindered the creation of new ones. There are chances for a rapid recovery in economic activity in both the east and west of Germany, but they can be utilized only if it is borne in mind that high wages cannot be coped with in view of the slackening of the economic situation in western Germany and the unsettled economic situation in eastern Germany.\textsuperscript{52}

Thus, a major obstacle to a rapid improvement of east German economy is the progressive approximation of wages towards the west German level. There are

\textsuperscript{50} Ibid.


large disparities between individual cases, but generally earnings prospects for enterprises competing with west German and foreign suppliers are still poor. The high increase in business investment is largely the result of government support measures.  

The picture, however, is not entirely one of despair. There are many signs that economic recovery has begun in eastern Germany, with some sectors having bounced back from the economic collapse. Following a 10 percent fall of eastern Germany's GDP in the first half of 1991, compared with the second half of 1990, the economy achieved a growth rate of 7.8 per cent in 1992 over the previous year. The increase in GDP was primarily the result of government capital inflows and an increase in domestic demand following monetary union. Between the second half of 1990 and the end to 1994, DM 525 billion flowed into the new Länder from western Germany, most of it to support investment and to develop the infrastructure. The rate of growth slowed down slightly to 5.8 per cent in 1993 on account of the recession in western Germany, but gained ground again in 1994 as GDP rose by 9.2 per cent.  

In the first half of 1995, GDP was about 7 percent higher than the previous year.  

Production began to recover in some sectors as early as 1991-92. Among these were the construction industry (financed through heavy State transfer for public projects and through private investment) and the services and craft sectors. In 1993,

---


54 Haupt, no.49, p.254.

for the first time since 1990, industrial production as a whole rose faster than domestic demand, and net production in the manufacturing sector increased in 1994 by 21.9 per cent over the previous year. The basis for the economic recovery is now widening as a growing number of industries are participating in the expansion. The expansion in construction companies, especially in residential building, was reason why production in this sector was 15 per cent more than in the previous year. Other industrial sectors sharing in this expansion were the plastics industry, metal construction, electrical engineering sector, and mechanical engineering sector since, 1994.56

This has increased employment, which rose by 1.1 per cent in 1994 after having fallen 3.0 per cent in 1993.57 The unemployment rate for the new Laender and East Berlin also fell slightly, from a yearly average of 15 per cent in 1993 to 14.8 per cent in 199458 and further 14 per cent in 1995,59 though it is still higher than in Western Germany (8.3 per cent).

The key impulses are still being generated by an economic policy which, by means of high financial transfer, seeks to overcome the serious shortcomings and constraints that still exists in companies and infrastructure, and promotes private consumption. East German companies still lack self-sustained momentum. This means that as the government-sponsored stimulus is scaled down the economy would expand more slowly. As such, it would take a long time before the growth becomes self-sustaining in the east German economy, and before the standard of living in

57 Parker, n.33, p.54.
58 Haupt, n.49, p.255.
eastern Germany reaches the west German level. In the words of Birgit Breuel, the
President of the Treuhandanstalt:

Many citizens of the old Federal Republic had assumed that a triumphal
march of the market economy would sweep away the evil empire of the
planned economy and that would be it. Thoughtful people were quickly
silenced in 1990. Nobody wished to sin against the great work of unity.
Problems were suppressed rather than analyzed soberly.
Because everything went and had to go at such a frantic speed, much
remained unsaid, in the hope that it would not have to be said. It remained
unsaid that the rebuilding of a country's entire economy would not take
months and years but decades. And above all, it remained unsaid that the
basic experience of all those concerned was virtually nil. Nobody knew for
sure how things might go.60

In the case of India, it had to move on to the track of liberalization for which
it was hardly prepared mentally as well as institutionally61 under pressures of the
on-going global changes, accompanied by the internal economic turmoil. The
industries which under the changed dispensation bore the responsibility for taking the
initiative and carrying out new programmes in widely varying areas of economic
activity, were not prepared for gaining independence from State protection. Many
Indian firms, spoilt for decades by the absence of competition at home or abroad, felt
that the ground had vanished from under their feet.62 A leading Indian industrialist
commented:

He is not opposed to liberalization provided that its scope is limited... If the
bottom 10 to 20 per cent of firms is taken over or forced to close, that is
inevitable. But if the top ten are also threatened then we will have to ask the

60 Birgit Breuel, "Grenzenlos uberfordert", quoted in Mike Dennis, Social and


62 Clive Crook, n.39.
government to deal with it ... biggest concern appears to be stopping foreign investors from taking over family controlled public companies.63

As such, Indian industrialists were almost taken by surprise when the new policy was announced. Now, even after five years of the operation of the new economic regime, Indian firms contemplate setting up their club or forum with a view to facing collectively the growing competition of the western transnational intruders into the Indian market. Clearly, five years since the initiation of the new economic regime, there is need to do stock-taking, and one finds that there has perhaps not been any appreciable progression in new industrial initiatives, new innovative products, and/or even firming up of strategic alliances within or even across the region.64 Judged in global terms, Indian markets still remain among the most protected, regulated and over-administered in the world. For this, India's reformer still has a lot to do, otherwise "under the prevailing circumstances, the take-overs and mergers of the Indian firms could not be ruled out."65

All this suggests that the reform has, as yet, been inadequate to tackle the grave problems facing the economy. A study of 240 manufacturing public sector companies compared with private manufacturers revealed that wage costs in the public sector were far higher, and fixed costs were higher by an even higher margin. The reason was the same as in the inefficient public sector of former GDR, that is, bad management. More promisingly, the public sector in India has started selling shares in some concerns, but its avowed aim is to retain 51 per cent, thereby denying

---


private owners control, and so far it has sold nowhere near 49 per cent of the enterprises concerned. Also, such sale of shares of public enterprises is not going to reduce the public sector deficit on a long-term basis particularly as shares have been transferred from the central government to mainly public financial institutions.\textsuperscript{66} Adding together the deficit is now roughly 10 per cent of GDP, about the same as in 1990-91. Furthermore, it would make the task of attracting private investment difficult unless the inefficiency of the existing infrastructure is tackled at its root. The power sector is the starkest example which requires alteration. The state electricity boards in India may be the most ruinously inefficient public utilities in the world. In the financial sector, full convertibility of rupee is not possible due to large deficit, and heavy government borrowing greatly complicates the task of economic management.

In India, the budget deficit has been reduced by curtailing growth-inducing investment expenditures, passing the burden to public enterprises and state governments by reducing transfers, increasing dividend payments by public enterprises and sale of shares of public enterprises. Between 1990 and 1995, central government spending went up by just over 6 per cent in real terms (current spending went up by 13 per cent and capital spending fell by 19 per cent). As pointed out, the government has done the opposite of what would be advised by sound economic policy, reducing capital spending much more than current spending. Also, subsidies remain the best example of spending to no purpose. The fertilizer subsidy came down from about 0.9 per cent (1991) to 0.6 per cent (1996); food subsidy was 0.5

per cent (1996) and state-level subsidies are being paid for agricultural use of irrigation and power. Between 1991 and 1996 the bill for food subsidies went up by 40 per cent in real terms, but the proportion of the total devoted to food distribution programmes fell from 70 per cent to less than 50 per cent. Moreover, the tax system still relies too much on complicated trade and commodity taxes, levied on a narrow base and therefore price distorting and too little on simpler, more broad-based taxes on income and expenditure. Since income or consumption taxes have not been raised or wage policy changed, the main channel for reducing domestic consumption seems to be through an inflation-induced reduction in the real incomes of the salaried classes.

In the trade sector no initial upswing was evident in India until 1993. Interestingly enough, India's imports in 1990 ($23.4 billion) were almost equal to those in 1993 ($23.8 billion). However, foreign exchange reserves have gone up to more than $20 billion. But the comfort implicit in the size of reserves may be more illusory than real, as pointed out by two Indian scholars, and these foreign currency assets are more than matched by foreign exchange liabilities, which have short maturities and can be withdrawn on demand.

To sum up, the convergence/divergence of economy experiments, in eastern Germany and India have not yielded desired results. But both of them are determined to overcome the existing difficulties, owing to their local socio-economic variations and globalization of world trade. In this regard, the prospects of economic recovery

67 Clive Crook, n.39.

68 Agarwal, n.66, p.38.

in eastern Germany is much higher as compared to India. This is mainly due to assistance from West Germany, a leading world exporter of manufactured goods. In contrast, India lacks such arrangement and still engaged in preliminary streamlining of its economy.