Economic Collapse and a New Beginning after 1990 (2020)

Abstract

An economist outlines the reasons for the collapse of the East German economy during the transition from planned economy to market economy that cost about one third of the former jobs and threw the new states into a deep recession from which they are only slowly recovering.

Source

Economic collapse and a new beginning after 1990

Low productivity, outdated factories, and the collapse of markets. In the wake of the monetary union, East German industries did not enjoy a good starting position, as they had to face global competition practically overnight. The result was shock therapy for the economy.

The facts

The transformation of a planned economy into a market economy was accompanied by hopes that soon proved to be illusory. It was originally expected that reunification and the restructuring of the East German economy would be mutually reinforcing events. These expectations were not met. Instead, the political integration of the two states was followed by economic collapse in eastern Germany.

Phasing out the planned economy and the resultant adjustment crisis

A dramatic transformation in the employment structures in eastern and western Germany took place before and after the fall of communism as a result of the phasing out of the East German planned economy and the introduction of free-market principles. Within two years, large-scale enterprises, if they still existed, had shrunk to small or medium-sized businesses. The sobering and abstract figures, however, conceal the effects of a profound economic and social adjustment crisis, whose impact on the eastern German population can only be compared to the Great Depression of the 1930s.

The end of industrial conglomerates

In the 1980s, most of the GDR labor force worked in large-scale enterprises with more than 1,000 employees. In the industrial sector, the proportion of people working in large-scale enterprises was nearly twice as great as in the Federal Republic of Germany (75.7% compared to 39.3%). This had to do with the economic structure of the GDR, in which large industrial conglomerates played a leading role. From 1987, these conglomerates— similar to corporations in the West— formed into operational consortia, known as state-owned enterprises (VEB). The expectation was that these industries would thereby be able work more effectively within a particular sector (Steiner 1999).

In 1989, there were 173 centrally planned conglomerates and a further 259 administered at the level of the old East German districts. Political attempts to preserve these structures in a reunited Germany failed early on. By June 1990, some 200 conglomerates had dissolved themselves and the VEBs had been converted into stock corporations or limited liability companies. On July 1, 1990, the Treuhandanstalt (THA), an agency established to serve as an institutional trustee, began its task of privatizing state-owned assets. The conglomerates were broken up into individual companies. This was done in order to separate viable businesses from unprofitable industrial divisions.

In a second stage aimed at attracting potential buyers, large-scale enterprises cut their workforces to re-size themselves as small or medium-sized businesses. On the basis of its final balance sheet, however, it appears that the THA was not successful in its selloff endeavor. By the time the THA had dissolved itself in 1994, the agency had incurred losses amounting to DM 256 billion. This corresponded to an average net loss of DM 17 million for every company sold (Windolf 2001, p. 399). There were various reasons for this failure. The decisive factors, however, seem to have been the economic and political conditions under which the restructuring of the East German economy took place. This difficult environment cannot be compared to that faced by other Eastern European transition countries.

There is general agreement among economists and social scientists that privatization in East Germany, in contrast to all other former socialist countries, entailed the most severe sort of "shock therapy" for East German industries. The reason lies in the nature of the monetary union and the process and consequences of reunification. When the monetary union came into force, goods from East German factories were immediately, and without any period of transition, subject to export on a new currency basis and thereby a different basis for valuation. Until 1989, the East German economy had, in various ways, been integrated into the overall economic planning of the COMECON countries (Council for Mutual Economic Assistance – the economic alliance of socialist states), leading to close trading relations among these countries. As a result of the monetary union, East German companies had to face global competition virtually overnight and were completely unprepared. What followed was a complete collapse of trade between East German companies and their former trading partners to the East. West German and Western European companies acquired a growing share of exports to Eastern European transformation countries, who were more prepared to spend their foreign currency on "western" products on the assumption that they were of better quality than East German goods. Correspondingly, exports from the western German federal states to Eastern Europe grew by 40 percent between 1990 and 1993, while during the same time period, exports to the region from the territory of former East Germany shrunk by 79 percent (Wirtschaftsatlas 1994, p. 50 f.). In addition, the monetary union and reunification led to West German goods flooding an unprotected East German market. There was no way of partitioning the markets of the West and the East within a united Germany, for example by introducing protective tariffs. At the same time, East German companies also faced competition within the single market of the European Community. This situation triggered a reunification boom in western Germany. By contrast, eastern Germany was confronted with a sweeping economic crisis. East German factories lost their regional eastern markets to western competition at a time when their own products were not even available on foreign western markets, as trade with western countries had up until then been regulated centrally by state authorities.

Many companies found their very existence imperiled as a result of enormous disadvantageous factors that occurred simultaneously, e.g., the monetary union, the collapse of traditional markets, the consequences of reunification, unfamiliar competition, uncompetitive products and a lack of market development, as well as the legacy of the East German socialist economy, which, among other things, was characterized by low labor productivity, an integrated corporate conception, and outdated production facilities. Under these circumstances, the sales efforts of the THA, transpiring in parallel, were often not very helpful.

The consequences of this economic shock therapy can be seen in the structural changes that have taken place in the eastern German economy. Two years after the end of the GDR, only a minority of the workforce remained employed in large-scale companies. However, this only reflects to a limited extent the overall consequences of the economic upheaval, as it does not take into consideration the number of dismissed employees and corporate insolvencies. These additional consequences of the systemic upheaval are illustrated by the collapse of production in eastern Germany and the extent of staff redundancy in the early phase of economic transformation. Two years after reunification, industrial production in eastern Germany was 73 percent lower than the level of 1989 (Windolf 2001, p. 396). The substantial collapse in employment levels in various sectors occurred relatively independently of whether privatization was successful or not. The economic sociologist Paul Windolf (2001, p. 411) estimates that in the period between 1990 and 1995, about 80 percent of the working population in the territory of the former GDR lost their jobs temporarily or permanently. Regardless of how one categorizes the political end of the GDR, the transformation of its economic structures can be best described by the term “revolution.” Its consequences can be felt to this day. They were and remain manageable only through the deployment of massive financial resources by the German federal government and the old federal states.

Economic collapse and a new beginning after 1990 **The development of employment structures in the mining and manufacturing industries from 1988 to 1992** **The number of workplaces in percent**		
	1988	
Workforce	East	West
less than/or 50	0.2	8.3
51 – 200	3.3	20.8
201 – 1000	20.9	31.6
more than 1000	75.7	39.3
	1992	
less than 50	9.6	8.8
50 – 199	25.9	21.8
200 – 999	33.5	33
1000 or more	31	36.4

Further reading

M. Fritsch, “Entrepreneurship, Entry and Performance of New Business Compared in Two Growth Regimes: East and West Germany.” *Journal of Evolutionary Economics* 14 (2004): 525–42.

B. Lutz and H. Grünert, “Der Zerfall der Beschäftigungsstrukturen der DDR 1989-1993.” In B. Lutz et al., eds., *Arbeit, Arbeitsmarkt und Betriebe*. Opladen, 1996, pp. 69–120.

A. Steiner, “Zwischen Konsumversprechen und Innovationszwang. Zum wirtschaftlichen Niedergang der DDR.” In K.H. Jarausch and M. Sabrow, eds., *Weg in den Untergang. Der innere Zerfall der DDR*. Göttingen, 1999, pp. 153–92.

Windolf, P., “Die wirtschaftliche Transformation. Politische und ökonomische Systemrationalitäten.“ In W. Schluchter and P.E. Quint, eds., *Der Vereinigungsschock*. Weilerswist, 2001, pp. 392–413.

Wirtschaftsatlas Neue Bundesländer. Gotha, 1994.

Source: Fritsch 2004, p. 532

Source: Bernd Martens, “Wirtschaftlicher Zusammenbruch und Neuanfang nach 1990,” Bundeszentrale für politische Bildung, http://www.bpb.de/geschichte/deutsche-einheit/lange-wege-der-deutschen-einheit/47133/zusammenbruch?p=all

Translation: Pam Selwyn

Recommended Citation: Economic Collapse and a New Beginning after 1990 (2020), published in: German History in Documents and Images, <https://germanhistorydocs.org/en/a-new-germany-1990-2023/ghdi:document-5306> [March 20, 2025].