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GERMAN

German Unification after 20 Years: Achievements and Challenges

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INTRODUCTION

When German unification was finalized in October 1990, it marked the culmination of a process that no one could have imagined 11 months earlier: the fall of the Berlin Wall. On the night of November 9, 1989, Willy Brandt, the former federal chancellor and mayor of Berlin famously declared, "Now grows together, what belongs together." Forty years of division, based on the seemingly implacable force of Soviet bayonets, had etched a life of permanent separation deeply in the minds of the German people. Few foresaw that this system would end so suddenly and yet so unspectacularly, by simply crumbling into thin air. No unification institute, no Kremlin or East Berlin expert, and no journalist saw that the inexorable forces of Soviet decline, popular power in East Germany, and savvy diplomacy under West Germany's Helmut Kohl, would soon result in a unified Germany surrounded, for the first time in its history, by friendly neighbors.

However, the immediate years after unification appeared somewhat less auspicious. As unification euphoria ended, hangover set in, and the new nation would soon wake up to the economic difficulties of an East Germany in transition, and the arrival of a deep recession in Western Europe. Though often forgotten among today's more dramatic financial crises, the 1992–1993 West European financial crisis pushed the European Monetary System to the brink of dissolution—resulting in compromises on the euro that haunt the Eurozone today. Unification, thought to be a matter easily paid for by privatization, turned out to be a costly endeavor for the West. At the same time, results were far less rapid than initially anticipated, failing to match the post-war economic boom in West Germany.

Today, 20 years after unification the balance sheet looks quite different. Politically, Germany has been firmly established as a stable democracy at home (though with many of the same problems facing other Western democracies) as well as a dominant (but not domineering) player in Europe. Economically, while some issues still remain, comparison with other case studies on the transition to democracy and a market economy show that no other nation has made the transition so rapidly, successfully, and completely as East Germany. Somewhat surprisingly, social integration has been one area where the process of unification has lagged; and in fact, various challenges still remain in this and other areas. This paper accordingly reviews the way in which Germany unified through large-scale institutional transfers, and discusses the political and economic aspects of unification.

THE ACHIEVEMENT OF GERMAN UNIFICATION: INSTITUTIONAL TRANSFER

The process of German unification gained unexpected speed after growing popular dissent sent communist rulers home in the autumn of 1989, prompting the famous "Monday demonstrations"; first in Leipzig, and then throughout East Germany. This was remarkable, since at first, neither the people demonstrating for freedom (to express themselves and to travel freely) nor outside observers (including most West Germans) even had unification in mind.

As we know today, the West German Secret Service (*Bundesnachrichtendienst BND*) was already reporting in 1986 that the idea of German nationality (as opposed to East German nationality) had become firmly entrenched in the East, which the communist leadership in East Berlin had claimed for the socialist part of Germany. The organizers of the early demonstrations, who had come mostly from peace and environmental movements affiliated with the church (the only institution with even limited autonomy from the state in East Germany) did not seek or view unification as a realistic goal. Neither did West German politicians, with the exception of the conservative wing of the Christian Democratic Union, and in particular the Christian Social Union.

Additionally, international hurdles to unification seemed to be insurmountable. These included the expected veto of the Soviet Union, which maintained an army of half a million soldiers in East Germany, and concerns from neighbors in both the East and West. Nevertheless, in one year unification was achieved. The path was not a lengthy constitutional process with a new, all-German constitutional assembly, but the simple accession of five new states of East Germany ("new," since the states in East Germany had been dissolved in 1952 only to be refounded in 1990) to the West German constitution, the Basic Law. West German law in its entirety thus became valid for East Germany as well. Politically, this solution was congenial, since it elegantly skirted the vagaries of a constitutional process. However, at the same time, this solution did not comprehensively address the question of the new German identity and "inner unity."

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posed a partnership treaty with the West, including a substantial (but by today's experience completely insufficient) amount of 15 billion Deutschmarks in aid. West German Chancellor Helmut Kohl answered with a 10-point counterproposal, which for the first time included a long-term perspective for unification, starting first with a confederation. The rapid decline of state authority in East Germany and the mass migration of 600,000 refugees six months after the opening of the wall, however, soon made these plans obsolete. In March 1990 the first (and last) free elections for the East German parliament (*Volkskammer*, or People's Chamber) produced an overwhelming majority for an alliance of conservative parties pleading for rapid economic and monetary union between both parts of Germany. This also had been a Kohl election campaign promise. In May 1990, a Fund for German Unity was created by West Germany of 115 billion Deutschmarks, a sum thought to be adequate to deal with unification costs, which was understood mainly in terms of rebuilding East Germany's infrastructure. The hope of the government as well as of many economists was that as soon as market forces were freed from regulation in East Germany, a similar economic boom would set in as occurred in West Germany after World War II, when the so-called "Social Market Economy" was created under the leadership of Ludwig Erhard. On May 18, 1990, the newly elected prime minister of East Germany, Lothar de Mazière, and Kohl signed the "Treaty on Economic, Monetary and Social Union." When it went into effect in July 1990, the five new states of East Germany were founded. A month later, the "Treaty on German Unity" was signed. It went into force on October 3, 1990, thus reestablishing German unity four decades after the founding of the Federal Republic of Germany and the German Democratic Republic.

Unification meant a comprehensive institutional transfer with minimal exceptions or transition rules for East Germany. A completely new set of institutions, legal norms and organizations was immediately imposed on East Germany, as well as a new set of highly bureaucratic administrative proceedings, and high and costly West German environmental and social standards. Without these impositions, East German productivity and income levels could have immediately neared West German levels.

Nevertheless, institutional transfer brought immediate advantages for East Germany compared to all other Central and Eastern European transition states. East Germany was the only country, in which the much discussed institutional "Big Bang," i.e. the sudden and immediate transformation from a socialist to a market economy, actually occurred. Legal preconditions for this were created by the treaties of May and August 1990. In contrast, most of the other transition states needed one or two decades to create similar institutional environments, including Poland in 1991 and Russia in 1993, despite explicitly speaking of "Big Bang" institutional changes. In short, uncertainty, which had been one of the biggest obstacles for investment in transitioning post-Communist countries, was removed in a single stroke in East Germany.

The problem of transparent law enforcement is particularly important in this respect, since administrations, courts, management, and all other institutions related to governance are among the weakest links in transitioning states. After 1990, thousands of civil servants, managers and professors were sent from the West to the East to implement, enforce and teach the new institutions. The West Germans were often met with deep distrust by their students in the East, due to their superior knowledge (which was sometimes arrogantly displayed). Nevertheless, West Germans made invaluable contributions to unification of the country's institutional systems.

The social science faculties of universities, schools, and courts all profited immensely from their knowledge. For example, soon after unification some East German universities developed into centers of advanced research and teaching. In contrast to its counterparts in other Central and Eastern European states, who suffered for decades from a dwindling pool of qualified staff, East Germany was able to maintain its talented people as income levels rapidly converged.

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DOMESTIC AND FOREIGN POLICY IN UNIFIED GERMANY: STABLE DEMOCRACY AND HEIGHTENED STATURE IN EUROPE AND THE WORLD

Domestic Policy After Unification

Domestic policy issues also were dominated by institutional transfer from the West. New political institutions were largely accepted *in toto*; and after an initial transition period the party system in the East converged with that of the West, with two notable differences. The political milieus of West German social democracy and Christian democracy, including trade unions and their social networks, as well as the Catholic constituency of rural West Germany, were almost completely absent in East Germany. At the same time there was a stable group of about twenty percent of voters who supported the former Communist Party's successors (first the "Party of Democratic Socialism," and then later the "Left Party").

This is not surprising, considering unification inevitably entailed losers as well as winners. Though they were not "losers" in material terms (since virtually everyone was soon much better off than they had been before unification), they were losers in terms of power and influence. This group included the most loyal former party functionaries, secret service members, and army personnel.

Since then, the post-communist successor parties in the East have become older (in terms of the average age of their party members), but have still managed to consistently attract young voters, and even new voters in the West thanks to a decade-long debate over cuts in the German welfare system. By and large, the constituency for the former communists has diluted the constituency for the Social Democratic Party by one-third of their potential voters (who now vote for the new Left Party), while significantly influencing the German party system, which had been very stable in the four decades preceding unification. As of 2010, the Left Party has been firmly established as a new player, with up to 30 percent of voters in the East, and some five to ten percent of voters in the West.

A second, and probably related development is the slow erosion of acceptance of democratic institutions. This phenomenon is by no means a German phenomenon alone; it exists in most mature Western European democracies. In Germany, this is related to the circumstances of the relatively poorer regions of the East, where voter absenteeism is highest. This is partly due

to the lack of any democratic tradition (democracy in East Germany was abandoned in 1933, i.e. for almost 55 years East Germany was governed by non-democratic systems). This is also true for the vacuum in values once the communist ideology broke down, a vaccum which can be observed in the rise of both right and left wing extremism on the fringes of youth culture.

Twenty years after unification it is increasingly difficult to speak of "East" vs. "West" in German politics. New political cultures have developed, and in some areas there is pan-German pride regarding the quality, craftsmanship, and prestige of German products. The quick convergence of the Deutschmark has also helped. In other areas differences may be larger between North and South Germany than between East and West, leading to distinct new political environments; for example the economically more successful Southeast versus the lagging Northeast. To a large extent perceived differences are a generational problem, with the younger generation in the East and West often converging more strongly than the older generation.

Foreign Policy After Unification – A Strong, Reliable Partner for Europe and the World

In foreign policy, the results of the unification process were as unexpected as in other fields: The firm integration of Germany in West European economic structures (i.e. the European Community and the European Union, and from 1998, the European Monetary Union) and Western military structures like NATO could not at all have been expected. Earlier, the Soviet Union had floated the idea of a neutral state. Fortunately, it was convinced that the German position in-between East and West (*Zwischeneuropa*) had been one of the major factors for political instability between the two World Wars. French and British opposition to German unification were also overcome by Germany's Western-led integration. The same held true for Poland and Czechoslovakia. Originally the transition was viewed with mistrust and fear of renewed border issues; both countries later became closely allied to Germany when it became a promoter of their early acceptance into NATO and the European Union.

For the first few years after unification, Germany was mainly inward looking, concentrating more on questions of inner unity and economic policy than grand foreign policy designs. The larger Germany, now by far the largest economy and most populous state in the EU, did not become more outwardly assertive; instead it became rather introverted. The change of government to a Social Democratic/Green Party coalition from 1998 to 2005 under Gerhard Schroeder partially changed this, due to the urgent challenges of the times; but the new united Germany was more of an active foreign policy partner than an assertive lone player.

In the European Union, Germany remains dominant, but not dominating. At any rate, the enlargement rounds of 1995, 2004, and 2007 shrank the relative weight of large Western European states vis-à-vis smaller accession candidates, while Germany remained widely consensus oriented. Original flirtations by Gerhard Schroeder with the British government of Tony Blair for a new axis of "third way labor parties" were soon abandoned again for the traditionally strong Franco-German partnership in the EU.

Today, having mastered the challenges of unification, Germany is more active and assertive in international politics than it has been for decades. This remains mostly in the form of "soft power," rather than power politics or military involvement. Due to the legacy of World War II, Germany still maintains a certain degree of restraint; though in 1998 it did participate in military actions in places like Kosovo and Afghanistan.

THE ECONOMICS OF GERMAN UNIFICATION

Financing German Unification

After the political changes in East Germany in late 1989, the original forecasts of costs of unification were still very modest. Although the deplorable state of East Germany's economy became visible after the opening of the border, most politicians and economic experts hoped that unification could largely be self-financed through revenue from privatization. In early 1990, the last communist prime minister of East Germany, Hans Modrow, estimated the value of East German collective property (*volkseigenes Vermoegen*) to be around 1.6 trillion Ostmarks. Even with a realistic exchange rate for the East German mark, this would have required astronomical sums to pay for the costs of unification. However, the notion of collective property itself proved to be fleeting. Nobody knew this better than the people of East Germany who left for the West. From November 1989, when the borders opened, more than 600,000 people fled East Germany in half a year, exacerbating the problems of the economy. This was especially true since the most likely to leave were the younger and more flexible workers as well as the highly-educated and skilled. Still, forecasts of unification remained relatively modest. In May 1990, West Germany established the German Unity Fund with 115 billion Deutschmarks (around $80 billion then). However, the Treuhand Organization, responsible for privatization of East Germany's companies, accumulated debts of 205 billion Deutschmarks alone, and this did not include any of the infrastructure investment or any of the social transfers necessary to stop mass migration from East to West.

In terms of political and monetary stability, economic unification was a spectacular success and the German Deutschmark remained stable, with only modest inflationary pressure even while accommodating the addition of 16 million additional users overnight. Still, this came at an economic cost. From 1993 onwards Germany was in a permanent state of economic crisis, with unemployment at historical peaks and public debt rapidly accumulating. Also, the European monetary system, due to the (understandable, but ultimately costly) unwillingness of other European states to adjust to Germany's high interest policy, finally crashed. It is especially ironic that Germany, which had insisted on a three percent limit on public deficits for governments in the European Monetary Union, was one of the first violators of this rule, thereby damaging its role as a European anchor of economic stability.

East and West Germany did not enter unification as equals in terms of political or economic strength or in population and size. After unification West Germany averaged roughly 64 million people, East Germany 17 million people. At the same time, it was well known that East Germany is not necessarily an unfavorable economic location *per se*. Before World War II, the East even had a GDP slightly higher than the average throughout the German Reich, partly due to the strong industrial region in Saxony.

In fiscal policy, unification was a major challenge. It has undergone drastic changes during the last twenty years, from the original modest forecasts to the more realistic assessments that have been applied later with hindsight. Since 1990 the costs of unification in terms of net transfers from West to East have been around €1,300 billion to €1,600 billion, with an annual increase of almost €100 billion. Of this sum, around two-thirds to three-quarters were used for social transfers (in other words, consumption), and only €250 billion were used for investment.

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fers from the state like social insurance and pensions, special aid for improving infrastructure, and aid for enterprises in East Germany (in principal this also applies to poorer regions in the West), as well as programs for East Germany proper. These have included one-time tasks like the currency union, the costs of the withdrawal of the Soviet army, the aforementioned privatization, and other historic debts like the rehabilitation of the environment in many places. Germany financed these challenges in a variety of ways. New state debt covered a large share; regional redistribution covered it to some extent; and special funds from the European Union to a very small degree. A specific new tax and general tax also were raised and social contributions were increased.

Among the most widely debated measures has been the so-called "solidarity surcharge," though it only covers a small portion of the costs described above. In 1990 the new government under Helmut Kohl rejected tax increases. However, worsening macro-economic and budgetary conditions soon made the solidarity surcharge necessary. In addition to unification costs, contributions to the first Gulf war (Operation Desert Storm) as well as support for Central and Eastern European states was needed.[1] Originally, the surcharge was thought to be temporary (from July 1, 1991 to June 30, 1992), with a nominal income tax rate of 7.5 percent (and an actual rate of 3.75 percent; since the tax was applied only for a half year in 1991, and a half year in 1992). However, from 1995, when the surcharge was re-introduced, up to 1997 the annual rate was 7.5 percent. Thereafter until today the surcharge has been 5.5 percent annually. The surcharge is also progressive, in line with the income tax. For small incomes taxed up to €972 (€1,944 for married couples) in annual income tax, no solidarity surcharge is levied. Above this threshold, the solidarity surcharge rate increases continuously until it reaches 5.5 percent where the annual income tax is €1,340.69 (€2,681.38 for married couples). In 2009 the surcharge netted €11.9 billion.

Public deficits in Germany were not a sole consequence of unification. Aggressive extension of the welfare state in the 1970s created public debt, and in the early 1980s, huge debt was one of the main reasons Kohl and his Christian Democrats won office, since they promised to halt any further debt-financing. However, this was easier said than done. It took another six years, before the goal of a surplus on the central government level almost became true. This was in 1989, before unification changed everything again. Germany's state debt after 1990 exploded.

[1] Both, however, can also be seen as indirect costs of unification, since they were at least partly a political price paid for support for the German unification process.

The year 2007 marked an important event in Germany 17 years after unification. The German Statistical Office revealed in February 2008, that for the first time since unification, German public sector budgets (i.e. the central, regional and local governments plus social security funds) had reached a structural surplus. There had already been a surplus once before in the year 2000, but only thanks to a huge special revenue windfall from the auctioning of mobile phone (UTMS) licenses. In 2006, there had been a public deficit of €36.9 billion or 1.6 percent of GDP, compared to a tiny surplus of €200 million in 2007. In 2008 and 2009 debt jumped again due to the global financial crisis. Though debt after 1990 cannot automatically qualify as "unification debt," it is important to note that German debt levels after unification rose much faster than the OECD average. Moreover, from the point of view of financing unification, debt financing was not necessarily an evil: given that many of the problems exposed after unification were indeed the result of long-standing problems and policies in East Germany like environmental devastation or neglect of infrastructure investment. In light of this, debt financing was certainly justified. However, from a policy point of view, increasing debt reduces the ability to maintain fiscal flexibility, in particular the ability to pursue policies like infrastructure investment that enhance competitiveness. Accordingly, rapidly rising debt levels not only caused problems for Germany in the eurozone, with its criteria regarding debt and deficits, but also reduced the ability to carry out policies necessary for East Germany's recovery.

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A Transfer Economy or a Modern and Sustainable Market Economy?

If transfers were massive, what did they achieve? After twenty years, the success of transfers in terms of the rapid improvement in living conditions in East Germany is clearly visible. GDP per capita has more than doubled (from € 9,751 in 1991 to €19,500 in 2009); productivity has soared; net household income has more than doubled and net household wealth has almost tripled; though this is likely underreported due to an industry structure dominated by highly specialized small and medium sized enterprises (many of these enterprises are parts makers for larger West German exporters; for example, in the car manufacturing industry of Saxony).

At the same time, people worked fewer hours, had more living space, and more doctors and dentists per capita. Life expectancy rose by six years for men and women alike (to 76.1 and 82.2 years respectively). This is markedly different from the transition in Central and East European states, which sometimes (particularly during

the initial transition) saw a massive decline in living standards, and in some cases (e.g. Russia) even plummeting life expectancy.

Although transfers were massive, an important gap still remains in economic achievement between West and East. In terms of GDP, East Germany rapidly converged to the West in the first four years after unification (from 42.5 percent of West German GDP in 1991 to 64.1 percent in 1994). From then to now, however increases have been at a snail's pace, and East German GDP has stabilized at around 76 percent of Western GDP. In terms of living standards, however, East Germans (in gross terms) enjoy more than 80 percent of the Western standard of living due to a mixture of lower prices (especially rents), lower taxes (due to progressive taxation), and transfers. East German pensions are even higher than in the West (on average) because East Germans generally worked continuously, and the female economic participation rate was at record highs. However, all other possible indicators of economic convergence indicate a lasting gap, including headquarters of companies, taxes paid, R&D locations, exports, capital stock, productivity, workplace (per population), and private investment. Naturally, so much money invested was not without consequences. Today, East Germany's infrastructure is superior in many cases to that of West Germany. The universities exhibit an excellent relationship between academic personnel and students, different from their Western counterparts. Spending for East Germany also had consequences in the West, where local and regional spending on infrastructure decreased by more than one third.

East German industry in particular displayed great resilience during the 2008–2009 economic crisis. After the initial breakdown, a complete renewal of the industry structure created new, competitive clusters of SMEs. These involved chip and car manufacturing industries in Saxony, chemicals in Saxony-Anhalt, and biotechnology near Berlin, to name a few. These new enterprises are the backbone of renewed economies truly resembling the "flourishing landscapes" which Kohl predicted in 1990. It took twenty years to achieve this renewal, but today it is immediately clear to visitors that it was worth the wait: where formerly declining old cities were threatened by complete destruction and monotonous socialist rebuilding, today medieval cities like Erfurt and Goerlitz have been beautifully restored. Former environmental disaster areas like the Wismut uranium mines or the brown coal (lignite) fields in many parts of East Germany have become parks and nature reserves.

Surely, some challenges remain. When discussing the success of post-unification policies, too often complete convergence with the Western part of the country is taken as the standard of success. This makes little sense. Instead, Germany's example should be compared with other countries transitioning from the same or similar post-communist heritage. On these grounds, East Germany has been by far the most successful case. Remaining challenges like persistently high unemployment and dependence on transfers should not be taken lightly, but can be resolved (indeed, the unemployment problem might be transitory, given current demographic trends).

CONCLUSION: THE REMAINING CHALLENGE OF "INNER UNITY"

After twenty years of unification, Germany is a stable and economically successful state that is confident enough to manage the remaining challenges of unification. One of these remaining challenges is the difference in social perceptions between the East and West. To address this, the importance of "inner unity" for a suc-

cessful unification process had been recognized early on, but the difficulties in reaching this inner unity were not anticipated and the issue remains unresolved. The challenge of a "wall in the mind," once the real Berlin wall was removed, is not a challenge to be resolved in months or years, but will take generations. The assimilation of the East to the Western model in most issues (whether they are political, social or economic) is a good explanatory model for most changes. However, the duration of this assimilation has taken much longer than expected and the Western model itself has been modified during this process. While the process of assimilation was the focus of attention of social scientists from the beginning of the unification process, changes in West Germany itself were often overlooked. The West Germans are characterized as "winners" of 1989, though in particular regions (e.g. the border regions) or sectors (where East German companies could produce more competitively) it was the West that became the "loser" after 1989.

The main challenges of the socio-political transition derive from the outright reconfiguration of the external circumstances in which economic insecurity, job loss, and a competitive society are significant factors. On the other hand, they also arise from the former society's psycho-social legacy. As many East German citizens realized painfully after the transition, the ostensive "niche society" of the GDR had mainly been an illusion. The control system that found its most evident expression in the *Stasi* (State Security Service of the GDR, i.e. the secret police) infiltrated even the most intimate niches of society. Traumas and feelings of being a "lost generation" still haunted the middle-aged generation, that was still too young for retirement but too old to adapt to fundamental changes. The older citizens of the former GDR, cocooned in their actually existing private niches, and the young ones, who had less trouble assimilating, were less afflicted. Today, feelings of being different in East and West still persist, though there is no serious desire to return to the pre-1989 environment, neither in East nor West, and people are generally happy with their living conditions.

German unification was overall a very successful process. Above all, it was peaceful, and happened with the consent of all neighbors. Post-unification policies showed as well that economic convergence, like social convergence, took much longer than previously expected. However, after twenty years, these challenges are no longer a threat to the stability of the country. Thus, it remains to be seen how large the challenges for Korea to unify will be. The German experience offers a positive lesson, but at the same time shows that unification needs a long-term approach over several generations. SQ

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German unification, Helmut Kohl, NATO, institutional transfer, niche society

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