

**"Restructuring Enterprises in Eastern Europe",  
Comment on W. Carlin and C. Mayer**

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## Discussion

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This is a good paper on the economics of control and restructuring in the context of privatization, with special application to the German Treuhand (the study of which takes up nearly two-thirds of the paper). I have two main comments. First, the paper favours restructuring before privatization, and argues that the Treuhand follows this principle. I am not sure that this interpretation is correct. Indeed, the Treuhand has always argued that the task of restructuring firms prior to privatization would be too great a burden. 'Restructuring through privatization' is its avowed principle. It is true that the agency is nevertheless forced to do a lot of restructuring work, because it cannot sell the big communist firms and combines as they are. It has to split and unbundle the old businesses (and, as a rule of thumb, to fire two-thirds of the workforce) to create units that are small enough for sale. True, this is restructuring of a kind, but it is at the behest of private purchasers. This is (rightly) a far cry from the British policy, where a long and complicated restructuring process preceded privatization.

Second, as the authors point out in Section 5.5, East Germans have been practically excluded from the purchase of state-owned assets. This is a major problem, even a scandal. The currency conversion at monetary union exchanged East German financial wealth (money and savings accounts) into Deutschmark wealth, concentrating exclusively on transactions cash requirements. The conversion rate was chosen so that, relative to disposable income, East Germans received the same proportion of M3 money as West Germans possessed. However, East Germans were not given the financial equivalent of their former 'people's wealth' which would have enabled them to repurchase the real assets of the GDR. Even though the Treuhand sells its assets at market-clearing prices, the East German population has practically no chance of participating.

When the Treuhand began its work it expected sales revenues of around DM 600 bn. Treuhand officials no longer like to mention this because the agency will be lucky to generate even a tenth of these

revenues in the long run. This suggests that there are significant absorption problems created by the sales strategy, problems which also imply an unnecessary delay in private investment.

One kind of absorption problem is the rapid exhaustion of the purchasers' risk-bearing capacity. The Treuhand does not sell shares, only whole companies. You and I may wish to help bear the risks of the East German economy by incorporating Treuhand shares in our portfolios, but we cannot. We can contribute only by buying whole companies and becoming entrepreneurs. The paper offers some remarks on this issue but certainly does not pay full tribute to it.

The same is true for the second absorption problem which consists of the severe credit constraints faced by potential buyers of Treuhand assets. Unresolved property disputes and the absence of equity capital make it practically impossible for East Germans to borrow for the purpose of buying Treuhand assets. Even West Germans and foreigners would have had difficulties in financing the DM 600 bn. the Treuhand originally expected. Well managed firms that have optimized their debt equity ratios under tax aspects do not have free surplus equity which they could use to participate in unexpected asset offerings of the order of magnitude the Treuhand had in mind.

A third absorption problem is the macroeconomic stock-flow problem. Given that the Treuhand revenues are being, and have to be, spent on commodity purchases rather than the repayment of government debt, the sale of East Germany's assets must be financed by freeing West German or foreign savings from other uses. Unlike the microeconomic stock-flow mismatch, which implies individually perceived credit constraints, the macroeconomic mismatch rations credit indirectly by increasing the interest rate. This increase reduces the capitalized value of the Treuhand assets' returns and lowers the bids of potential buyers.

These absorption problems not only violate the distributional aims of German unification policy, but they also imply severe reductions in private restructuring investment. The Treuhand revenue absorbs risk capital, exhausts individual borrowing capacities and places a burden on the capital market which increases the financial costs of business loans. Today the East German upswing is not yet under way, East German industrial output is stagnating at one-third of its pre-unification level and employment is still declining.

There are remedies for the deficiencies of the Treuhand strategy. Compare the Czechoslovakian and the German approaches. The advantage of the Czechoslovakian give-away strategy is that it avoids the absorption problems described. The advantage of the Treuhand strategy is that it brings in new management immediately with the act of privatization. It would be possible to combine these advantages

if the Treuhand stopped selling its assets for cash. Instead of requiring payment in cash, it could credit the purchase price or, better still, retain a silent fractional ownership in the firm. That way, in effect, the Treuhand would return the purchasing price in the form of risk-bearing equity capital to the firm. This would increase the present value of Treuhand revenues, stimulate private restructuring investment and make it possible to distribute claims on the former state-owned assets to the East German people. It would hasten the upswing and give East Germans some share of the wealth they had accumulated under communism. Capitalism needs capitalists, and capitalists need capital. I wish the Treuhand had respected this wisdom.