DFG-Transferprojekt: *„Wissenstransfer als interkulturelle Translation: Erarbeitung modellhafter Praxen transformationsvorbereitender Aktivitäten in Korea"*

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Path creation by unification.

The emergence of a family capitalism in a re-established south-north gap between the New German *Länder*

Preface

The following sketch of the outcomes of German unification for the East German industrial base does not try to provide a complete overview but highlights some crucial decisions and outcomes which have had a long-lasting impact on the competitiveness of East German companies and on the way East German business leaders play a role. This paper focuses on explaining the formation of the post-communist indigenous businesses as corporate actors and a social group, which was the result of basic decisions made during the unification process. In contrast to other Central East European countries (CEE), I regard East Germany as an extreme case of a new version of 'dependent market economy', based on skilled industrial work (DME).[1] East Germany, along with the Czech Republic, Slovakia, Hungary and Poland, share the fact that key industries, including the banking sector, were taken over by western companies. They even share the high proportion of West German investors. This was a result of rapid market liberalization, privatization and European integration[2], interestingly independent of which method of privatization politics was chosen. The created path lead to the emergence of 'native' oligarchs as a significant social group; in all CEE countries indigenous business is rather small, as opposed to Russia, Ukraine and to some extent, Romania. While they all had to find their entry into the European and global value chains on the basis of low costs, East German companies found their niches disadvantaged by the currency union, which produced higher labor costs when compared to their neighbors. Moreover, the simultaneous transition in CEE followed more or less the same master plan of rapid liberalization and privatization which created a seller's market for state companies and an abundance of low-cost production capacities in the very moment as Europe's industrial base shrunk and offshoring towards East Asia gained momentum. Both developments restricted the growth expectations of East German enterprises after the end of the unification boom, which was mainly driven by public investments, financial transfers in consumption, and the quick rise of wages.[3]

It might be unlikely that North Korea will have the chance for a self-determined path towards capitalism. Facing China's strong influence, it is also unlikely that North Korea can be integrated into Korea as undisturbed as the former GDR was unified with Germany. Hence, the author of

[1] Andreas Nölke and Arjan Vliegenthart (2009) introduced the *'dependent market economy'* (DME) as a third type of capitalism alongside liberal and the coordinated market economy (LME/CME). In terms of company financing and corporate governance, it stresses the dependence on intra-firm hierarchies within western transnational companies, controlled by a headquarters outside the region, producing relatively complex industrial goods, which pursue an appeasement of skilled labor and company-level collective agreements, while their expenditures on training is limited, as they restrict their 'embedding' to regional or national intra-firm networks. Hence, DMEs develop the complete institutional set of neither CMEs nor LMEs. See also King and Szelenyi 2005 and Bluhm 2010.

[2] For the CEE counties, the influence of European integration came somewhat later. Yet, several studies show that the European Union pushed for a further privatization in preparation of the EU enlargement (for example, in telecommunications, banks and the steel industry).

[3] The effect of the currency union on wages is in sharp contrast to the macroeconomic stabilization and austerity policy that led to a fall in wages, from which there has been only a slow recovery.

this paper does not expect that the transition to a market economy in North Korea to lead to a similar outcome in terms of industry structure and business elite formation. Instead, the East German case (and the East European transition in general) might sharpen the awareness of the long-lasting effects of decisions made right at the beginning of the process. The debate on the 'colonization' of East Germany and the dominance of western MNCs in Hungary (for example), on the one hand, and the frustration of Russians about their oligarchs, on the other hand, indicates that the question of who owns and runs business in a transition country is a sensitive matter.

Basic Decisions

In the short period between the opening of the Hungarian borders in Summer 1989 and the first free elections in March 1990, several options were discussed regarding the future of Germany: a) confederation versus unification; b) modus of unification (on the basis of a new constitution according to the Basic Law of the FRG, Art. 146 or as the integration of East Germany as a set of regions (*New Bundesländer* according to Art. 23); c) the exchange rate for the currency union. The idea of a confederation was historically out-of-date by the time these measures were debated. The East German population lost its desire for a confederation when the Berlin wall came down and shared a deep mistrust for any gradualism that might have delayed structural changes and lead to the possibility of a roll back.[4] Due to the outflow of dissidents over the GDR's 40 years existence, there were also no indigenous and legitimate counter elite to lead the country (cf. Land and Possekel 1998; Land 2013). Why Chancellor Helmut Kohl ignored the warnings of the *Bundesbank* president Karl Otto Pöhl when he decided for a 1: 1 exchange on wages and salaries and a substantial part of deposit savings that, in the short run, privileged East German consumers and voters and caused huge competitive disadvantages for East German companies is well documented (Tober 1997; Demary and Röhl 2009; Land 2013). Most scholars also agree that the currency union heavily determined the transition path in East Germany, while the population addressed their criticisms and anger to the privatization agency *Treuhandanstalt* (THA) (Wiesenthal 2003; Land 2013). It does not mean that there were no alternatives to the fast privatization course the THA took under Birgit Breuel. Originally, the THA was supposed to function as a holding structure for several branches prioritizing restructuring before privatization. Its first president, Dr. Detlev Rohwedder who was murdered by the RAF in April 1991, also preferred a strategy of industrial restructuring of industries for selling the conglomerates in pieces to western investors (cf. Seibel and Kapferer 1994). Yet a long-term transfer of public investment directed to East German state companies in order to form new competitors on European and global markets would have had little political support in the West. Moreover, a high rate of failure amongst these newcomers would have had to have been accepted as well. It was politically more expedient to finance the social costs of the course by the West German social security system and to establish a public-financed second labor market (job-creation schemes, in German: *Arbeitsbeschaffungsmaßnahmen, ABM*), which secured the industrial dismantling and were also used to eliminate environmental pollution (the so-called Chemical Triangle in Saxony-Anhalt between Buna, Leuna and Bitterfeld is considered today to be an environmental showcase).

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[4] I dispute the view that East Germans simply desired quick access to the wonder world of western consumption which Chancellor Kohl had promised. For East Germans, he also represented political professionalism and the expertise of the western market economy, which none of the 'dilatants' of the emerging political scene could credibly exhibit.

General Results

Comparing the transition results in East Germany with CEE, we might be able to get a vague notion of the outcomes of alternative paths. A confederation might have put East Germany in a similar competitive position like the Czech Republic with the advantage of sharing the same language with the major German investor and being under a stronger institutional influence and control of West Germany, which might have further eased the establishment of business there. However, this control would had been less than was the case after unification. The confederative path towards DME might have been therefore less radical and less costly for West German taxpayers facing the historically unique financial transfers since unification. As in the Visegrad-Four, deindustrialization of old industries, which that occurred in all transition countries across Eastern Europe, might have been compensated by reindustrialization through western investors (Bohle and Grekovits 2012). The Czech Republic, Slovakia, Hungary and Poland, and the first in particular, were the only countries of the former Soviet bloc which experienced a recovery of their industrial base both in terms of share of GDP and employment (EBRD database).[5]

By 1993, East German employment declined from 8.9 million to 5.8 million people (35 per cent), from which 15 per cent were unemployed, in spite of huge early-retirement and ABM schemes (Land 2013: 109; in more detail Busch and Land 2012) and the drastic expansion of employment in new fields, above all in construction. In contrast to its CEE neighbors, the catch-up process with annual GDP growth rates of around 8 per cent (1992-1996) came to an early halt in 1997. Since that time, the real growth rates have never reached a level that promised economic convergence (cf. IWH 2009; BMWI 2012: 6).

In 2005, the unemployment rate in East Germany once again reached a high point at approximately 20 per cent (due to social protection reforms called "Agenda 2010"), in spite of the ongoing labor migration from East to West over the preceding 20 years (BMWI 2012: 16; May 2004). A turning point was only reached after the demographic change started to relax the labor market, causing the curious situation of continuing high unemployment in some regions and among thirty-five to sixty-five-olds and a simultaneous lack of skilled workers, laying ground for "an extremely volatile political constellation" that promotes xenophobia and far-right ideologies (Land 2013: 110; see Labor Market Projects of the SFB 580).[6]

In terms of industrial structure, one of the key features of the German version of "Shock Therapy" has been the drastic change in company size. While approximately 76 per cent of the enterprises in manufacturing had more than 1,000 employees in 1992 the number was only 31 per cent, with further declines (Fritsch 2004). In 2011, , East German manufacturers employed, on average, 167 workers, in contrast to 246 by West German enterprises (BMWI 2012: 3). Today there is only one headquarters of a large manufacturing company in East Germany, i.e. *Jenoptik* in Jena, thanks to a peculiar political coalition against the usual THA policy. The lack of large companies and headquarters is also a major reason why East Germany continues to constantly underperform, in terms of R&D personnel per 10,000 employees compared to the West (-51 per cent in 2009) (BMWI 2012: 22).

[5] The overall labor force participation, however, is lower than in Germany or Russia (UNECE Database 2012), indicating that western integration went with drasticly uncompensated employment losses in all countries.
[6] On average, too, the unemployment rate is double that in West Germany in 2011 (11.3 per cent to 6 per cent; BMWI 2012: 16).

After 10 years of unification, Werner Sinn and Frank Westermann (2001) spoke of East Germany as a new *Mezzogiorno*. Yet this view overlooks the regional differentiation within East Germany that follows, apart from Berlin, the historical South-North gap (Bluhm 1999; 2000; Fritsch 2004; Fritsch *et al.* 2012). Especially regions first industrialized within the planned economy and without a tradition of medium-sized industrial companies were almost completely deindustrialized. Consequently, the balk of enterprises, the interview partners of our research project within the SFB 580, stems from the South, i.e. from Saxony and Thuringia.

Features of East German Business Leaders as a Regional Elite

The transformation in East Germany represents an extreme case of elite turnover (see also Walder 2003), since, in fact, in all sectors a professional 'counter-elite' was available due to the German re-unification. The far-reaching institutional transfer which was bound up with the re-unification entailed at the same time the transfer of top personnel from West to East. In the middle of the 1990s, the East German elite were underrepresented at a national level in comparison to their share of the overall population: of the 2,341 elite positions in politics, economics, science and culture, only 11.6 per cent (272) were occupied by East Germans (cf. Bürklin 1996; Welzel 1996; see also Windolf *et al.* 1999 for the economic sector). The proportion of the East German population is about one fifth. Among the 180 largest companies listed in the DAX, just two chairpersons were born or socialized in the GDR (Mau 2012).

Elite turnover was also heavily promoted by the privatization agency THA which not only preferred to 'sell'[7] companies and parts of companies to strategic western investors who promised but also systematically obstructed or even prevented buy-outs by East German management in favor of West-German buyers (cf. Pohlmann and Gergs 1999). In our qualitative interviews with East German entrepreneurs, they often complained about the injustice of the THA behavior that demanded relatively high prices from them for outsourced units and equipment. In addition to these asymmetric starting conditions in the THA privatization, the new East German entrepreneurs were also disadvantaged by the transferred German bank sector that classified the new East German entrepreneurship as high-risk investments due to the lack of markets, capital and a profound disbelief in their entrepreneurial skills. From state subsidies of exports to Eastern Europe aiming to prevent a total breakdown of trade (so-called *Hermesbürgschaften,*) mainly West German companies profited.

The majority of the business leaders of manufacturing enterprises we have interviewed between 2002 and 2009/10 reached their position in the early 1990s.[8] In 2005, 50 per cent of East German business leaders worked even in the same organizational unit (not enterprise!) (Martens 2008; Bluhm and Martens 2011). In 1989, those who made this move were approximately 40 years old, engineers or technicians with a university degree; around half of them made this step

[7] Selling is to some extent misleading. Due to the asymmetry between offers and demand on the markets for enterprises, the THA actually tried to 'buy' (western) investors and market shares for existing (eastern) industrial capacities. The price was often symbolic (1 D-Mark) and caused a lot of irritation in the East German population, especially when the promised investors turned out to be only interested in the real estates of the privatized company.

[8] From 2002 to 2009/10 we studied business leaders of medium-sized companies. In the final round, we also included large companies and banks. We also included an international comparison with Poland and Hungary. Target persons of the data collection in both cases were members of the first hierarchical level (CEOs, managing directors, other members of the board of managers, and entrepreneurs). Compare Table in Annex 1.

as shareholders, that means either as spin-offs of former companies or as founders of their own new companies, in order to become small but real entrepreneurs (Martens 2008). Only a few of them ever worked outside the economic sector (Bluhm, Martens and Trappmann 2014). While only a very small number of business leaders are women (below 10 per cent), the percentage in East Germany is slightly higher than in the West German sample.

As in Poland or Hungary, they reached their positions from second ranks, i.e. they were deputies, plant directors or heads of departments. In this respect East Germany followed the patterns in CEE, where a type of 'vertical reproduction' of economic elites from lower ranks was observed. The elite transfer, however, is still noticeable even after 20 years. In 2002, around two thirds of firms were managed by East Germans and one third by West Germans, a ratio that did not change substantially in the first decade of the 2000s. Larger companies in East Germany are more likely to have West German or foreign capital holders and West German executives, and if East Germans do own shares, their holdings are smaller. Only one East German heads a company with 1,000+ employees, another is head of a small savings bank.

Thoughts on the Society of East German Business Leaders

We did not explore Communist Party membership in our research the Communist Party. In studies on the social background of the SED successor *Partei des Demokratischen Sozialismus* (PDS) during the 1990s, entrepreneurs presented a relevant proportion of PDS members and were at least partly responsible for the pragmatic course the party took in the East German regions.

Our research focused on attitudes towards the so-called 'German Model' of coordinated capitalism. One of the original hypotheses has been that with the generational change in East and West Germany, neo-liberal thoughts become increasingly attractive and contributed to an erosion of cultural underpinning of the 'German model'. The outcomes of our research are ambivalent in this respect. On the one side, we found that basic features of the 'German Model', such as the vocational training system, a cooperative attitude to works council and a broader view on company's goals beyond maximizing profit, are widely shared. On the other side, only a minority embraces all features of the 'German Model', especially when it comes to the role of trade unions and collective bargaining. This result reflects the drastic decline of companies and employees covered by collective agreements in spite of decentralization and the opening of the system in the last 20 years.

East Germans perceive the role of collective bargaining between social partners more positively than the need for unions, which 39.2 per cent of the East German business leaders deem superfluous, in contrast to only 20.9 per cent of the West Germans. In terms of their negative perception of unions, East German business leaders are much closer to Polish business leaders (cf. Bluhm *et al.* 2013). Otherwise, agreeing to collaborate with works councils and with labour participation is more similar to the West German responses when compared with the Hungarian and Polish sample, indicating that there is not a rejection of *all* German institutions of organized labour. The dismay with unions is stronger among East Germans than in the West. This is partly the result of the fight of the transferred West German unions for rising wages above productivity after the creation of the economic and currency union and partly reflects the typical size of East German businesses. Smaller western enterprises are often hostile towards unionization as well. In addition, East Germans stress the dominance of owners interest in conflict situations within the company and the maximization of profit as the main company goal more frequently than West Germans, while at the same time their income generated from business is on average still significantly lower than in West Germany, reflecting again size differences and a still weaker market position (Martens 2008).

While in their attitude towards unions and profit maximization East German business leaders are more similar to their Hungarian and Polish counterparts, when it comes to the role of state in market regulation and redistribution, East German business leader display similar attitudes as West Germans. They reject significantly more often the idea of state market regulation and are more adverse to redistribution than Hungarians and Poles. At the same time, they, like West German business leaders, are more optimistic about the social outcomes of the market economy in terms of social justice and cohesion, in stark contrast to those from the East German population (Martens 2010; see more to attitudes Bluhm, Martens and Trappmann 2014). In sum, although East Germans differ significantly from West German business leaders in their attitudes towards key features of the 'German Model' due to the smaller business they conduct and the experience they had before and after unification, these differences are reduced in the wider comparison with CEE, indicating that the German institutional system has had an impact on the way East German business leaders think about operating in markets and the role of state.

Outlook

Our research project started with the idea of studying the first generational change of business leaders after 1989. Yet, in the comparison with West Germans, Polish and Hungarian business leaders, East German founders, even in 2009/10, were, to a large extent, still in their posts. The percentage of the business leader 45 years old and younger at the time of the last survey was the lowest in the East German sample with 14.5 per cent (Bluhm, Martens and Trappmann 2014); this means that the East German sample has the lowest share of business leaders who spent their entire career in a market economy. Yet, when asked about preparation for succession, almost as many East Germans want to keep their business within the family (34.8 per cent: 39.5 per cent), while external managers or companies play a negligible role in both parts of the country (Martens 2010: 33). Therefore, family business is re-emerging.

The late generation change of the business leaders is accompanied with a generational change of their employees, who were happy to keep their jobs and ready to accept competitive low wages even in the last two decades. In the next years, however, this generation will turn away from the labor market. Already now, free positions are increasingly difficult to fill, especially in those regions with a particularly high outflow of migrants since 1989. The lack of attractiveness and a xenophobic sub-culture obstruct the chances that East Germany, apart from the southern population centers (Dresden, Leipzig, probably Jena/Erfurt), to profit from the new inflow of labor migrants into Germany. This may put the existing business in the more marginalized regions into new risk. A further widening of the South-North gap within 'East Germany' is therefore likely.

Annex

Table 1 Composition the Sample

SAMPLE CHARACTERISTICS	COMPANY TYPES OF THE SAMPLE			
	Medium-sized companies (45-249)	Large companies (250-999)	Very large companies (≥ 1,000)	Banks
Poland	81	39	26	19
Hungary	105	20	24	20
Germany	314	86	79	44
Mean number of employees	115	482	8,807	2,345
Median of employees	100	428	3,500	516
Companies in West Germany	114	48	74	43
First-level West Germans	156	60	56	28
Companies in East Germany	200	38	5	1
First-level East Germans	129	14	1	1
% of respondents working at the first hierarchical level	91.1	87.1	79.8	82.9
% of respondents holding shares of the current company (all respondents)	45.3	19.7	9.5	3.7
% of respondents holding shares of the current company (top level only)	49.1	22.1	11.9	4.7

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