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**PREMISES FOR GERMAN UNIFICATION:
TWO CASE STUDIES IN THE AREA OF ECONOMIC COOPERATION**

by

JUTTA PACZULLA

**A thesis submitted to
the Faculty of Graduate Studies and Research
in partial fulfilment of
the requirements for the degree of**

**Master of Arts
The Norman Paterson School
of International Affairs**

**Carleton University
12 August 1991**

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ABSTRACT

This paper covers two case studies - trade between the Federal Republic of Germany (FRG) and the German Democratic Republic (GDR) prior to their unification in October 1990, and trade between the GDR and the European Community (EC). In both cases, the analysis was conducted with a view towards determining whether the economic links which evolved between the two sets of actors were such that they influenced the process of German unification.

The conclusion arrived at is that German unification is not a direct consequence of previously conducted relations, but a result of larger political developments. The trading relationships under examination were conducted in a highly government-controlled environment which limited the evolution of intensified forms of economic cooperation, and therefore were unable to create the premises for the merger of the two Germanys. However, inter-German and GDR-EC trade contributed towards keeping the German Question from being foreclosed.

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INTRODUCTION

Europe is going through a process of change. Cooperation in the European Community is being intensified and extended. The process of reform which began under the leadership of Mikhail Gorbachev in the Soviet Union made possible the dissolution of the old-type socialist régimes in Eastern Europe. The gradual elimination of fundamental systems-related differences means the end of the era of East-West conflict on the European continent. All of these events influence each other and have far-reaching implications for the overall situation in Europe. Among other things, they formed the basis for the creation of a new reality - a united Germany in the heart of Europe.

Throughout forty years of division, the two Germanys had developed antithetical political and economic systems. They shared the longest border between two opposite military and economic alliances: NATO and the Warsaw Pact; the European Community (EC) and the Council for Mutual Economic Assistance (CMEA). Divided Germany represented a microcosm of the ideological struggle between East and West. Nevertheless, bound by the stipulations spelled out in the preamble of the German Basic Law, ever since the creation of the GDR as a separate state in 1949, the government of the Federal Republic had remained committed to the idea of re-unification, even

though this commitment manifested itself in different approaches over time. When in late 1989 the revolutionary events in East Germany led to the collapse of the government in East Berlin and subsequently to the fall of the Berlin Wall, Bonn seized the opportunity to put its commitment into practice. The process picked up momentum and culminated in German economic, political and social union on 1 July 1990, and full-scale political unification on 3 October 1990, both of which were consolidated by the all-German election held on 2 December 1991. "Project Unity" had come full circle. Unification was achieved despite what seemed at the time to be insurmountable barriers.

The collapse of the GDR and its merger with the Federal Republic mean more than simply the addition of five new states and a unified Berlin to the West German federation. Unification has thrown open an array of questions, dealing both with the domestic and international implications. The questions address vastly different issue-areas, ranging from the political and economic spheres to security and socio-cultural issues. Needless to say, the framework of this paper does not allow for a discussion of all of those facets of the so-called German Question.

Most of the issues which have dominated the media coverage about Germany will not be addressed here. Nor will an attempt be made to re-create the process of unification which could, for example, be achieved by an analysis of the decisions that

progressively brought the two Germanys closer to a merger. The immediate effects of German unification, such as those reflected in the domestic debates currently going on in Germany, will also not become a focus.

While the parameters are set for unification, the practical completion of the merger is far from accomplished. It is a process that is in flux - every step along the way throws open new and unanticipated scenarios. Decisions are being formulated continuously, each coping with different sets of problems. It is not the intent of the author to give an account of those.

The main focus will be on East-West cooperation prior to unification. Specifically, two case studies in the area of economic cooperation will be conducted: one dealing with the development of inter-German trade, the other with the history of trade relations between the GDR and the European Community. An evaluation of the institutional set-up for the conduct of these two trade relationships will illustrate that they represent an atypical situation. Trade in these particular instances was not only highly regulated and controlled on the government level, but was also essentially "arms-length" in nature. The character of the trade was defined in terms of restricted merchandise exchanges under a system of bilateral clearing. These limited parameters had the result that other forms of economic interaction, such as those which are structurally more intensive, were not free to develop.

The evidence appears when trends in inter-German and GDR-EC trade are surveyed over lengthy periods of time. The volume and the commodity structure, if evaluated from an economic vantage point, indicate that factors other than those originating in the sphere of economics played a role in the evolution of the trade relationships. On the Western side, political considerations formed the primary motivation behind the engagement in trade with the GDR. Conversely, on the GDR side, while economic benefits were derived from inter-German and EC-GDR trade, political concerns placed restrictions on a further intensification of economic cooperation. Interestingly, the resulting asymmetry of perspectives did not adversely affect the negotiating positions of the involved actors. An evaluation of attempts on the part of West Germany to pursue linkage politics will support that conclusion.

Due to the fact that the trade relations under discussion represent a cross-over between the spheres of economics and politics, the analytical concepts chosen to accommodate a meaningful assessment were taken from the body of theoretical literature dealing with international relations. Specifically, certain concepts from the literature, focused on economic and political interdependence, were singled out. By applying concepts such as 'mutual adjustment', 'asymmetry', and 'spill-over' to the unique situations of inter-German and GDR-EC relations, it is hoped that the broader long-term implications of the nature of the relationships will be clarified. As a corollary, the applicability

of the interdependence approach will be tested in an as yet untested setting. The setting is new on two accounts. First, it is a situation where economic activity is highly regulated and government-controlled. Second, political and economic cooperation is taking place on the basis of cutting across two economically and politically different systems.

The analysis is intended to link the legacy of inter-German, and by extension GDR-EC relations to the much altered situation after German unification. The fundamental question to be addressed is whether the evolution of these relations can be viewed as an influencing factor in regard to German unification. In other words, it will be examined whether the hypothesis is correct, that the policy of rapprochement, as exercised by the government of the Federal Republic since at least the late 1960's, created an environment conducive to the goal of eventual re-unification, but would not have achieved the unification of the two Germanys on its own, in the absence of dramatic changes in the international order. A supplementary analysis relates to the approach taken by the European Community. In the context of its decision to accommodate German unification by absorbing the territories of the former GDR into the Common Market, it is important to assess whether the evolution of GDR-EC relations had an influence on that decision.

In short, the hypothesis is that economic cooperation between the two Germanys and the GDR and EC did not develop to such a

degree that it could have led to German unification without the development of major external political factors. In fact, the trade figures indicate that cooperation remained on a relatively superficial level. Due to the fact that trade with the GDR was influenced by political considerations, it did not develop the structural foundation necessary for an intensification of the economic links. Nor did the volume of trade presuppose an adjustment on either side. The difficulties currently encountered in the attempt to merge the two German economies illustrate that structural economic adjustment prior to unification was minimal.

That is not to say, however, that trade with East Germany had no consequence at all. Within its limited parameters, the trade developed a certain stability, as illustrated by the fact that external East-West crises did not adversely affect the trading relationship. However, the advantages of the trade were found overwhelmingly in the political area, especially from the point of view of the West. Trade with East Germany helped foster a process of political rapprochement, and in this indirect way, it contributed to keeping the goal of unification on the agenda and to maintaining a mind-set on the part of the population that would favour unification in the event that developments would allow for that option to become a reality.

CHAPTER 1. THEORETICAL APPROACHES

In order to determine to what degree inter-German relations and GDR-EC relations influenced unification and the subsequent integration of a unified Germany into the European Community, it is helpful to consider the applicability of theoretical concepts that have grown out of the study of international relations. However, within the context of a theoretical approach, it must be borne in mind that Germany represents a unique case. A number of theoretical concepts lose their relevance when applied to inter-German and German-European relations. For example, most of the traditional integration literature presupposes the emergence of a process of cooperation, be it in economic or political terms, between sovereign actors which have not previously been part of a greater unit. Germany was a unified country between 1871 and 1945. It was forcefully divided, and practically most previous intra-national contacts were cut off artificially. This is an atypical circumstance which requires an adaptation of the more standard ideas about integration.

1.1. CONCEPTS OF INTEGRATION VERSUS INTERDEPENDENCE

In general, the argument can be made that traditional integration literature has a limited applicability to the German situation. Too many of the premises are incongruent with the foundations for inter-German relations and GDR-EC relations, thereby rendering the integration paradigm impractical as an

analytical tool for the evaluation of different facets of these relationships.

Western economic integration literature has a built-in fundamental bias. It is largely based on the principles of the market. An almost exclusive emphasis on economic factors, and by extension on the profit motive, limits an understanding of forms of cooperation such as those addressed in this paper. The integration approach would not suffice, for example, to delineate the FRG's interests in fostering inter-German trade. The case of Germany, and for that matter East-West European integration in general, presupposes that political factors are taken into account as well. For instance, a brief consideration of the history of EC-CMEA relations illustrates that economic cooperation, as expressed in agreements such as the "Joint Declaration", signed in Luxembourg in June 1988, are actually political in nature. In this instance, the declaration, rather than representing an actual trade régime, was intended as a framework to set the stage for bilateral negotiations on trade and cooperation.¹

A similar conclusion can be drawn in the case of Germany. While a wide range of economic agreements have been signed, at least from the West German perspective, the motivation was most often political. Actual trade figures make that clear. Both

¹ Tomann, Horst. "EC Internal Market: An Opportunity for CMEA Countries?", Intereconomics, November/December 1989, p. 308

inter-German trade and trade between the GDR and the Common Market prior to German unification represented only a small fraction of overall trade involvement. Furthermore, economic integration literature presupposes that economic links are created beneath the state level, thereby leading to a loss of sovereignty on the part of the national governments. Again, in the case of Germany that does not hold true, simply because the respective German governments were the principal actors in setting the framework for trade and economic cooperation. This is particularly true in light of the fact that the GDR operated within the boundaries of a command economy in which, by definition, the state determined economic activity.

In general, integration literature falls short in addressing levels of interaction between states which adhere to different economic systems. Charles Pentland pointed out that "integration works best when dealing with types of states that have a developed liberal economy and a pluralistic society".² More recently, Bettina Hürni argued along similar lines when she concluded her study of East-West economic integration by saying that "integration theory and also practical experience prove that integration works best among homogeneous partners, with similar, and not complementary, foreign trade structures and with similar economies".³ Again, these

² Pentland, Charles. International Theory and European Integration, London, UK: Faber & Faber Ltd., 1973, p. 24

³ Hürni, Bettina. "European Integration: West and East", Intereconomics, July/August 1989, p. 174

statements call into question the relevance of integration paradigms as far as inter-German relations and GDR-EC trade are concerned.

1.2. KEY CONCLUSIONS OF INTERNATIONAL RELATIONS THEORY

Prior to determining to what degree certain other theoretical concepts of international relations are adequate for the analysis of factors having an impact on German unification, there is a need to define in more precise terms what these concepts are. Needless to say, the focus here will not be on how these concepts have evolved over time; that would be too ambitious a task. The focus will be placed on certain key conclusions which have been reached and an evaluation of their applicability in the issue-areas under discussion here.

The basis for all theories of international politics is the attempt to make sense of the complex nature of interactions between nation-states as well as between other international actors. Based on that, it is ultimately hoped that decisions affecting the future can be arrived at in a more rational and informed manner. At the core of this lies the assumption that understanding will lead to a reduction in conflict and, by extension, to greater stability and peace. Representing the philosophical heritage of liberalism, this assumption implies a reversal of the notion that politics are based on power in the form of military might and wealth exclusively. It presupposed that human nature is capable of changing, hopefully for

the better, and that factors other than power and wealth could have an impact. The complex nature of modern politics, domestic as well as international, required more diverse categories of analysis. While certainly not an irrelevant concept, the essence of power politics failed to account for many political developments that occurred in recent history. As one example, the increased importance of economic interaction and cooperation required refined tools for analysis. Both the integration and interdependence literatures represent an attempt to fill this analytical void. However, for reasons outlined above, the conclusion has been drawn that certain concepts derived from the interdependence rather than integration literature are more applicable in the context of the issues under discussion here.

1.3. DEFINITION OF TERMS

In the traditional usage, economic interdependence was defined as "the dollar value of economic transactions among regions or countries, either in absolute terms, or relative to their total transactions".⁴ However, this broad definition, supplied by Richard N. Cooper in 1972, was generally deemed inadequate for reaching conclusions after engaging in empirical case studies. Much debate has ensued since then. The debate reached a point when the lack of clarity about concepts such as "dependence", "interdependence" and "integration" became so encompassing that participants in the

⁴ Cooper, Richard N. "Economic Interdependence and Foreign Policy in the Seventies", World Politics, No. 24, January 1972, p. 159

debate referred back to the work of Adam Smith in their search for clarification. Writing in the 18th century, Smith had explained interdependence as "a likely consequence in the sense that exchange relationships involved benefits that satisfied mutual needs and which would therefore, by definition, be costly to forego".⁵ Kenneth Waltz, one of the influential scholars of international relations, has agreed with this formulation but applied it to a broader context, including political and strategic relations. Using the opportunity cost concept of economists, he espoused the view that "the cost of disengagement from a given relationship is a measure of interdependence".⁶ In contrast to this, both Joseph Nye and Robert Keohane have objected to defining interdependence in terms of mutual benefits. Applying the concept to the strategic relationship between the US and USSR during the 1970's, that is, observing an escalating nuclear arms race, they have contended that "an interdependent relationship may have such negative consequences that both parties would be quite happy to cease contact with one another entirely, foregoing any benefits that such contacts may bring".⁷ The point is that mutually unpleasant relationships, such as arms races, are maintained because the likely alternatives would

⁵ Quoted in David A. Baldwin, "Interdependence and Power: A Conceptual Analysis", International Organization, Vol. 34, No. 4, 1980, p. 478

⁶ Waltz, Kenneth. "The Myth of Interdependence" in The International Corporation, edited by Charles Kindleberger, Cambridge, MA: 1970

⁷ Keohane, Robert O. and Joseph S. Nye, Jr., "International Interdependence and Integration", in Handbook of Political Science, Vol. 8, 1975, p. 370

be more unpleasant. David Baldwin concurred when he wrote, "the benefits of interdependence should be defined in terms of the values of the parties and the likely effects on those values of breaking the relationship. If there is little or no effect, or if the parties would actually be better off, the relationship should not be described as interdependent. It is in this sense, and in this sense only, that interdependence involves mutual benefits".⁸

Kal Holsti has pointed out that one of the strong points of the analysis presented by Nye and Keohane in their ground-breaking work Power and Interdependence is that "it does not assume ... that disparities in economic capability or vulnerability necessarily lead to inequitable bargaining outcomes, much less to permanent hierarchy".⁹ He based his comment on what the two scholars had written earlier. They had suggested that

a parsimonious way to conceptualize diverse sources of power - and therefore to explain distributions of power resources among actors in world politics - is to regard power as deriving from patterns of asymmetrical interdependence between actors in the issue-areas in which they are involved with one another.¹⁰

⁸ Baldwin, David. "Power and Interdependence: A Conceptual Analysis", International Organization, Vol. 34, No. 4, 1980, p. 483

⁹ Holsti, Kal J. "A New International Politics? Diplomacy in Complex Interdependence", International Organization, No. 32, Spring 1978, p. 520

¹⁰ Keohane, Robert O. and Joseph S. Nye Jr., "World Politics and the International Economic System", in The Future of the International Economic System, edited by C. Fred Bergsten, Lexington, MA: Lexington Books, 1973, pp. 122-23

In light of this, the argument can be made that interdependence literature offers analytical concepts that can help in evaluating the degree of cooperation that existed between the two German states and between East Germany and the European Community prior to unification, that is, ever since the emergence of Willy Brandt's 'Ostpolitik'. Once the government of the Federal Republic abandoned its claim to an exclusive right to represent German interests, a policy which had made contacts with East Berlin impossible for fear that they might have served as a legitimization of the East German state, a certain level of inter-German and subsequently East German-European cooperation emerged. The links that evolved were both political and economic in nature. Both German states derived benefits from this newly defined relationship. However, the mutual benefits did not necessarily originate in the same spheres, nor were they symmetrical in scope.

In order to evaluate the relationships that emerged over the years, Nye and Keohane's approach to interdependence serves a useful function. They stated that

cooperation is viewed by policy-makers as a means to other objectives rather than an end in itself. Increased cooperation does not necessarily foster human values in world politics, but it does often help. It is important to define cooperation as mutual adjustment rather than simply as a situation in which common interests outweigh conflicting ones.¹¹

This assertion is based on two core assumptions. First, cooperation

¹¹ Keohane, Robert O. and Joseph S. Nye, Jr. Power and Interdependence: World Politics in Transition, Boston, MA: Little & Brown, 1977

is possible without overly limiting the autonomy of the involved actors (in this particular case the actors are states). Thus, cooperation does not render the instruments of domestic policy obsolete, as is often implied by theories of economic integration. The latter reflect a tendency to view cooperation as a process whereby increased integration automatically brings with it a decrease in sovereignty. Applied to the case studies of inter-German and GDR-EC relations, the former approach confirms the empirical data, while the latter approach would lead to misinterpretations.

Second, cooperation between political/economic units leads to a better mutual understanding in the long run and thus can help contain points of friction and conflict. That is not to say, however, that cooperation automatically resolves conflict. On the contrary, cooperation can, in effect, create points of contention that were not on the agenda prior to cooperation. The point is that a cooperative relationship can, over a period of time, make the involved actors experience the resolution of conflict situations, thereby reinforcing the view that mutual adjustment is beneficial. This so-called learning process (a concept that Nye has elaborated on in the context of the strategic relationship between the US and USSR)¹² can create positive feedback that leaves its mark on an otherwise difficult relationship.

¹² Nye, Joseph S.. Jr. "Nuclear Learning and US-Soviet Security Régimes", International Organization, Vol. 41, No. 3, Summer 1987

Again, in the cases of inter-German and GDR-EC relations, the argument can be made that the cooperative links between the involved units, over the decades, reinforced the commitment on both sides of the divide to improve their relations. That is not to say, however, that the development of the relations progressively improved without setbacks and misperceptions, especially in light of the fact that a number of external factors played an important role. Nevertheless, as the history of inter-German and GDR-EC relations will illustrate, the relations became more solid over time, to the point where ties between the two Germanys, for instance, flourished despite phases of rising political tensions in East-West relations.

The study of inter-German trade and GDR-EC trade as special cases of cooperation illustrates that separating the spheres of economics and politics is not possible. Almost by definition, the two are linked together. For example, on the side of the Federal Republic, interest in trade with the GDR was based almost exclusively on political motivations. The assumption was that an active trade relationship could counter-balance the policy of demarcation as practised by the GDR government, and thereby keep the German Question from being foreclosed. Ultimately, this assumption proved to have been correct. Despite some setbacks, interaction between the two states intensified, making the relationship more solid and comprehensive as time went by.

Again, this shows that a learning curve exists in international relations. Once régimes, in this case trading régimes, are established and turn out to be functional, they not only get reinforced over time, but they also open doors for negotiations in issue-areas which previously seemed too complex or too sensitive to be handled effectively. Drawing on the study of international régimes conducted by Robert Keohane, the argument can be made that the process of cooperation between the two Germanys, and to a lesser degree between East Germany and the Common Market, created patterns, which represented relationships of mutual benefit, thereby making the abandonment of such cooperation more costly as time went by. According to Keohane,

international cooperation is a process through which policies actually followed by governments come to be regarded by their partners as facilitating realization of their own objectives, as a result of policy coordination.¹³

Régimes are relatively efficient institutions, compared with the alternative of having a myriad of unrelated agreements, since their principles, rules, and institutions create linkages among issues that give actors incentives to reach mutually beneficial agreements. They thrive in situations where states have common as well as conflicting interests on multiple, over-lapping issues and where externalities are difficult but not impossible to deal with through bargaining. Where these conditions exist, international régimes can be of value to states.¹⁴

Inter-German relations, more than GDR-EC relations, benefitted from this process of cooperation. It created a situation where

¹³ Keohane, Robert O. After Hegemony - Cooperation and Discord in the World Political Economy. Princeton, MA: Princeton University Press, 1984, p. 63

¹⁴ *Ibid.*, p. 97

negotiations in one area helped to open negotiations in other areas, without implying direct linkage. Generally, linkage in the sphere of East-West relations did not have a high success rate. Countries of the East bloc, including the GDR, remained sensitive to Western attempts at linkage politics. In part, this can be explained in terms of power dynamics. There existed a perceived, and justified, fear on the part of East bloc governments that gaining economic advantages automatically implied being forced to pay a political price. Such compromises were difficult to justify in societies where régime legitimacy was weak to begin with. This applied particularly to the East European countries which, in contrast to the Soviet Union, were engaged in a continuous struggle to legitimize their system of government, since Communism had not come about in these countries by way of genuine revolution but was imposed on them by a hegemonic power.

In short, inter-German and, by extension, GDR-EC cooperation evolved on a more subtle basis. The notion that it was merely an attempt by Bonn or Brussels to gain leverage in respect to SED policies is misleading. Had that been the case, the interactive relationships would not have survived the various political crises that occurred and would have put the relationships to the test. Cooperation took on a dynamism of its own, despite external pressures, proving the validity of two points:

1. ...international régimes are easier to maintain than to construct. The principles, rules, institutions, and procedures of international régimes, and the informal patterns of interaction that develop in conjunction with them, become

useful to governments as arrangements permitting communication and therefore reducing transaction costs and facilitating the exchange of information.¹⁵ [In short], the high costs of régime-building help existing régimes to persist.¹⁶

2. Where issue density is low, ad hoc agreements may well be sufficient; but where it is high [as in the case of inter-German relations], régimes will reduce the costs of continually taking into account the effect of one set of agreements on others.¹⁷

Thus, when evaluating spill-over effects, the experience gained from cooperation in one area (economics) fostered a process of increased cooperation in other areas (politics), and vice versa. In this respect, the FRG-GDR relationship represented a unique case. Other cooperative East-West relationships seemed manageable only when narrow in focus, that is, when spill-over was at a minimum. A case in point is the amount of exposure to Western media enjoyed by East German citizens. If the exposure to the West attained by GDR citizens is measured in comparison to their East European or Soviet counterparts, it is clear that no other society within the East bloc had the same type of 'window to the West'. The impact of this should not be underestimated. The process may well have emphasized tensions that existed between the East German population and the government. The GDR citizens must have developed an understanding for the advantages as well as the problems faced by liberal Western democracies. Problems such as unemployment and

¹⁵ Keohane, Robert O., op cit., p. 102 (Similar concepts are put forth by Stephen Krasner and Kenneth Oye.)

¹⁶ Ibid., p. 103

¹⁷ Ibid., p. 79

inflation, which did not officially exist in any socialist society, in turn may have helped destroy, at least to some extent, the myths about the West that seemed so powerful in deceiving people by making them believe that market economies are only one short step away from paradise itself. Despite this, however, for many East Germans, the yardstick for progress remained the other Germany rather than the other socialist states.¹⁸

1.4. APPLICABILITY OF INTERDEPENDENCE CONCEPTS

In short, the reasons why certain aspects of the interdependence literature are applicable to the case study of Germany are manifold: First, while being intellectually rigorous, the concepts used to gage the impact of interdependence in international relations leave sufficient freedom to explore different issue-areas. Within the framework of this paper, they allow for the distinction between economic and political links and the impact they had upon each other. One aspect which is important to the discussion of inter-German relations, for example, is the effect of political rapprochement on the evolution of economic ties, and vice versa. It needs to be established whether there has been a certain amount of spill-over from one sphere to the other, and whether a trend line can indeed be detected.

Second, the concepts behind interdependence have a wider

¹⁸ Hamilton, Daniel. "Dateline East Germany: The Wall Behind the Wall", Foreign Policy, Fall 1989, p. 183

application in the sense of providing a framework for an analysis of relations between two politically and economically very different systems. This creates the possibility not only of defining the barriers that are set by the systems but also of determining whether cooperative links have had an impact on the systems themselves.

At this point, the assumption can be made that such a reciprocal dynamism exists, but it is necessary to delineate exactly what the influences are and what they imply. Ultimately, and by way of drawing conclusions from the foregoing, the question to be addressed is whether or not the development over the decades of inter-German and GDR-EC trade relations has in any way contributed to German unification, either the decision in favour of unification itself or the method and pace of the process once the political decision was made.

CHAPTER 2. CASE STUDY: INTER-GERMAN TRADE

2.1. COMPARISON BETWEEN THE FEDERAL REPUBLIC OF GERMANY AND THE GERMAN DEMOCRATIC REPUBLIC

The overt differences between the two German states were substantial. While the Federal Republic was comprised of a geographic area measuring 249,000 square kilometres, the GDR covered less than half of that with its 108,000 square kilometres. In terms of population, a different ratio applied. While West Germany counted roughly 60 million inhabitants, there were approximately 16 million GDR citizens, just over a quarter in comparison.¹⁹ While these factors alone would have manifested themselves in different levels of economic performance, the contrasts between the two German states were reinforced by the differences in their respective political and economic systems. Politically, the FRG emerged as a parliamentary democracy with a federal structure, while the GDR went the socialist route, implying a centralized state with a high degree of power vested in the party, in this case the Socialist Unity Party (SED). Economically, their systems were based on different premises as far as the questions of ownership and the degree of state participation and control were concerned. The Federal Republic instituted the so-

¹⁹ The population figures for 1988 were 61.4 million FRG citizens in comparison to 16.7 GDR citizens. From: "Federal Republic of Germany and German Democratic Republic: Comparison of Selected Economic and Social Indicators in 1988", in German Unification - Economic Issues, Occasional Paper No. 75, edited by L. Lipschitz et al., Washington, DC: International Monetary Fund, December 1990, p. XV (see TABLE I)

called social market economy, which is fundamentally based on private ownership and competition between the means of production. In contrast, the GDR adhered to principles of Marxism-Leninism by creating a centralized and planned command economy.

During the initial phase after the war, even in the Western zones, there existed a lobby in favour of the establishment of a planned economy with substantial state participation. This view was supported by members of both the Socialist and Christian Democratic parties. They particularly favoured the idea of nationalizing heavy industry and segments of the financial and credit mechanisms. At that time, the strongest voice against such developments came from the parties of liberal colour; they argued that private ownership and enterprise form the core of a healthy economy. Ultimately, the latter option prevailed, not least of all because it was favoured by the Western allies and by the Americans in particular. An important step in this direction was the creation of the so-called Bizonal Economic Council in 1947 and the appointment of Ludwig Erhard as its director. A proponent of the social market economy, Erhard represented a school of thought which regarded the economic and social order as based on freedom, but which simultaneously emphasized the role to be played by the state. The state was regarded as an instrument that "should legislate to secure the highest degree of economic freedom equiparate with the highest level of social justice. The state was to be the arbiter and to rectify imbalances and injustices that the free market forces were

unable to influence or encompass".²⁰ In short, the freedom to engage in economic activity in pursuit of profit was to be balanced by state legislation in protection of the economic and socially weak. Competition was to be orderly guided, with strict regulation of cartels and monopolies. At the same time, continual economic growth and full employment were regarded as vital goals, while freedom to engage in foreign trade and free currency convertibility were to be guaranteed. Coupled with external factors, the relative economic success enjoyed in the Western zone in the period from 1948 to 1952 had the effect of gathering more support for Erhard's policies.²¹

A different pattern emerged in the GDR. The economic conditions in that part were particularly unfavourable for a speedy recovery from the destruction caused by World War II. The Eastern area had developed very close economic links with the Western part prior to the war because, though near to sufficient in agricultural and food production, it did not contain a large industrial base and was therefore dependent on support from the rest of Germany in that regard. Viewed in conjunction with the general lack of natural resources, it becomes obvious that the division of Germany had a traumatic effect on the Eastern economy. The loss of previous economic links forced the GDR government to engage in the costly

²⁰ Mellor, Roy E.H. The Two Germanies - A Modern Geography, London, UK: Harper & Row Publishers, 1978, p. 177

²¹ Ibid., pp. 169-182

process of establishing an industrial base. Although the Eastern portion of Germany emerged from the war less physically destroyed than its counter-part, the remaining capacity was greatly diminished by demands for reparations and repeated Soviet attempts at dismantling the economy. It is estimated that the Soviets reduced East German capacity in the chemical and metal processing industries by about two thirds.²² This, together with a complete turn around in trade relations, that is, the re-orientation from the West towards the East, left the GDR in a difficult economic situation.

Once the East German state was established, the adoption of socialism implied radical change in the ownership of the means of production and property. In addition, the economy was to be guided by a central authority. The premise for economic development was the rational use of resources and labour, with the long-term aim of achieving full employment and, by extension, of eliminating the unpredictable nature of business cycles. The initial phase after the war was characterized by the nationalization of both land and industrial capacity. State participation also grew in regard to private enterprises, ultimately leading to the virtual elimination of the private sector. The so-called State Planning Commission was established. Although its responsibilities were changed and re-defined over time, it nevertheless retained full responsibility for

²² Dietz, Raimund. Die Wirtschaft der DDR (1950-1974), Vienna: Wiener Institut für Internationale Wirtschaftsvergleiche, Forschungsbericht Nr. 37, October 1976, pp. 5-6

planning economic development in association with the several industrial and other economic ministries. The Commission's task was to coordinate plans, both medium and long-term in scope, designed to meet objectives as decided upon by the People's Chamber [Volkskammer]. The latter implied a great deal of political control over economic decisions, be it in the area of industrial policy, inter-CMEA relations or inter-German trade. Whereas in the Federal Republic, or in any other liberal Western economy, the market forces of supply and demand are the primary determinants for the regulation of production and trade, in East Germany planners set these in advance. Fulfilment of the plan, rather than the profit motive, emerged as the dominant driving force behind the economy.²³

TABLE I. FRG AND GDR: COMPARISON OF SELECTED ECONOMIC AND SOCIAL INDICATORS IN 1988

	FRG	GDR
Area and population		
Area (1,000 sq.km.)	249	108
Population (millions)	61.4	16.7
(In percent of population)		
Of working age	67.0	65.0
Pensioners	18.5	16.0
Employment		
Total employed (millions)	27.4	9.0
(In percent of population)	44.5	53.9
Female employment (in percent of total employment)	38.1	48.6
Employment by sector (in percent of total)		
Agriculture and Forestry	4.0	10.8
Mining, Manufacturing, Construction	39.8	47.1
Other Sectors	56.2	42.1

²³ Ibid., pp. 169-182. Also: East Germany - A Country Study, Area Handbook Series, 1989 Edition

	FRG	GDR
Household Income, Consumption, and Saving		
Average monthly gross earnings (DM/M)	3,850	1,270
Household saving (in percent of disposable income)	12.8	7.1
Households with: (in percent of total)		
Automobiles	97	52
Colour television	94	52
Telephone	98	7
Production, Investment, Prices (Annual real growth rate, 1980-88)		
GNP/NMP	1.7	4.2
Gross fixed investment	0.7	2.0
Of which: Machinery and Equipment	2.4	5.0
Consumer prices (annual percent rate of change, 1980-88)	2.9	-
External Trade in Goods (In percent of total exports)		
Exports to state-trading countries	4.4	69.5
Imports from state-trading countries	4.7	68.7
Trade balance (In percent of GNP/NMP)	6.0	1.0
Of which: State-trading countries	0.2	1.0
Monetary Accounts of Households		
Household financial assets (billions DM/M)	1,196.6	167.2
Velocity of money		1.11
0.97 ²⁴		

In terms of quantifiable indicators, over the decades it became clear that a remarkable gap was developing between the two societies. Figures generated prior to unification indicate that on the average, employment in the East was higher than in the West:

²⁴ Lipschitz, L. et al. German Unification - Economic Issues, IMP Occasional Paper No. 75, Washington, DC: International Monetary Fund, December 1990, p. 50

44.5 percent of the population in the FRG versus 53.9 in the GDR. The difference was due mostly to higher female employment in the GDR economy (48.6 percent versus 38.1 percent) and a slightly younger overall make-up of the population. Economic growth rates differed; so did engagement in trade.²⁵ The most visible result of these differences was an uneven balance between the respective standards of living. While this can be illustrated in different ways, for instance, in terms of income, household savings and consumption, as Table I shows, every person who ever crossed the border from one German state to the other recognized the gap immediately.

2.2. DOES THE "SPECIAL CASE" ARGUMENT APPLY TO GERMANY?

Although integrated into separate supranational economic organizations which, parallel to their political/military counterparts, represented the division of the world into opposed ideological camps, contact between the two Germanys never broke off entirely. The contacts varied in degree and intensity over time; they cut across different spheres, manifesting themselves in the diplomatic, political or economic spheres. They never diminished to a point where no inter-German relationship existed.

From the outset, inter-German relations were viewed as representing a "special" type of relationship. Although the division of Europe was formalized by the creation of separate

²⁵ See TABLE I.

political entities, the FRG and the GDR, inter-German relations were treated separately from other inter-state relations.

However, at a symposium held in 1975, Rudolf Bernhardt put forth the unique argument that apart from external factors, he could not concede to view inter-German relations as different from other inter-state relations. He pointed out that states are sovereign and independent actors on the international stage and therefore at liberty to pursue and define their relationships with other states. As long as there is no clash with international rules of conduct, the system allows for a wide variety of inter-state relations, ranging from very close links to practical non-recognition.²⁶ According to Bernhardt, inter-German relations represented typical inter-state relations, merely characterized by a relatively greater amount of intensity. He termed the factors which contradicted this scheme external; for example, this was so in reference to limits placed on German sovereignty as a result of the remaining four-power responsibilities in Germany and Berlin.

The discussion below will illustrate that Bernhardt's argument was not congruent with reality. Inter-German trade did represent a special case. Atypical of an economic relationship, it was to a large degree politically motivated. In addition, it took place in

²⁶ Bernhardt, Rudolf. "Besondere innerdeutsche Beziehungen - Leerformel oder Realität?", in Finis Germaniae: Zur Lage Deutschlands nach den Ostverträgen und Helsinki - Symposium vom 11.-13. Dezember 1975, edited by I. Münch et al., Frankfurt: Metzner Verlag, 1977, pp. 85-87

a highly controlled environment, with the power of decision-making vested in a small number of involved actors, implying that economic forces were not developing according to their natural course.

2.3. INTER-GERMAN TRADE AS A LINK BETWEEN THE SPHERES OF ECONOMICS AND POLITICS

The history of inter-German trade relations will be examined in light of the foregoing comments. Jerzy Skibinski, in an article written in 1973, argued that many factors in the economic relations between the GDR and the FRG indicated a close connection between politics and economics.²⁷ He went so far as to state that

practice has shown that improvements in East-West economic cooperation depended on improvements in the political climate. The primacy of politics over economics - the reverse of the normal relationship between these two factors in the process of social development - has been apparent particularly clearly in relations between the two German states. Economic relations between them have always reflected the political climate and have been used to achieve definite political goals.²⁸

Skibinski's argument retains some validity. Certainly it would be inappropriate to divorce altogether the spheres of politics and economics. His conclusions hold true especially within the overall framework of East-West relations. However, in light of the developments in inter-German trade, it can be seen that fluctuations in trade between the two states could not be directly

²⁷ Skibinski, Jerzy. "Evolution of trade relations between the GDR and Federal Germany (1949-1972)", Polish Western Affairs, Vol. 14, No. 2, 1973, pp. 175-99

²⁸ Ibid., p. 175

linked to the political climate governing relations between them.²⁹

Or, as Jürgen Nitz put it,

favourable political relations will not automatically and directly lead to better economic relations, and an aggravation of the world's political situation will not necessarily have an adverse impact upon economic relations between the two German states... Politics and economics are thus relatively independent of each other.³⁰

Economic cooperation outside the sphere of trade was practically non-existent. In other words, trade represented the core of economic activity between the two Germanys. The argument will be pursued that, although trade represented a special case, it remains legitimate to assess its contents and implications by using concepts derived from traditional international relations analysis. Ultimately, the question to be answered is whether trade in the long run created spill-over effects into other areas of inter-German relations. By extension, there is a need to evaluate whether the development of inter-German cooperation created a basis for greater structural adjustments, that is, reform of the production process to accommodate inter-German trade. If that were the case, and depending on the degree of accommodation, this in turn could have influenced the goal of unification, and, in light of recent developments, perhaps even have created a starting point for post-unification integration.

²⁹ Frey, Eric G. Division and Détente - The Germanies and their Alliances, New York, NY: Praeger Publishers, 1987, p. 36

³⁰ Nitz, Jürgen. "GDR-FRG Economic Relations", in The Two German States and European Security, edited by F. Stephen Larrabee, London, UK: Macmillan Press and the Institute for East-West Security Studies, 1989, pp. 295-96

2.4. GERMAN DEFINITIONS:

INTER-GERMAN TRADE AS EXTERNAL OR INTERNAL TRADE

Ever since their foundation, trade between the two German states developed on the border-line between external and internal trade. Just after World War II, the Federal Republic termed it inter-zonal trade [Interzonenhandel], thereby emphasizing the existence of the Soviet zone of occupation. The term also reflected the FRG's initial unwillingness to accept the GDR as a separate German state. The term continued to be in use until the end of the 1960's when Willy Brandt's new Ostpolitik found expression in the acceptance of the GDR as a sovereign state. In the GDR, on the other hand, trade between the two Germanys was called inner-German trade [innerdeutscher Handel] or inter-German trade [interdeutscher Handel].³¹ By the time the Federal Republic adopted this expression, the GDR had already taken up a new position in this area, referring to "foreign trade with the Federal Republic of Germany and separate foreign trade with West Berlin".

This could be brushed aside as a simple matter of semantics, but in fact, the way in which both the FRG and GDR used a certain terminology to describe their trade relations with the respective German counterpart had great implications as to how this trade was conducted. As will be seen later, resulting from the different ways in which inter-German trade was defined, a trade relationship with unique features emerged. The fundamentally different political

³¹ Skibinski, J., op cit., p. 176

positions and legal interpretations assigned by the two German states to their mutual economic relations can be expressed in the following manner: while the GDR regarded trade with the FRG as foreign trade and, in addition, reported its economic relations with West Berlin separately, West Germany took a different stand. For the FRG, it remained inter-German trade and not foreign trade. Like the GDR, the FRG also differentiated between trade with the GDR, that is, the former Soviet zone of occupation, and the Eastern part of the city of Berlin, which from the Western point of view was not viewed as a part of either the Soviet zone or the GDR.

From the West German perspective, for political and constitutional reasons this trade did not fall under the regulations of its 1961 foreign trade law [Aussenwirtschaftsgesetz], and therefore was not listed under 'foreign trade' in its statistical publications, but rather under 'domestic trade'. The West German authorities were concerned to keep the special status of German-German trade to a point where they forbade international organizations to create statistics that would amalgamate the figures for trade turnover for both Germanys.³² Inter-German trade was governed by special rules and was regarded as unique. This was expressed clearly in the decision by the West German Federal Constitutional Court of July 31, 1973, with regard to the Basic Treaty:

³² Kaser, Michael. "The Economic Dimension", in Germany between East and West, edited by Edwina Moreton, Cambridge, UK: Royal Institute for International Affairs, 1987, p. 126

The GDR is part of Germany and cannot be regarded as a foreign country in its relationship to the Federal Republic of Germany. Therefore, for example, the former inter-zonal trade and the current inner-German trade which corresponds to it did not, and do not, constitute foreign trade.³³

Based on this, not the ministry responsible for foreign trade, but a special board for inter-zone trade supervised inter-German trade since 1949. Called 'Treuhandstelle für Interzonenhandel', the board was set up to maintain contacts and conclude agreements with the GDR authorities and give the appearance that trade relations with the GDR were not of official character. The board originally had its headquarters in Frankfurt but moved to West Berlin in 1950. It did not have governmental powers and was controlled by the Federal Ministry of Finance and Economics. Within that ministry it was subordinated not to the Foreign Trade Department but to the Department for Industrial Economy.³⁴ In contrast to trade with other East bloc countries, which is considered automatically legal if not explicitly prohibited, every individual business transaction with the GDR required the approval of this board, thus providing the West German government with an extraordinary amount of control over trade relations with East Germany.³⁵

In the GDR, a similar approach was practised. The Ministry

³³ Leptin, Gert. "Economic Relations between the two German States", in The Two German States and European Security, edited by F. Stephen Larrabee, London, UK: Macmillan Press and the Institute for East-West Security Studies, 1989, p. 271

³⁴ Skibinski, J., op cit., p. 176

³⁵ Frey, Eric G., op cit., p. 30

responsible for the conduct of Foreign Trade had a decision-making monopoly on issues related to inter-German trade.³⁶ In contrast to the West German parallel, however, for the GDR government, this type of approach was not atypical. In line with a highly centralized economic process, foreign trade decisions were made on an individual basis by the appropriate authorities.

2.5. INTER-GERMAN TRADE: INSTITUTIONAL FRAMEWORK

(a) THE POTSDAM AGREEMENT

While the wartime allies were pre-occupied with consolidating the post-war order of Europe and the division of Germany, inter-zonal trade never came to a complete standstill. During the very initial phase after the war, this was in line with an allied decision taken during the Potsdam negotiations of July 1945. It stipulated that the zones of occupation were to constitute a single economic area. The reasoning for this was based on the fact that traditional interdependence of the several zones implied that the exchange of goods between them could not be cut off arbitrarily and was necessary for reconstruction.³⁷ However, union in the economic sphere, it was soon realized, was an unrealistic requirement in the context of on-going political developments.³⁸ The exchange of goods could not be conducted without the continuous approval from the

³⁶ Leptin, Gert, op cit., p. 272

³⁷ Stahnke, Arthur A. The Economic Dimensions and Political Context of FRG-GDR Trade, East European Economic Assessment Series, Washington, DC: US Congress Joint Economic Committee, 1981, p. 357

³⁸ Ibid., p. 358

appropriate occupation authorities, a rule which in effect represented a move in the direction of laying the foundation for a very controlled trade environment. In regard to the earlier discussion on varying definitions, the Potsdam Agreement had the effect of exempting inter-German trade from the framework of typical foreign trade relations.

(b) THE FRANKFURT AGREEMENT

During this early phase, despite allied imposed rules, trade retained an informal character, particularly in Berlin where the exchange of goods could hardly be controlled according to zonal barriers and was often conducted in a semi-clandestine fashion. It is difficult to assess the volume of exchange during this period, not least of all because the German economy was generally in a state of chaos following the destruction of the war. In addition, no comprehensive framework for the conduct of economic links existed. The latter situation was altered by the signing of the Frankfurt Agreement in October 1949. Although limited in scope, the agreement provided for a commodity exchange worth up to 300 million marks on either side.³⁹ Under the agreement, West Berlin was to gain a larger share in trade with the GDR, amounting to one-third of West German deliveries to the GDR. Furthermore, it introduced for the first time a classification of goods into Group A, embracing quota commodities subject to restrictions, and Group B, comprising goods free of the quota system. The first group included

³⁹ Skibinski, J., op cit., p. 179

rolled and cast products, pig iron, steel and scrap iron on the Western side, and rye, wheat, potatoes and sugar on the Eastern side. The quotas were broken down as follows: 150,000 tons of rolled products, 25,000 tons of cast products, and 50,000 tons of scrap iron on the side of the West; in comparison to 40,000 tons of rye, 40,000 tons of wheat, 40,000 tons of sugar, and 100,000 tons of potatoes on the other side.⁴⁰ The value of deliveries in Group A was not allowed to exceed 15 million VE (settlement units). Should one side not abide by these regulations, the other side was justified in halting its deliveries.

Important in the context of later developments in inter-German trade, the agreement established the procedures for making payments and maintaining accounts by creating a system whereby each partner to a transaction would make or receive payment to or from the bank of its own currency area, the Deutsche Bundesbank or the State Bank respectively. This system of indirect payments or bilateral 'clearing arrangement' was a unique feature of trade between the FRG and state-trading countries. It implied that temporary imbalances in accounts would occur. They were to be adjusted by the so-called 'Swing Credit', to be addressed in greater detail below. The problem of currency unevenness and setting an appropriate exchange rate was solved by the introduction of a settlement unit [VE = Verrechnungseinheit] which created a ratio of 1:1 for the

⁴⁰ The break-down of Group A commodities appears in Archiv der Gegenwart, 1948/49, p. 2094; cited by J. Skibinski, op cit., p. 179

respective German currencies in the area of trade.⁴¹ Prior to the conclusion of the Frankfurt Agreement, the relation between the two currencies had been 1:4 or 1:5 in favour of the Western mark. The argument was made, however, that despite the shift in ratio, the introduction of the settlement unit did not establish a parity relationship between the D-mark West and the D-mark East.⁴² Rather than reflecting the relative purchasing power of the two currencies, the rate reflected the supply-demand situation of the GDR currency. In 1950, the Frankfurt Agreement received a further supplement which provided for East German deliveries of 699,000 tons of lignite briquettes to the FRG and West Berlin, in return for 50,000 tons of gas coal and 76,000 tons of metallurgical coke from West Germany.⁴³ In short, the Frankfurt Agreement set the stage for further negotiations on issues surrounding inter-German trade. In its basic form, it already contained many of the elements that were to regulate inter-German trade links.

(c) THE BERLIN AGREEMENT

The next major step occurred in 1951, when inter-German trade was formalized through a more comprehensive trade agreement, the so-called Berlin Agreement. All status problems, including the status of West Berlin, were circumvented by the definition of the

⁴¹ Stahnke, Arthur A., op cit., p. 360

⁴² Cornelsen, Doris et al. Handbook of the Economy of the German Democratic Republic, Westmead, UK: Saxon House, 1979, p. 249

⁴³ Skibinski, J., op cit., p. 176

document as the Berlin Agreement on the Regulation of Goods Traffic between the Currency Areas DM-West and Currency Areas DM-East. This meant that each German government signed for their respective currency regions, thereby avoiding the politically difficult task of addressing the Berlin question. The agreement was concluded for an indefinite period and could be terminated at the end of each year, subject to 3-months prior notification.⁴⁴ The agreement covered the exchange of goods and services, and methods of payments. It was administered on the side of the FRG by the Trustee Board for Inter-zone Trade and the Ministry for Foreign Trade on the side of the GDR. In the eyes of Eric Frey, the Berlin Agreement managed "to allow trade relations to flourish independently of political fluctuations and status conflicts".⁴⁵

The agreement preserved the classification of goods into two groups: Group I, consisting of so-called 'hard' (ie., strategic) goods subject to strict quotas, and Group II, consisting of 'soft' goods excluded from the quota system.⁴⁶ The first category included wood products, lignite, diesel fuel, iron, steel, products of the machine, transport, steel, iron and shipbuilding industries, as well as electronic and office equipment on the side of the GDR; and on the side of the FRG, it included products of the iron industries, rolled steel, rolling mills, equipment for a number of

⁴⁴ Cornelsen, Doris et al., op cit., p. 249

⁴⁵ Frey, Eric G., op cit., p. 30

⁴⁶ Skibinski, J., op cit., p. 182

different industrial plant processes, mining equipment, metals, products of the machine, transport, steel, iron and shipbuilding industries, as well as electronic and office equipment.⁴⁷ Moreover, the agreement introduced a system of four settlement accounts which actually proved very cumbersome in practice and that system was subsequently modified. Only Account I for quota goods and Account II for non-restricted products were preserved.⁴⁸ Building on the Frankfurt Agreement, the Berlin Agreement retained and expanded on the clause dealing with payments. To quote from the Handbook of the Economy of the German Democratic Republic:

Payments are effected exclusively by way of clearing between the two note-issuing banks. Debtors settle their obligations, and creditors receive payments through banks authorized to handle this trade in the territory of the respective state. The claims of the supplying firms are settled by the payments received from the purchasers.⁴⁹

In order to make the clearing arrangement work, a provision had to be set up to allow for temporary imbalances:

To avoid stoppages of the flow of goods in both directions as a result of time lags in settling claims, the two sides are permitted to overdraw their clearing accounts up to a certain limit, the swing.⁵⁰

The use of an interest-free overdraft facility in the context of bilateral trade relations is not untypical. According to John

⁴⁷ Bröll, Werner. Die Wirtschaft der DDR - Lage und Aussichten, München: Günther Olzog Verlag, 1970, p. 120

⁴⁸ Skibinski, J., op cit., p. 184

⁴⁹ Cornelsen, Doris et al., op cit., p. 250

⁵⁰ Ibid., p. 250

Garland, "it is customary in any bilateral exchange that the banks of the participating countries extend technical credits to guarantee the reciprocal flow of payments despite inevitable temporary imbalances in trade accounts".⁵¹ However, in the case of the German-German trade relationship, the use of the swing credit was almost exclusively one-sided and turned into a system of continuous interest-free credits for the GDR.

Another aspect formulated by the agreement concerned the issue of decision-making control. The agreement stipulated that from the FRG's perspective, trade with the GDR was subject to special licensing, tendering and other restrictive procedures. Thus, in essence all trade with the GDR was treated as prohibited unless explicitly approved (contrary to more regular trade practices). In practice, some commodities received general approval, some ad hoc approval on a case-by-case basis, and others were subject to a strict quota system.⁵²

In short, by the time the Berlin Agreement was ratified, inter-German trade had received an institutional umbrella under which it was to operate. Emphasis should be placed on the fact that the agreement indicated that trade between the two separate parts of a once unified country was not anticipated to come to a

⁵¹ Garland, John. "FRG-GDR Relations", in East European Economies: Slow Growth in the 1980's, Volume 3, Washington, DC: US Congress Joint Economic Committee, 1986, p. 173

⁵² Ibid., p. 173

standstill. More importantly, however, the agreement laid the foundation for a highly controlled trade environment with the respective government institutions having more input than would be the case under more typical circumstances. In regard to the evolution of an interdependent relationship, this had the effect of limiting decision-making processes to a small number of actors, while at the same time limiting the influence of international economic market forces. The process made the concept of selective engagement possible, whereby each government followed its own policies, often directed at influencing the other side.⁵³

2.6. INTER-GERMAN TRADE: TRENDS AND VOLUME

Over the long-term, inter-German trade showed increased growth, though this development was not characterized by an even upward curve. High average annual rates of growth for 1956-1960 (12.7 percent for FRG exports and 14.3 percent for those of the GDR) were followed by a much more modest increase for the period 1961-1965 (FRG exports - 5.6 percent; GDR exports - 3.2 percent). For the period between the late 1960's and early 1970's, when the FRG's 'Ostpolitik' resulted in trade restrictions being replaced by trade supporting policies, annual growth rates jumped to an annual average of 17.5 percent (FRG exports) and 10.0 percent (GDR exports).⁵⁴ During the last two decades, as Table II indicates,

⁵³ Dean, Jonathan. "Directions in inner-German Relations", *Orbis*, Vol. 29, No. 3, Fall 1985, p. 623

⁵⁴ Stahnke, Arthur A., op cit., p. 347

substantial real growth occurred mainly in 1972, 1976, 1980, 1982, and 1983.

In contrast to the 1980's, however, much of the growth during the 1970's was price-determined rather than real. Price movements during the 1970's favoured the GDR whose terms of trade improved significantly based on its exports of petroleum and chemical products to West Germany.⁵⁵ Price increases, especially in the oil sector in the wake of the 1973 oil crisis, amounted to an important factor in temporarily changing the bilateral trade balance between the FRG and GDR. At that time, the GDR engaged in re-exporting oil acquired from the Soviet Union at below world market prices. In addition, the growth in the 1970's decade was also influenced by the GDR's policy of diversification, that is, the attempt to decrease East German dependence on the FRG as a trading partner by way of increased integration into the world economy. Once hard-currency problems manifested themselves in the late 1970's and especially the early 1980's, a renewed increase in inter-German trade could be registered.

⁵⁵ Garland, John, op cit., p. 175

TABLE II - FRG-GDR TRADE, 1950-1982 (GOODS AND SERVICES)
[in million VE]

	FRG Exports	GDR Exports	Turnover
1950 -----	359.0	450.8	809.8
1951 -----	155.0	158.2	313.2
1952 -----	153.5	119.0	272.5
1953 -----	261.4	294.7	556.1
1954 -----	450.4	434.4	884.8
1955 -----	576.4	583.5	1,159.9
1956 -----	671.5	656.7	1,328.2
1957 -----	838.3	844.7	1,683.0
1958 -----	872.8	879.8	1,752.6
1959 -----	1,062.6	935.4	1,998.0
1960 -----	1,030.3	1,007.3	2,037.6
1961 -----	911.0	917.3	1,828.3
1962 -----	901.6	898.8	1,800.4
1963 -----	907.2	1,028.7	1,935.9
1964 -----	1,192.8	1,111.9	2,304.7
1965 -----	1,224.9	1,249.0	2,473.9
1966 -----	1,680.9	1,323.7	3,004.6
1967 -----	1,490.7	1,254.7	2,745.4
1968 -----	1,458.5	1,450.5	2,909.0
1969 -----	2,077.8	1,656.1	3,733.9
1970 -----	2,438.9	2,064.2	4,548.1
1971 -----	2,652.3	2,581.5	5,233.8
1972 -----	2,959.8	2,394.8	5,354.6
1973 -----	2,938.2	2,688.1	5,626.3
1974 -----	3,662.0	3,256.2	6,918.2
1975 -----	4,028.2	3,390.9	7,419.1
1976 -----	4,469.9	3,938.4	8,408.3
1977 -----	4,662.7	4,070.8	8,733.5
1978 -----	4,754.4	4,066.4	8,820.8
1979 -----	5,092.8	4,791.8	9,884.6
1980 -----	5,874.8	5,854.9	11,729.7
1981 -----	6,128.8	6,349.5	12,478.3
1982 -----	7,079.8	6,988.2	14,068.0 ⁵⁶

⁵⁶ Ibid., pp. 175-76

TABLE III - INTER-GERMAN TRADE SINCE 1980
[in million DM]

	GOODS			SERVICES		
	FRG Orders	FRG Deliveries	Turnover	FRG Orders	FRG Deliveries	Turnover
1980	5,580	5,293	10,873	438	932	1,370
1981	6,051	5,575	11,626	486	1,038	1,524
1982	6,639	6,382	13,022	536	1,138	1,674
1983	6,878	6,947	13,825	867	1,209	2,076
1984	7,744	6,408	14,152	752	1,300	2,052
1985	7,636	7,901	15,537	822	1,273	2,095
1986	6,844	7,454	14,298	860	1,197	2,057
1987	6,647	7,367	14,014	826	1,114	1,940
1988	6,789	7,234	14,023	974	1,060	2,034
1989	7,205	8,104	15,309	1,044	1,117	2,161 ⁵⁷

TABLE IV - INTER-GERMAN TRADE SINCE 1980
[in percent]

	NOMINAL			REAL		
	FRG Orders	FRG Deliveries	Turnover	FRG Orders	FRG Deliveries	Turnover
1980	21.6	12.2	16.8	5.6	2.8	4.0
1981	8.4	5.3	6.9	-1.4	-2.6	-2.1
1982	9.7	14.5	12.0	10.3	12.3	11.4
1983	3.6	8.8	6.2	6.0	7.7	7.0
1984	12.6	-7.8	2.4	7.3	-11.6	-3.6
1985	-1.4	23.3	9.8	-2.9	25.8	12.2
1986	-10.4	-5.7	-8.0	3.7	4.9	4.4
1987	-2.9	-1.2	-2.0	3.8	3.6	3.7
1988	2.1	-1.8	0.1	1.4	-3.9	-1.8
1989	6.1	12.0	9.2	-0.4	2.6	1.3 ⁵⁸

⁵⁷ Deutsches Institut für Wirtschaftsforschung. "Inner-deutscher Handel im Übergang", Wochenbericht 25/1990, p. 328

⁵⁸ Ibid., p. 328

The weekly reports published by the German Institute for Economic Research in Berlin (DIW), covering the period from 1980 until unification, illustrate that the decade was marked by two major trends: increased inter-German trade at the beginning of the 1980's, and a substantial turn-around of that trend after mid-decade. In 1980, the volume of inter-German trade amounted to DM 10.9 billion which represented an overall increase of 17 percent.⁵⁹ Inter-German trade received a boost mainly due to increased GDR exports rather than FRG exports. At the time, the GDR government was determined to prevent deficits in its trade relationship with the FRG. With the intention of making efficient use of the swing credit arrangement and assisted by major government-backed loans from the FRG, it initially appeared that the GDR might achieve its goal. Despite predictions that the unfavourable international political climate would negatively influence inter-German trade, the upward trend did not come to a halt immediately after 1980. In fact, in 1982 another relative peak, though less significant than the one in 1980, was registered in inter-German trade, especially from the point of view of the GDR because it managed to stabilize its trade balance with the FRG.^{60 61}

⁵⁹ Deutsches Institut für Wirtschaftsforschung. "Innerdeutscher Handel: Eingengter Expansionsspielraum", Wochenbericht 12/1981, p. 137

⁶⁰ Deutsches Institut für Wirtschaftsforschung. "Innerdeutscher Handel ohne Dynamik", Wochenbericht 22/1982, p. 283-92

The year 1982 saw an increase in inter-German trade of 13 percent, implying that the overall trade volume had risen to DM 14.1 billion.⁶² In contrast to 1980, however, the growth rate was based on an increased flow of goods from the West to the East. The reason behind that was the GDR's continuing debtor status in relation to OECD countries other than the FRG.⁶³

The year 1982 can be viewed as the last year of real growth in inter-German trade. After that, FRG-GDR trade experienced a relative decline. At the beginning of 1986, the Berlin Institute assessed that inner-German trade had little chance of success in the future if the GDR was unable, or unwilling, to engage in new and more intense types of economic cooperation. The recommendations included a greater amount of East German adjustment to the West German market in the sphere of traditional GDR export commodities. As well, the GDR government was indirectly encouraged to be more innovative in regard to joint ventures and other more intensive types of East-West industrial cooperation.⁶⁴ This occurred at a

⁶¹ Deutsches Institut für Wirtschaftsforschung. "Verschuldungsproblematik vermindert Wachstumschancen in der DDR", Wochenbericht 32/1982, pp. 411-17

⁶² Plötz, Peter. "DDR" in Die wirtschaftliche Entwicklung in ausgewählten sozialistischen Ländern Osteuropas zur Jahreswende 1982/83, Hamburg: Institut für Wirtschaftsforschung, 1983, pp. 92-93

⁶³ Deutsches Institut für Wirtschaftsforschung. "Westverschuldung der DDR begünstigt innerdeutschen Handel", Wochenbericht 10/1983, pp. 132-39

⁶⁴ Institut für Wirtschaftsforschung. "Innerdeutscher Handel: Kontinuität erforderlich", Wochenbericht 10/1986, pp. 119-29

time when Gorbachev had already announced his new and revolutionary ideas about economic and political development, including increased East-West economic cooperation. In other words, unlike other precedents in the past, the GDR had no external political reasons to refrain from intensifying German-German cooperation. The Honecker régime's fear of structural economic reforms had more to do with its own vulnerability in terms of political legitimacy.

In late 1987, a poll was conducted during which West German firms were asked about their attitudes regarding East Germany as an economic cooperation partner. The result was surprising: managers in FRG firms had a high regard for the East Germans and would have liked to see increased cooperation on the firm level. For those firms with experience in FRG-GDR economic cooperation, the most common form of cooperation was said to be licensed production and joint ventures in third countries. The common view was held that German-German economic cooperation must be intensified in the future, particularly in the area of joint ventures on German territory.⁶⁵

In comparison to economic cooperation between West Germany and East European countries in general, the GDR's situation carried greater potential, not least of all because the two German societies were linked through a common language and a similar

⁶⁵ Deutsches Institut für Wirtschaftsforschung. "Die DDR als Kooperationspartner", Wochenbericht 46/1988, pp. 615-23

technological culture. However, the SED government seemed to be more willing to negotiate bilateral cooperation agreements with countries other than the FRG.⁶⁶ Apart from some isolated examples, fear of political repercussions prevented the Honecker régime from involving the GDR economy in more progressive and structurally more intensified forms of cooperation with the FRG. Cooperative ventures such as the Volkswagen deal of 1983 which permitted the GDR to produce Volkswagen engines in the GDR,⁶⁷ and joint ventures in the area of plant construction in third countries like Bulgaria, the Sudan and Ethiopia,⁶⁸ were the exception rather than the rule. The fact that joint ventures almost exclusively took place in third countries illustrates the degree of sensitivity felt by the GDR government in relation to Western economic exposure.

More intensive forms of East-West trade played a minor role in GDR-FRG trade, although the GDR government repeatedly made official statements which underscored its willingness to develop economic cooperation with West Germans, as long as it stayed within the framework of the more general type of cooperation between the CMEA states and Western industrial countries.⁶⁹ Limiting cooperation to

⁶⁶ McMillan, Carl H. "East-West Industrial Cooperation", East European Economies Post-Helsinki, Washington, DC: US Congress Joint Economic Committee, 1977, p. 1205

⁶⁷ Dean, Jonathan. "Directions in inner-German relations", Orbis, Vol. 29, No. 3, Fall 1985, p. 631

⁶⁸ Nitz, Jürgen, op cit., p. 303

⁶⁹ Ibid., pp. 302-3

this framework in itself illustrated a lack of commitment. The SED's hesitation to integrate the GDR into the international division of labour illustrates that the régime, much like many of the other régimes in Eastern Europe at the time, was out of step with international economic developments.

In analyzing trends in FRG-GDR trade, the question of links between political and economic decisions cannot be ignored. Although having studied different sets of trade figures, a number of different analysts arrived at similar conclusions. Michael Kaser has argued that "it is possible to conclude that inter-German trade has risen somewhat more slowly than East-West trade in general, but that the difference is not such as to support a contention that political factors have either constrained or encouraged inter-German trade".⁷⁰ In the same vein, Gert Leptin made the point that "examining overall developments in trade, it becomes clear that the political climate must considerably worsen to have a lasting effect on inter-German trade (as with, for example, the Korean War and the construction of the Berlin Wall)".⁷¹ Looking at the issue from an East German point of view, Jürgen Nitz made a similar argument.⁷²

In agreement with the cited authors, the original thesis or the assumption which was commonly held during the beginning stages

⁷⁰ Kaser, Michael, *op cit.*, p. 127

⁷¹ Leptin, Gert, *op cit.*, p. 275

⁷² Nitz, Jürgen, *op cit.*, p. 295

of inter-German trade - namely that inter-German trade is subject solely to external political influences - can be modified. More accurately, political factors influencing inter-German trade were determined on the level of the two involved governments. The intensity of inter-German trade was determined depending on their political motivations or considerations,

In fact, what seemed to hold true in the case of inter-German trade can be applied, though with certain qualifications, to East-West trade in general. The idea that economic interaction automatically leads to political leverage is an idea which has lost its validity. That is not to say, however, that no links between the two spheres existed. Linkage was possible and it had potential long-term effects, yet it manifested itself in more subtle ways than had previously been assumed. In the case of inter-German trade, a certain symmetry of interests had emerged over the years. While on the GDR side, the interests were more economic in nature and on the FRG side, they seemed to bear more political characteristics, the interests nevertheless formed a certain congruency without which German-German trade could not have sustained itself.

2.7. INTER-GERMAN TRADE: COMMODITY STRUCTURE

During the early stages of inter-German trade, the actual structure and volume of trade was determined by political considerations more than was the case in later years. During the

1950's, West German exports to the East were subject to the limitations of the Western strategic embargo. If compared to trade during 1949, the year the two German states were set up, the result of the embargo manifested itself in a decline in the flow of steel products and machinery. Apart from the embargo, as discussed earlier under the stipulations of the Frankfurt Agreement, trade was permitted only under conditions of limited value and strict matching of product types. During this phase, three main components characterized the bulk of inter-German trade: chemical products, textiles and foodstuffs.⁷³

A different picture emerged during the 1960's. Trade liberalizations came into effect, culminating in a set of new rules governing FRG-GDR trade after the introduction of Ostpolitik which, among other things, made the export of complete plant and machinery possible. The eastward flow of goods and commodities at that stage was comprised of agricultural products and foodstuffs. As well, an expansion in the export of coking coal and coke took place, while non-ferrous products and machinery gained in importance. The transfer of chemical products and fertilizers fluctuated throughout the decade.⁷⁴ In comparison, the westward flow of goods primarily contained foodstuffs, chemicals and light machinery. The flow of diesel fuel and gasoline dropped sharply, whereas the export of

⁷³ Stahnke, Arthur A., op cit., pp. 350-51

⁷⁴ Ibid., p. 351

textiles significantly increased.⁷⁵

In the 1970's, inter-German trade diversified in comparison to the previous decades. On the side of the FRG, the main export commodities were machine construction equipment (15-22 percent of total sales), chemical products (15-21 percent), iron and steel (6-12 percent), non-ferrous and semi-finished metals (4-12 percent), and textiles and clothing (4-8 percent). On the side of the GDR, the picture was as follows: textiles and clothing (17-20 percent of total sales), agricultural products (20 percent), mineral oil products (4-15 percent), chemical products (4-9 percent), and iron and steel (5-8 percent).⁷⁶ As Tables V and VI indicate, this basic trend continued into the 1980's.

TABLE V - STRUCTURE OF FRG EXPORTS TO GDR
[Percent share of total]

	1966-70	1971-75	1976-79	1981-82
Primary and producers' goods	51.8	53.8	53.2	56.5
Iron and steel	16.0	12.8	11.0	8.0
Chemicals	21.3	23.2	20.6	21.0
Nonferrous metals	9.1	8.6	6.7	7.9
Capital goods	22.8	23.8	29.1	22.6
Consumer goods	8.3	9.5	7.6	7.4
Agricultural goods, foodstuffs	16.5	11.7	9.9	12.5 ⁷⁷

⁷⁵ Ibid., p. 351

⁷⁶ Ibid., p. 353

⁷⁷ Garland, John, op cit., p. 182

TABLE VI - STRUCTURE OF GDR EXPORTS TO FRG
[Percent share of total]

	1966-70	1971-75	1976-79	1981-82
Primary and producers' goods	30.9	38.9	44.5	56.4
Petroleum products	2.9	9.8	16.1	24.0
Iron and steel	4.7	7.7	6.9	4.8
Chemicals	8.3	9.0	10.2	13.0
Capital goods	13.6	10.7	10.5	9.8
Consumer goods	29.4	30.6	28.8	22.0
Agricultural goods, foodstuffs	25.6	19.5	15.4	10.8 ⁷⁸

Generally, the commodity structure of inter-German trade did not develop parallel to the level of development attained by the two economies. Above all, it was not sufficiently differentiated. It represented an atypical case because trade between the two Germanys was characterized by a flow of goods of which over half comprised primary and intermediate products. In 1981-1982, 56.5 percent of the trade was concentrated in these sectors.⁷⁹ The exchange of capital goods, in particular plant and machinery, was relatively low, while basic materials and semi-manufactured goods prevailed. Products of the agriculture and food-processing industries ranked particularly high. The relatively low level of trade differentiation was particularly marked on the side of the GDR contribution to inter-German trade, 40 percent of which was made up of agricultural products and foodstuffs.⁸⁰

⁷⁸ Ibid., p. 183

⁷⁹ Ibid., p. 180

⁸⁰ Cornelsen, Doris et al., op cit., p. 254

During the 1980's, a shift in the commodity structure towards more highly processed goods was noticeable. For instance, within the range of chemical products, there was a movement towards delivering more plastics, plastic products and man-made fibres.⁸¹ A similar trend could be detected in the area of textiles and clothing. In contrast, the brown coal sector, which had been traditionally strong on the side of the GDR, declined in importance.⁸² Despite these changes in trade patterns, trade differentiation remained relatively low.

2.8. INTER-GERMAN TRADE: GOALS AND GAINS

(a) THE GERMAN DEMOCRATIC REPUBLIC

Official announcements by the GDR government as to the reasons behind its pursuit of inter-German trade were very rare. When such statements were made, they tended to be on the vague side, with international-political overtones. Economic benefits in real terms were hardly ever mentioned. During the 1980's, the GDR, like its CMEA partners, was involved in a process of announcing a greater interest in integrating into the international division of labour. Parallel to negotiations of cooperative framework agreements between the EC and CMEA, the GDR government pronounced an interest in activating economic and scientific-technological relations with Western countries, and with the FRG in particular. These concepts were re-affirmed by the resolutions adopted at the XIth Party

⁸¹ Ibid., pp. 254-55

⁸² Ibid., p. 254

Congress in April 1986.⁸³ The following statement was made:

The GDR, like other CMEA countries, is committed to building such relations [inter-system economic cooperation] primarily to preserve and consolidate peaceful relations among all states and to utilize advantages resulting from economic cooperation for the development of the GDR national economy. It is in this spirit that the GDR - along with the other CMEA countries - is working toward the long-term expansion of fruitful commercial and other economic links as well as scientific-technological relations with Western industrial countries at practically all levels... This policy is in full accordance with the CSCE Final Act of Helsinki and the 1983 recommendations made by the Madrid Follow-Up Conference.⁸⁴

A similar message was conveyed by Erich Honecker in November 1985, when he made the following remark in an interview with the West German daily Saarbrücker Zeitung:

We are in favour of expanded relations of cooperation. There is no factual reason not to do it. Cooperation between GDR and FRG firms, too, serves mutual interests.⁸⁵

Clearly, the GDR derived certain benefits from the conduct of inter-German trade. These included, for example, agreement, exemption from duties and tariffs - consequently, a special relationship of the GDR to the European Community. While the FRG's interest in inter-German trade was primarily political in nature, the opposite held true for the GDR. Contrary to official comments, the GDR government was highly sensitive to the effects of increased East-West economic cooperation. It feared that spill-over from the sphere of economics to politics could result in increased

⁸³ Nitz, Jürgen, op cit., p. 298

⁸⁴ Ibid., p. 298

⁸⁵ Ibid., p. 302

resentment on the part of the population towards SED policies. In other words, at times of low political legitimacy, engagement in inter-German trade brought with it political risks for the government in East Berlin.

The GDR's pursuit of trade with the FRG appeared, not without good reason, to be based on economic calculations. Although fluctuating in relation to GDR trade with other countries, trade with the FRG represented on the average roughly 10 percent of all foreign trade engaged in by the GDR and approximately 30 percent of its trade with the West.⁸⁶ By way of comparison, the FRG trade with East Germany constituted only about 20 percent of its trade with East bloc countries and only 1.5 percent of all its trade.⁸⁷ Needless to say, in statistical terms alone, the FRG was one of the most important trading partners for the GDR, rivalled only by the Soviet Union.⁸⁸

In terms of the commodity structure characterizing inter-German trade, it has already been pointed out that the exchange of

⁸⁶ For a detailed statistical overview of GDR exports, see: Bethkenhagen, Jochen and Horst Lambrecht. Die Außenhandelsbeziehungen der DDR vor dem Hintergrund von Produktion und Verbrauch, Köln: Bundesinstitut für ostwissenschaftliche und internationale Studien, Vol. 19, 1979, pp. 39-54

⁸⁷ Donovan, Barbara. "Benefits to the GDR from the FRG", in Soviet/East European Survey, 1987-1988, Selected Research and Analysis Series from Radio Free Europe/Radio Liberty, edited by Vojtech Mastny, Boulder, CO: Westview Press, 1988, p. 318

⁸⁸ Ibid., p. 49

goods did not reflect the developmental level of the respective German economies. However, while technology transfers eastward as well as the flow of consumer goods were limited quantitatively, in actual terms, they were of great value to the East German economy. West German transactions could occasionally assist in opening up bottlenecks by providing spare parts and services at short notice. In the area of consumer goods, the reception of West German television programmes throughout the GDR and the affiliated desire for Western products on the part of the population required some Western consumer goods to be on sale in the GDR.⁸⁹

Certain special arrangements made trade with the FRG an attractive proposition. Apart from the clearing agreement, the so-called swing credit, which was originally designed to compensate for short-term imbalances between imports and exports, was a lucrative option from the point of view of the GDR government. Although the swing was intended to be made use of by both sides, since the early 1960's only the GDR took advantage of it. In effect, the swing developed as an interest-free overdraft facility.

The permissible swing level rose substantially over time. While set at 16 million VE in 1949, it increased gradually at first, and more rapidly since the 1960's.⁹⁰ At the end of the 1960's, the swing was "dynamized" which meant that its level was

⁸⁹ Kaser, Michael, op cit., p. 129

⁹⁰ Garland, John, op cit., pp. 201-203

set at 25 percent of the value of GDR exports in the preceding year. The intention on the part of the West German government was to encourage increased inter-German trade. By that time, Ostpolitik had emerged as an important foreign policy goal, and the changes in the swing arrangement were considered to be one practical option for inducing enhanced German-German cooperation.

As Diagram I indicates, by 1970 the swing limit had climbed to 440 million VE, and reached the point of 850 million VE by 1976, where it remained until the early 1980's. After an interlude of three years with the swing rate at a lower level, mutual agreement between the two governments brought it back up to the 850 million VE level where it remained into the late 1980's. In the mid-1970's, the decision was made to change from the system of dynamic swing rates and return to fixed swing limits. That is the reason why the swing remained unchanged in the period from 1976 to 1982, and again from 1986 until the collapse of the GDR government.

Tables VII and VIII show that the GDR never went beyond the prescribed swing limits, nor did the East German government always use the swing to full capacity. The fluctuations were at times due to political factors influencing the intensity of inter-German cooperation. As an illustration, consider that during the late 1970's, East Berlin developed an increased sensitivity towards political pressures from Bonn and consequently pursued a policy of trade diversification whereby the GDR's Western trade was re-

directed from the FRG to other Western industrialized countries. Other political decisions on the part of the SED government could manifest themselves in a general emphasis on economic autarky which implied a turning away from trade with the West more generally. Increased economic autarky could be motivated by internal economic or political considerations as much as by changes in the GDR's trade relations with the Soviet Union and other CMEA partners.

DIAGRAM I - EAST-WEST GERMAN SWING ARRANGEMENT
[VE millions]⁹¹

⁹¹ Garland, John, op cit., p. 202

TABLE VII - SWING UTILIZATION

	Swing limit [VE m]	Swing use [VE m]	Swing use [%]	Cumulative deficit of GDR [VE b]	Share of deficit financed by swing [%]
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1970	440	387	88.0	1.35	28.7
1971	440	413	93.9	1.20	34.4
1972	585	539	92.1	1.75	30.8
1973	620	592	95.5	1.75	33.8
1974	660	559	84.7	1.91	29.3
1975	790	711	90.0	2.39	29.8
1976	850	786	92.5	2.58	30.5
1977	850	748	88.0	2.97	25.2
1978	850	677	79.6	3.68	18.4
1979	850	748	88.0	3.91	19.1
1980	850	745	87.6	3.87	19.3
1981	850	676	79.5	3.65	18.5
1982	850	582	68.5	3.70	15.7 ⁹²

TABLE VIII - FINANCIAL INDICATORS IN INTER-GERMAN TRADE

	Unit	1980	1982	1983	1984	1985	1986	1987	1988
Swing Limit	million DM	850	850	770	690	600	850	850	850
Swing Use	million DM	745	582	543	210	170	185	402	265
Cumulative Debt Level	%	69	57	60	40	47	58	65	58
Swing Use	%	88	68	71	30	28	22	47	31
Payments by Swing	%	19	15	13	7	5	5	9	7
Swing-Deliveries Ratio	%	13	9	8	3	2	3	6	4 ⁹³

⁹² Ibid, . p. 203

⁹³ Deutsches Institut für Wirtschaftsforschung. "Inner-deutscher Handel: Expansionsmöglichkeiten wirklich nutzen!", Wochenbericht 9-10/1989, p. 97

While it represented an attractive option for a country in need of hard currency earnings, a side benefit to the swing arrangement was the impact it had on making the GDR more creditworthy in the eyes of Western banks outside the Federal Republic, thereby inducing a kind of implicit financial umbrella. Moreover, the clearing and swing arrangements allowed the GDR to conduct trade without the use of foreign currency, thereby creating an advantageous position for the GDR to engage in trade involving hard currency exchanges with other countries. This situation explains, for instance, why the volume of inter-German trade rose significantly during the early 1980's.

To illustrate, in the early 1980's, a consortium of West German banks made two loans to the GDR, totalling almost 2 billion D-mark and guaranteed by the West German government.⁹⁴ These loans provided a much-needed buffer to help the GDR maintain regular payments on its outstanding debts and position its economy for recovery. Like most other East European countries, the GDR had overextended itself financially; that is, during the early to mid-1970's, it had taken advantage of the high liquidity on the international financial market and involved itself in borrowing practices which led to high levels of foreign debt. By the early 1980's, the GDR had one of the highest debts of any East European

⁹⁴ Hamilton, Daniel. "Dateline East Germany: The Wall Behind the Wall", Foreign Policy, Fall 1989, p. 180

country after Poland. In the case of Poland, this situation led to severe economic circumstances involving a continued practice of trying to make debt rescheduling arrangements with international economic bodies and the imposition of austerity programmes domestically. In the case of East Germany, the FRG connection helped alleviate some the problems.

Tables IX and X indicate the levels of East German hard-currency debt accumulated during this period. Unable to receive further loans from Western banks or governments other than the FRG, and short of foreign exchange, the GDR government turned to the FRG to cover the import of basic commodities, including food and energy. Interestingly enough, this trend was not reversed by the cooling of East-West relations in 1981, which occurred after the imposition of martial law in Poland. On the contrary, during that time, inter-German trade was experiencing one of its high points.

TABLE IX - GDR HARD CURRENCY DEBT
[millions US dollars]

	1971	1975	1977	1979	1980
Commercial debt	855	4,485	6,140	9,100	11,200
of which:					
Owed to US banks	n/a	n/a	1,168	1,390	1,356
Official backed debt	553	703	1,005	1,200	1,400
Gross debt	1,408	5,188	7,145	10,300	12,600
Net debt	1,205	3,548	6,159	8,400	10,400 [%]

[%] Oechsler, Ronald G. "GDR: Performance and Prospects in Trade with the West", in East-West Trade: The Prospects to 1985, Washington, DC: US Congress Joint Economic Committee, 1982, p. 154

TABLE X - GDR HARD CURRENCY DEBT
[billion US dollars]

	1983	1984	1985	1986	1987	1988	1989
Liabilities with Western governments & banks	8.4	8.3	10.2	11.6	14.1	15.6	17.0
Gross debt	12.3	12.0	13.0	15.3	18.4	20.2	22.3
Net debt	8.9	7.4	6.5	7.8	9.4	10.4	9.4 ⁹⁶

Other regulations governing inter-German trade favoured the GDR. For example, the FRG exempted goods from the GDR of all duties normally levied on imports, and reduced the value-added tax which is imposed on domestic trade. The cost of the value-added tax shortfalls in 1970 alone was estimated to amount to approximately DM 130 million annually.⁹⁷ The shortfalls also helped make East German goods more competitive and thus contributed to a more balanced trade account between the two states.

As well, the special arrangements of inter-German trade turned the GDR into a de facto member of the European Community. East Germany had the same duty-free access to the West German market as other EC countries. It could sell its agricultural products for the artificially high prices set by the Common Agricultural Policy (CAP), and take advantage of a number of other EC privileges which

⁹⁶ Economist Intelligence Unit. East Germany - Country Profile (1990-91), Annual Survey of Political and Economic Background, London, UK: EIU Limited, p. 35

⁹⁷ Stahnke, Arthur A., op cit., p. 365

will be described in greater detail in the following chapter. This special status of inter-German trade had been formalized in a protocol appended to the Treaty of Rome which was negotiated in 1959. The GDR's special status was reconfirmed in 1974. The assumption could have been made that the GDR's EC access posed a problem for countries other than the FRG, that is, countries without the same type of political considerations for the GDR. However, while the concern was legitimate, it never grew into a problem in practice. As will be seen later, this can be attributed primarily to the negligible amount of East German goods being re-exported once they had reached the West German market.

Outside the sphere of trade, the GDR received payments from West Germany which were usually referred to as 'para-economic payments'. These included transit fees to West Berlin, postal fees, road tolls, and special construction projects.

Official German figures show annual payments to the GDR at an annual rate of about DM 1.2 billion, including in recent years a lump sum payment of DM 500 million for transit fees to Berlin; DM 200 million for postal payments; DM 50 million for road tolls for travel within the GDR; DM 200 million as income from the obligatory currency exchanges; and DM 100 million for sewer and waste disposal for the Western sectors of Berlin. To this must be added payments of DM 1 billion in earnings of foreign currency shops through personal remittances by Federal Germans to GDR residents; the benefits derived from swing credits; and Federal German ransoming of political prisoners in the GDR at DM 200 million annually.⁹⁸

In short, from an economic point of view, the indirect

⁹⁸ Dean, Jonathan, op cit., p. 617

benefits derived from a preferential trade relationship plus the so-called 'para-economic payments' made life easier for the GDR government. Some have argued that the GDR relied on inter-German trade to protect against short-term economic disturbances and overcome bottlenecks in its domestic economy.⁹⁹ Others maintained that the GDR's special status in relation to the FRG assisted significantly in making the GDR one of the most successful socialist countries in the East bloc.¹⁰⁰ While the GDR government maintained for years that the relatively good economic performance of East Germany could be attributed to its special brand of socialism, the figures cited above indicate that implicit subsidies from the Federal Republic were rather substantive, and certainly not without effect on the performance of the East German economy.

That is not to say, however, that the GDR government always regarded inter-German trade as a problem-free activity. On the contrary, the benefits derived from inter-German trade induced the East German government to continuously evaluate its dependence on the FRG. At times, the GDR leadership feared that too much trade would make the GDR vulnerable to pressures from West German hardliners and would open the country to too much Western influence, thus undermining its policy of demarcation. As a result, the GDR leadership was careful to limit inter-German trade to politically

⁹⁹ Hamilton, Daniel, op cit., p. 181

¹⁰⁰ Griffith, William E. "The German Democratic Republic", in Central and Eastern Europe: The Opening Curtain?, edited by William E. Griffith, Boulder, CO: Westview Press, 1989, pp. 323-24

acceptable levels. To this end, it attempted to introduce a policy of trade diversification during the 1970's. Initially, the policy was successful, due, among other things, to the fact that short-term and long-term loans were made freely available by Western banks outside the FRG. In large part, this was due to an exceptionally high degree of liquidity on the international financial market at the time based on the surplus of Petrodollars.¹⁰¹ However, as Table XI shows, a rise in East German indebtedness occurred in the late 1970's and early 1980's. This coincided with a financial crisis on an international scale. With decreased financial liquidity and the subsequent problems experienced by the GDR in servicing its hard currency debt, the option of trade diversification became much more limited during that period.

TABLE XI - GDR DEBT TO WESTERN BANKS (EXCLUDING FRG)
[in billions of US dollars]

	Gross Debt	Net Debt	Servicing Requirement	Debt Service Ratio Excl. (%)	Incl. FRG Ratio (%)
1978		5.31	2.30	163	62
1979	9.53	6.17	3.03	185	72
1980	10.93	7.83	3.71	177	74
1981	11.60	8.28	4.24	194	87
1982	9.55	6.90	4.36	183	85 ¹⁰²

¹⁰¹ Vogel, Heinrich. The Politics of East-West Economic Relations Reconsidered: A German View, Vol. 22, Köln: Bundesinstitut für ostwissenschaftliche und internationale Studien, 1982, p. 8

¹⁰² Garland, John, op cit., p. 180

While the motivations behind the engagement in inter-German trade on the part of the GDR were economic in nature, there were some political considerations that entered into the equation as well. Naturally these are intangible factors, difficult to quantify, but nevertheless important. First, the flow of goods must have created for GDR citizens a sense of contact with their West German neighbours. In the eyes of the GDR government this could have had the effect of diverting attention from other more threatening channels of contact, for instance, the peace movement or the Protestant Church.¹⁰³ In other words, by providing consumer goods to certain segments of the population, a type of social contract was established whereby those people able to buy consumer goods would refrain from engaging in anti-government politics. A second political consideration could have been that trade with the GDR encouraged a positive interest on the part of the FRG in relations with Eastern Europe generally, thus contributing to a greater amount of neutrality with respect to the United States than might otherwise may have been the case.¹⁰⁴ Despite these considerations, the conclusion remains that the primary East German motivation in engaging in inter-German trade was to be found in the sphere of economics.

¹⁰³ Kaser, Michael, *op cit.*, p. 128

¹⁰⁴ *Ibid.*, p. 128

(b) THE FEDERAL REPUBLIC OF GERMANY

On the side of the Federal Republic, the intentions behind inter-German trade were quite different. The stimuli were generated primarily in the political sphere. In economic terms, inter-German trade was not particularly important for the FRG. West German trade with the GDR constituted only about 20 percent of its trade with East bloc countries and only 1.5 percent of all its trade.¹⁰⁵ According to one statistical overview, FRG-GDR trade contributed only 1.6 percent of the annual West German GNP.¹⁰⁶

However, as some authors have argued, for the companies that exported to the GDR, inter-German trade constituted a large part of their revenues and accounted for almost 100,000 jobs.¹⁰⁷ One study posited that the ratio of job creation through inter-German trade on the Western side had a corresponding rate of loss of work on the Eastern side. In other words, while increases in German-German trade, specifically when the flow of goods went from the West to the East, resulted in the creation of jobs in the FRG, the exact opposite held true for the GDR. Using the statistics for the years 1980, 1984 and 1988, the German Institute for Economic Research arrived at the conclusion that indeed inter-German trade created job opportunities in the Federal Republic. After a sectoral break-

¹⁰⁵ Donovan, Barbara, op cit., p. 320

¹⁰⁶ Frey, Eric G., op cit., p. 30

¹⁰⁷ Stahnke, Arthur A., op cit., p. 356

down, it became clear that during all three years under examination, the machinery producing industry ranked highest in terms of profiting from trade with the GDR. The sector next in line was the electronics industry, a fact which also gives an indication of the GDR's import needs.¹⁰⁸ Moreover, the companies involved in inter-German trade were mostly middle-sized and part of a group of firms that, as members of the German Council for Industry and Trade, enjoyed a high degree of political clout, especially with the governing CDU/CSU coalition.

In other words, inter-German trade enjoyed the support of certain lobbies which pressed for the enhancement of trade relations for economic reasons and opposed the use of trade as a political instrument. Mention should also be made of the fact that West Berlin benefitted disproportionately from inter-German trade; businesses located in West Berlin contributed only 3 percent of the annual West German GNP, but 28 percent of inter-German trade.

Beyond that, there existed four main political reasons behind the FRG's pursuit of inter-German trade. First, and foremost, inter-German trade could be regarded as a means to keep the German Question alive, and with it the goal of eventual German reunification. As stipulated in the Basic Law, the government of the Federal Republic was legally bound to pursue that goal. Second,

¹⁰⁸ Deutsches Institut für Wirtschaftsforschung. "Beschäftigungsaspekte des innerdeutschen Handels in der Bundesrepublik Deutschland", Wochenbericht 31/1991, pp. 435-39

without reunification on the immediate horizon, the FRG's commercial relations constituted a humanitarian commitment to those living in the other Germany. Trade was regarded as fulfilling a 'bracket' or 'clasp' function¹⁰⁹, providing ties between the two Germanys even when the political climate was counter-conducive. In harmony with this political goal, the West German government encouraged mainly small and medium-sized companies to conduct the major share of inter-German trade because this created maximum possible human contact in the pursuit of business transactions.¹¹⁰ Third, the West German government perceived the non-commercial or para-economic payments it made to the GDR as a legitimation of the 'bracket' role.¹¹¹ It always had the option of pointing to its generosity and goodwill when negotiations between the two German states in other issue-areas were being slowed down for reasons other than economic ones. And fourth, the normalization of inter-German economic relations helped to ensure the security of and continued access to West Berlin.¹¹²

However, throughout there were critics who questioned the desirability of inter-German trade. Both within the FRG and internationally voices of concern and doubt were raised. In the domestic context, Finance Minister Ludwig Erhard said in a speech

¹⁰⁹ Kaser, Michael, op cit., p. 128

¹¹⁰ Frey, Eric G., op cit., p. 30

¹¹¹ Kaser, Michael, op cit., p. 128

¹¹² Ibid., p. 128

held in 1960:

In West Germany intra-German trade is the most unimportant thing there is. I would throw it into the den of wolves tomorrow, because we deliver to the Eastern zone products that undoubtedly are very important to holders of power over there. Conversely, we get products from them that we don't need and the Soviet zone cannot sell elsewhere. It is, in other words, a one-way trade... The only reason we support intra-German trade is to secure the freedom of Berlin and free access to Berlin...¹¹³

Although he was speaking over thirty years ago, many of the points made by Erhard have re-surfaced time and again.

Even to this day, after unification has taken place, certain segments of West German society feel that Bonn is left with paying the bills for mistakes made by the SED leadership. This attitude appeared, for instance, during the political debate over an increase in taxes in order to help finance unification. These same people opposed the principles of Ostpolitik during the 1970's and 1980's, founding their views on the argument that German-German rapprochement was a one-sided effort by the FRG to bail out the GDR, with the result of prolonging the inevitable fall of socialism. Now that socialism has indeed crumbled in the GDR, they feel vindicated and automatically equate every mistake admitted by the communists with a success for the Western capitalist system. Beyond this rather simplistic approach, some West Germans felt that subsidizing the GDR economy was too costly, especially when considered in light of the actual political accommodation achieved.

¹¹³ Quoted in Alexis S. Loeber, "The Significance of Intra-German Trade in Divided Germany", Co-existence, Vol. 16, No. 2, 1979, p. 160

However, there are two considerations that should be taken into account. First, as mentioned before, there were some economic benefits the FRG derived from inter-German trade. Because those benefits were concentrated around a small number of medium-sized firms in very specific sectors of the economy, doing without inter-German trade would have had adverse effects. This is true particularly for West Berlin which handled a disproportionately large share of inter-German trade. At the end of the 1980's, approximately 6,000 to 7,000 small and medium-sized West German firms engaged in business with the GDR.¹¹⁴ Second, Alexis Loeber has calculated West German contributions to the GDR for the year 1971 and found that in comparison to the FRG's GNP, the amount was negligible. Taking a 1971 estimate of Bonn's yearly direct and indirect contribution to East Germany, DM 800 million, and comparing this to West Germany's GNP, DM 758.8 billion in 1971, the sum turns out to be only 0.1 percent of the GNP.¹¹⁵ This ratio did not change very much over the years. For example, in 1986 the sum represented only 0.06 percent of the FRG's annual GNP.¹¹⁶ Curiously enough, in 1971, the amount represented an approximate equivalent to total German public capital aid to South America in 1970.¹¹⁷ In comparative terms, the media coverage and public

¹¹⁴ Nitz, Jürgen, *op cit.*, p. 302

¹¹⁵ Loeber, Alexis, *op cit.*, p. 161

¹¹⁶ Frey, Eric G., *op cit.*, p. 47

¹¹⁷ Loeber, Alexis, *op cit.*, p. 161

attention in reference to inter-German trade was more keen, with the effect of creating a continuous wide-spread public debate on the issue. In comparison to, for instance, development aid to the Third World, subsidies to the GDR carried with them more emotional implications. More often than not, the issue was linked to the long-term goal of re-unification. As argued earlier, from Bonn's perspective, inter-German trade was meant to provide the so-called 'bracket' function. On the basis of the stipulations in the Basic Law, the ultimate goal of re-unification, no matter how vague or distant, always remained a policy goal. In some respects, this scenario created a paradox - the paradox of rapprochement. Some analysts have argued that re-unification through rapprochement is by definition impossible. Taking that argument into account, the conclusion could be drawn that inter-German relations were much more complex in character than the domestic critics of inter-German trade were willing to admit.

International critics of inter-German trade existed as well. They were mainly representatives of EC member countries, and specifically criticized the GDR's special position in the European Community. The issue will be dealt with in the following chapter which is focused on the relations between the GDR and the EC. Generally, while the GDR government tried to de-emphasize its country's economic dependence on inter-German trade and the special status that was associated with it, there were criticisms coming from the West, both from within the FRG and other countries.

Although some of the criticisms were valid, they did not do justice to the complexities of the issues involved in inter-German trade. More than anything, they reflected a certain attitude regarding East-West cooperation in general, namely that the West was engaged in helping the socialist régimes of the East bloc to cover up their economic mismanagement problems. By extension, this view implies that increased economic dependence of the East European countries should be used as a lever to achieve political accommodation. Again, at least in the case of inter-German trade, the link between the spheres of economics and politics were not as direct. On a number of occasions, the theory of leverage was proven to be without practical applicability. The argument could be made, however, that the practice of cooperation and the functioning of the inter-German trade régime had a number of effects on other areas, both in the economic and political realms. These were not necessarily symmetrical in character, nor apparent on a continual basis. The effects were more subtle than the leverage approach would have it.

2.9. ASYMMETRY OF GOALS AND THE ISSUE OF LINKAGE

Given the asymmetry of aims and needs between the two German states, that is, between the FRG's pursuit of political goals and the GDR's economic interests in inter-German trade, West German policy-makers repeatedly wondered whether they could use trade, or rather trade denial, in order to obtain more political concessions from the GDR. Especially during the 1970's, the conservative

opposition parties challenged the SPD/FDP coalition government to use economic leverage more effectively. Since the beginning of inter-German trade, the FRG implicitly maintained linkage between trade and free transit to West Berlin.

For instance, when in early 1960, during the height of the Berlin crisis, the East Germans increased the pressure on the city by interrupting transit traffic, the FRG threatened that it would not extend the Berlin Agreement which was due to expire at the end of the year. West German officials, however, soon gained an awareness that this measure would likely be counter-productive and probably not alter East German behaviour. Before the end of that year, the problem was resolved when the trade agreement was renewed without conditions.

The GDR government drew the following conclusion from the episode; under the economic policy of promoting disturbance-free development [Störfreimachung], it cut back significantly on its trade with the FRG. It was not until 1964, that inter-German trade began to pick up again. The West Germans, in turn, learned their lesson from this event as well, and after 1960, no explicit attempt to link trade to politics was made. Although in 1965 the FRG maintained confirmation of limited linkage between trade and transit to West Berlin, the beginning of negotiations on the transit agreement in the wake of the signing of the Quadripartite Agreement on Berlin made this policy obsolete. The Transit

Agreement was signed in 1971, securing the freedom of access to West Berlin by the Federal Republic in formal and legal terms. On the basis of such an arrangement, complaints about access could be channelled through the appropriate international legal institution, thereby limiting the applicability of linkage entirely in that area.

The only time the GDR government was willing to make political concessions was in return for direct West German loans. As an example, in 1974, the West German government linked the extension of an increased swing credit to the reduction of the East German minimum foreign currency exchange - and was successful in its approach. However, when Foreign Minister Hans-Dietrich Genscher applied the same strategy after the three-fold increase in the exchange rate in 1980, the East Germans did not yield; instead, they threatened to cut back on the volume of bilateral trade. In contrast, in 1982 Bonn managed to gain a general amnesty for East Germans who had left the country illegally between 1972 and 1981 in exchange for a renewal of the swing. And in 1985, the GDR pledged to restrict the influx of Tamil refugees who flew to East Berlin only to move to the Western part of the city.

In short, while occasionally politics and economics, or more specifically politics and trade, crossed each other in the pursuit of inter-German relations, the point can be made that direct linkage proved mostly counter-productive. Fluctuations in inter-

German trade were more a reflection of the GDR's economic needs and political will to pursue a policy of satisfying these needs than anything else. Moreover, the two Germanys were not acting in a political vacuum. Apart from establishing a certain amount of independence over the decades, due to the international character of the so-called German Question, each German partner remained forced to take larger political realities into account. This meant that their freedom of manoeuvre was strictly speaking limited,¹¹⁸ which in turn confirms more general conclusions about experiences with linkage politics in the arena of East-West trade. Although often pursued, and despite some minor successes, linkage did not emerge as a viable policy option.¹¹⁹

The interplay of economic and political considerations in the context of relations between the two Germanys confirms the notion of asymmetrical interdependence, as put forward by Nye and Keohane.¹²⁰ In terms of a comparison of economic power, the GDR was the weaker partner in the German-German relationship. Nevertheless, East Germany did not automatically become vulnerable as a result of the inequality. On the contrary, the above examples indicate that an asymmetry in power could be balanced against an asymmetry in interests. That is to say, the GDR's pursuit of

¹¹⁸ Stahnke, Arthur A., op cit., pp. 356-57

¹¹⁹ Vogel, Heinrich, op cit., p. 9

¹²⁰ Keohane, Robert O. and Joseph S. Nye, Jr., "World Politics and the International Economic System", op cit., pp. 122-23

certain economic goals was matched by West Germany's interest in specific political ends, with the result that East Berlin's bargaining position vis-à-vis Bonn was not necessarily weakened.

CHAPTER 3. CASE STUDY: UNITED GERMANY IN THE EUROPEAN COMMUNITY AND THE LEGACY OF GDR-EC TRADE

3.1. GDR-EC TRADE: THE INSTITUTIONAL FRAMEWORK

(a) THE TREATY OF ROME

The Treaty of Rome which created the European Economic Community in 1957 contained a special protocol dealing with the issues surrounding inter-German trade. Accepting the stipulations of the Berlin Agreement, which formed the framework for rules governing trade between the two Germanys, the protocol exempted that trade from EC jurisdiction. Thus, inter-German trade was treated differently in that tariffs, duties and quotas which, under normal circumstances, would be applicable to trade with third countries, were not instituted. In principle, the special status of GDR-FRG trade applied only to goods of German origin. For instance, EC quota and tariff restrictions were not affecting GDR deliveries to the FRG. Parallel to that, the FRG was at liberty to determine the conditions under which its trade with the GDR would take place without obtaining prior EC approval, as long as the Berlin Agreement was honoured.¹²¹ The protocol represented the acceptance, on the part of France, the Benelux countries, and Italy, of the special trade relationship between the two Germanys. Although the decision reflected genuine policy on the part of the EC member states, it may have been influenced to some degree by

¹²¹ Stahnke, Arthur A., op cit., pp. 366-67

Bonn's policy of making the FRG's entry into the EC contingent upon the ratification of this protocol.¹²² At the time, none of the founding members of the EC had officially recognized the GDR as a sovereign country; it was still viewed as the Soviet Occupation Zone. Consequently, accepting inter-German relations as a special case governed by rules that varied from typical inter-state relations did not present contradictions, either legally, politically or diplomatically.

During the period from the early to mid-1960's, that is, prior to the emergence of Ostpolitik, Bonn's attitude towards GDR-EC relations was marked by unease.¹²³ In line with its political policy in regard to the status of the GDR and its goal of reunification, the government of the Federal Republic was opposed to the emergence of independent trade ties between the GDR and individual EC member states. Bonn feared that such relations signified the beginning of a more formal recognition of the GDR as a sovereign country, something it was trying hard to avoid. The concerns over ties between the East Germans and the EC were initiated in early 1960, when the process of transferring authority over trade issues from individual members to the EC began. As a result, when in 1961, the Community Council made the decision that EC members could conclude trade agreements with the state trading countries, agreements that could last up to and including 1965,

¹²² Loeber, Alexis, *op cit.*, p. 161

¹²³ Stahnke, Arthur A., *op cit.*, p. 370

Bonn managed to have the GDR excluded.¹²⁴ This indirectly reconfirmed East Germany's separate status from the point of view of the EC.

Parallel to this, in the context of the EC's creation of a common agricultural policy, a problem in respect to East German agricultural products emerged. The EC established an organ to regulate the flow of agricultural goods between the Community and so-called "third countries". Based on EC stipulations, because EC prices on agricultural products exceeded prices on the world market, an excise tax was imposed on agricultural imports from non-EC countries. At the same time, exporters of agricultural goods to third countries received subsidies to compensate them for the lower prices they received. The money for these subsidies was generated from within the EC through contributions by the individual member states.

In the mid-1960's, Bonn objected to the definition of the GDR as a third country. Brussels accepted the West German position after Bonn had threatened to default on its contributions to the EC agricultural subsidy fund. As a result, the GDR was not termed a third country and therefore, agricultural sales from the Common Market area to the GDR could not be subsidized. However, Brussels did create the compromise regulation that EC members, after

¹²⁴ Weidenfeld, Werner. "The European Community and Eastern Europe", Aussenpolitik, Vol. 38, No. 2, 1987, p. 3

consulting with Bonn, could adopt their own system of compensatory payments to their own exporters of agricultural products.¹²⁵

In effect, Bonn had developed the so-called 'sui generis' thesis which stated that trade with the GDR is neither domestic nor foreign, but a special case by itself. The thesis extended beyond agriculture and encompassed all areas of trade. Although the EC Commission did not go along with the thesis at first, the issue was addressed in a statement by the EC Council to the effect that the GDR is not a third country as far as the EC is concerned; should any EC member country feel harmed by the relation with the GDR, it can consult with the FRG.¹²⁶ Other examples occurred which illustrated the FRG's unequivocal commitment to enforcing the GDR's status as Soviet occupation zone. Non-acceptance of the GDR as a country in its own right formed part of a strategy that was intended to bring about the re-unification of Germany.

(b) THE BASIC TREATY

With the change in political philosophy in the FRG during the late 1960's and especially since the signing and ratification of the Basic Treaty in 1972, relations between the GDR and the EC went through transformations as well. The Basic Treaty represented a shift towards accepting the GDR as a fully sovereign state and placing FRG-GDR ties on the principle of mutual equality.

¹²⁵ Stahnke, Arthur A., op cit., p. 371

¹²⁶ Loeber, Alexis, op cit., p. 162

Philosophically, this attitude was based on the social democratic conviction that the policy of non-recognition was not capable of bringing about German re-unification, even ran counter to the goal of re-unification in the long run.

On the contrary, social democrats and their liberal allies postulated that the acceptance of political realities, that is, the post-war division of Europe, was a necessary pre-condition for establishing better and more intensified relations between the two German states. That contact, it was hoped, would lead to the breakdown of barriers and the eventual merger of the two Germanys. The attitude was reflected in two key-phrases at the time; Willy Brandt's concept of "two states in one nation" and Egon Bahr's "change through rapprochement"¹²⁷

Although the Basic Treaty accepted the existence of two separate states, clearly illustrated by the subsequent separate representation of the two German states in the United Nations, in terms of trade, the special regulations governing inter-German trade were re-confirmed. Article 7 of the supplementary protocol stipulated: "Trade between the Federal Republic of Germany and the German Democratic Republic is to be conducted on the basis of existing regulations [meaning the Berlin Agreement]. The Federal Republic of Germany and the German Democratic Republic will

¹²⁷ Brand, Peter and Herbert Ammon (eds.) Die Linke und die nationale Frage. Dokumente zur deutschen Einheit seit 1945, Hamburg: Rowohlt Verlag, 1981, see: pp. 235-40 and pp. 302-5

negotiate long-term agreements, with the goal of continuous progress in the development of trade relations; they will adapt outdated regulations and improve the trade structure".¹²⁸

Despite endorsement of a unique inter-German trade relationship, the recognition of the GDR as a sovereign state could have effected a complete change in its status vis-à-vis the EC. Theoretically, Brussels could have decided to "normalize" relations with East Germany and enforced the third country rule on East German trade with the Common Market, including West Germany. However, the political will of Chancellor Willy Brandt as well as his successor Helmut Schmidt and their continued support of the 'sui generis' argument, coupled with the relatively insignificant amount of East German trade, led to acquiescence on the part of the other EC members.¹²⁹

In due course, the EC took the position that for all EC member states except West Germany, the GDR represented a third country. The Commission concluded that Common Market trade with East Germany was to be treated on exactly the same terms as trade with any other state trading country.¹³⁰ Based on EC law regarding trade between the Community and the socialist countries, this implied that

¹²⁸ Morawitz, Rudolf. "Der innerdeutsche Handel und die EWG nach dem Grundvertrag", Europa-Archiv, No. 10, 1973, p. 353

¹²⁹ Stahnke, Arthur A., op cit., p. 368

¹³⁰ Beise, Marc. "Die DDR und die Europäische Gemeinschaft", Europa-Archiv, No. 4, 1990, pp. 150-51

bilateral trading agreements could not be signed between individual EC member states and the GDR. EC trade with the GDR had to be conducted within the framework of the Community's approach to state trading countries.¹³¹ However, the regulations applying to inter-German trade remained in effect, thus FRG-GDR trade was not considered foreign trade and therefore was not subordinated to the EC régime. In reality, this meant that the Federal Republic could conduct inter-German trade on its own terms. One condition it had to comply with was the continuous monitoring of inter-German trade in order to avoid negative effects on the other EC economies.¹³²

In short, East German goods were allowed into the West German market without being subject to either external tariffs or the Community's quota system. In addition, permission was granted for East German goods to be transported beyond German borders into other Common Market territory without being subjected to border controls.¹³³ This clearly represented an exceptional arrangement. In protocols supplemented to the EC Treaties and dealing with former colonies such as Morocco and Tunisia, for instance, it was clearly outlined that goods emanating from the territories of former colonies can only be sold on the internal market and cannot leave the so-called "home market" without tariffs being

¹³¹ Bähr, Paul. "Handel und Handel zwischen Ost und West - Die Europäische Gemeinschaft und die Staatshandelsländer", Europa-Archiv, No. 5, 1973, p. 173

¹³² Beise, Marc, op cit., p. 151

¹³³ Morawitz, Rudolf, op cit., p. 356

retroactively applied.¹³⁴

3.2. GDR-EC TRADE: ALLEGATIONS OF ABUSE

The implications of the above regulations caused some concern among the EC members. The GDR came to be regarded as a 'de facto' member of the European Community, enjoying certain benefits due to its special status. Yet, East Germany was not represented in Brussels, nor did East Berlin contribute any membership dues. In short, the problem was regarded as a hole in the customs union¹³⁵.

By definition, a customs union has a high external tariff but eliminates tariffs between member countries. This improves the efficiency of production and, in theory, optimally allocates resources within its boundaries. The effectiveness of a customs union is, of course, undermined if a member breaks the protective common external tariff barrier. What added to the problem in the case of Germany was the fact that the leak in the customs union, even if assumed to be negligible, could not be easily assessed in quantitative terms.¹³⁶

¹³⁴ Ibid., p. 357

¹³⁵ Baylis, Thomas A. "The Economic Dimension of Inter-German Relations", in East Germany, West Germany, and the Soviet Union: Perspectives on a Changing Relationship, edited by T.A. Baylis, Ithaca, NY: Cornell University, Center for International Studies, 1986, p. 26

¹³⁶ Cornelsen, Doris et al. Handbook of the Economy of the German Democratic Republic, Westmead, UK: Saxon House, 1979, p. 252

Attempts by the EC Commission to quantify the volume and value of East German products which entered the Community encountered problems. It was a difficult, if not impossible, task to establish exact figures concerning the benefits that the GDR derived from its status vis-à-vis the EC. The East German statistics tended to be vague and inaccurate. In fact, it seemed to have been deliberate GDR policy to obscure trade figures. Imports and exports were not listed separately but merged, thus statistics could only convey turnover rates. In addition to that, it was found that East Berlin engaged in systematically undervaluing trade turnover figures.¹³⁷

Allegations have been made that on the West German side, although statistics were kept on all aspects of inter-German trade, calculations of its effect on the Common Market tended to be rare and not widely circulated.¹³⁸ Although the FRG was bound by EC law to keep inter-German trade transparent, the West German government at times took the stand that the transparency clause could only be applied within certain limits because it could otherwise decrease German autonomy in conducting inter-German relations.¹³⁹ These circumstances had a psychological effect on the other EC members. It certainly led to speculations as to the impact of inter-German

¹³⁷ Kaser, Michael. "The Economic Dimension", in Germany between East and West, edited by Edwina Moreton, London, UK: Cambridge University Press and Royal Institute for International Affairs, 1987, p. 127

¹³⁸ Pinder, John. "Kann die Europäische Gemeinschaft eine Ostpolitik betreiben?", Europa-Archiv, No. 4, 1974, p. 109

¹³⁹ Morawitz, Rudolf, op cit., p. 359

trade on the Community. While some authors down-played the impact of inter-German trade on the Common Market, others asserted its importance. Alexis Loeber, an American scholar, wrote,

the Commission states intra-German trade in the context of the EC is based on the principle that the Federal Republic absorbs all of the receipts from the GDR itself. It turns out that only about 1 percent of those goods imported from the GDR into the FRG are re-exported to other member countries.¹⁴⁰

On the East German side, economic benefits derived from GDR-EC trade by East Germany were consistently down-played. In 1989, an East German economist summed up the GDR's position by stating that "it is false to claim that East Germany is a 'clandestine member of the EC' or should be envied by others for having 'one leg in the EC'".¹⁴¹ In contrast, two West German commentators assigned a high degree of gain to the GDR economy based on its involvement in trade with the Common Market.¹⁴² It will be seen later that their assessments were contested by others.

Concerns were raised, for instance, about trade in the agricultural sector. The GDR was seen as being able to leak its products into the EC and receive high EC prices for them. Ultimately, this amounted to a substantial loss of income for the

¹⁴⁰ Loeber, Alexis, op cit., p. 162

¹⁴¹ Nitz, Jürgen, op cit., p. 304

¹⁴² Biskup, Reinhold. Deutschlands offene Handelsgrenze. Frankfurt: Ullstein Verlag, 1976 and Sighart Nehring, "Präferenzen und DDR-Exportstruktur im Innerdeutschen Handel", Weltwirtschaftliches Archiv, Vol. 114, No. 2, 1978

European Community while the benefits went to the GDR.¹⁴³ East German exports of agricultural goods intensified the already severe agricultural surpluses experienced by the Common Market and made it more difficult for other EC members to export agricultural goods to the Federal Republic due to the fact that after the absorption of East German exports, the FRG experienced almost complete saturation in that sector. Furthermore, the costs arising from trying to reduce the agricultural surpluses, which are partly created by the GDR as well, were carried by the EC without any East German contribution. Over the years, EC member countries have criticized these practices, going as far as calling inter-German trade a "huge Marshall Plan for the GDR - paid for by the EC members".¹⁴⁴ The argument can be made that this was an exaggeration of reality. Agricultural products originating in the GDR tended to find their outlet mainly in West Berlin, thus not affecting the overall West German agricultural market too dramatically.¹⁴⁵

A general allegation was that West German firms illicitly exported goods to the Common Market which originated in the GDR, with the aim of circumventing the tariffs and duties mandatory on trade between the GDR and the EC countries other than the Federal Republic. Apparently, these complaints most often related not to

¹⁴³ Loeber, Alexis, op cit., p. 162

¹⁴⁴ Ibid., p. 162

¹⁴⁵ Ibid., p. 163

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PM-1 3½"x4" PHOTOGRAPHIC MICROCOPY TARGET
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the agricultural but to the chemical and heavy machinery sectors.¹⁴⁶ In this context, it is noteworthy that a limited framework for such activity existed. In 1992, the EC Parliament accepted Bonn's official position that the FRG engaged in re-exporting 0.8 percent of its imports from the GDR to other EC member states,¹⁴⁷ thereby giving its official stamp of approval to the process.

A second allegation indicating unfair play in inter-German trade was that the GDR took advantage of the special status of inter-German trade by illicitly re-exporting to the West goods which originated in other countries, sometimes in other CMEA member states but also in third countries in general. Indeed such instances occurred: a notable case, which reached the European Court of Justice, was one of Polish geese exported as if of GDR origin.¹⁴⁸ In another instance, 3 million tons of Soviet oil were resold in West Germany on GDR account.¹⁴⁹ In 1979, West German importers received South Korean and Taiwanese textiles from the GDR without paying the 14 percent customs duty and 12 percent import tax.¹⁵⁰ Such examples created fears that the GDR was emerging as a funnel for the exchange of goods between the state trading

¹⁴⁶ Garland, John, *op cit.*, p. 204

¹⁴⁷ *Ibid.*, p. 204

¹⁴⁸ Kaser, Michael, *op cit.*, p. 130

¹⁴⁹ *Ibid.*, p. 130

¹⁵⁰ Garland, John, *op cit.*, p. 204

countries and the Common Market. Not only was this regarded as an illegitimate use of inter-German trade, but it also raised the concern that these practices would decrease the incentives on the part of the CMEA countries to negotiate trade agreements with the EC itself.¹⁵¹

Last but not least, goods identified as of West German origin could be legally subcontracted to the GDR in order to take advantage of the lower labour and production costs. These products, mainly consumer goods, were then allowed to enter the EC market from West Germany, meaning they could be circulated without any tariffs being charged.¹⁵² Although not a widespread practice, this particular possibility of circumventing EC rules was enhanced by certain incentives administered through the Berlin Agreement. As mentioned in the previous chapter, under the agreement, West German importers of East German goods were granted tax advantages of approximately 11 percent as well as an exemption from EC import duties of approximately 10 percent. West German exporters of goods to the GDR paid a value-added tax of 6 percent, less than half the normal VAT rate applicable to domestic trade.^{153 154}

¹⁵¹ Stahnke, Arthur A., op cit., p. 367

¹⁵² Garland, John, op cit., p. 205

¹⁵³ Morawitz, Rudolf, op cit., p. 359

¹⁵⁴ Bröll, Werner. Die Wirtschaft der DDR - Lage und Aussichten, München: Olzog Verlag, 1970, p. 127

In short, based on fully legal practices and encouraged by Bonn's offer of unique incentives, such activities could have become the rule. As will be argued below, however, there were a number of reasons which can explain why the special status of Germany within the EC did not develop into a serious practical problem which would have forced the Commission to create special legislation. The main reasons can be summarized as Bonn's sensitivity towards its EC partners, lack of substantive economic impact of GDR-FRG or GDR-EC trade, and the GDR's internal structural problems.

3.3. ARE THE CRITICS OF GDR-EC TRADE CORRECT?

(a) REACTIONS BY THE FEDERAL REPUBLIC OF GERMANY

The Bonn government could politically not afford to ignore news of illegitimate uses of the framework agreements governing inter-German trade. Its reactions indicate that it did not differentiate whether the abuses involved East or West German firms, or both. In response to the example quoted above, when South Korean and Taiwanese textiles were brought into the FRG market without having been made subject to tariffs, Bonn strengthened its controls, froze quotas for textile imports from the GDR, and practised greater transparency by submitting reports to the EC Commission on inter-German trade more frequently.¹⁵⁵

In order to guard against the possibility of the GDR emerging

¹⁵⁵ Garland, John, op cit., p. 204

as a channel for goods produced in other countries, the FRG Ministry of Economics established a wide range of procedures to determine the origin of GDR deliveries, and to make certain that the goods received were intended for West German end-users.¹⁵⁶ At times, this presented a difficult task. Because of the difficulty in making independent assessments, there were cases which made a determination of place of origin difficult, as with, for instance, bulk agricultural goods. In certain cases, monitoring distribution within the Common Market could entail a similar degree of difficulty, particularly since special transport arrangements freed GDR goods from border checks. Yet, a continued alertness on the part of the FRG government towards potential and real trade violations and swift reaction, once these occurred, over the years generated a higher level of trust in Brussels.

Moreover, in the absence of accommodation emanating from the German side, each EC member state had the right to impose sanctions. This form of self-protective measure could be applied if a government felt that its economy was undermined as a result of inter-German trade.¹⁵⁷ Suffice it to say that apart from the fact that this protective mechanism was available from the outset, and although EC members have time and again openly criticized inter-

¹⁵⁶ Stahnke, Arthur A., op cit., p. 367

¹⁵⁷ Ipsen, Hans Peter. "Innerdeutscher Handel - Zum Deutschland Bild der Europäischen Gemeinschaft", in Finis Germaniae? Symposium held 11-13 December 1977, edited by I. von Münch et al., Frankfurt: Metzner Verlag, 1977, p. 104

German trade for its adverse effects on the Common Market, as far as the records indicate, the mechanism was never activated.

**(b) ECONOMIC IMPACT OF GDR-EC TRADE:
VOLUME AND COMMODITY STRUCTURE**

In order to determine to what degree some of the allegations were justified, a more detailed examination of the volume and structure of GDR-EC trade is in order. Assuming that, in principle, the concerns by EC members were justified because indeed a leak existed in the common tariff barrier, if considered from a relativistic point of view, it probably did not amount to considerable losses for the EC. For reasons outlined above, exact trade statistics covering GDR-EC trade are difficult to find. Mainly they have to be inferred from analyses of East Germany's overall foreign trade.

Based on a comparison between FRG-GDR trade and GDR-EC trade, two West German authors independently asserted that the special advantages derived by the GDR through its engagement in trade with the Common Market were significant during the 1970's.¹⁵⁸ They both claimed that this was applicable in particular to the deliveries of textiles, a sector protected by the EC. However, in 1981, Arthur A. Stahnke commented on their conclusions by making the point that the reverse did not hold true, that is, East German

¹⁵⁸ Biskup, Reinhold. Deutschlands offene Handelsgrenze. Frankfurt: Ullstein Verlag, 1976 and Sighart Nehring, "Präferenzen und DDR-Exportstruktur im Innerdeutschen Handel", Weltwirtschaftliches Archiv, Vol. 114, No. 2, 1978

benefits did not translate into equal losses for the EC. "After all", he argued, "the extent of the GDR 'membership' in the Common Market can be no greater than the total turnover in its FRG trade, which, it will be remembered, has recently been less than 2 percent of West Germany's total foreign trade. In the controversial area of textiles, the GDR's share of FRG total imports is only about 5 percent. To date, the Common Market has not been saturated with GDR products".¹⁵⁹

In 1990, after conducting a detailed study of GDR-EC trade during the preceding decade, the German Institute for Economic Research confirmed Stahnke's conclusions.¹⁶⁰ East German trade with the EC represented only 5 percent of its total foreign trade. In contrast, West Germany's share of trade with the EC amounted to approximately 50 percent of its total foreign trade. The actual turnover achieved by the GDR in relation to the Common Market amounted to a mere 1/100 of the turnover achieved by the FRG in trade with the EC, and was therefore comparable in magnitude to the FRG's trade with Ireland. In 1987 and 1988 respectively, East German exports to the Common Market amounted to DM 3 billion. By comparison, in 1985, GDR exports had come to DM 4 billion, the maximum amount ever. In contrast, East German imports from the EC amounted to roughly DM 2 billion per annum during the first half of

¹⁵⁹ Stahnke, Arthur A., op cit., pp. 368-69

¹⁶⁰ Deutsches Institut für Wirtschaftsforschung. "Handelsbeziehungen der DDR zum Gemeinsamen Markt", Wochenbericht 9/1990, pp. 103-107

the 1980's, but increased in the latter part of the 1980's. As a result, in 1988 the trade balance was roughly even, similar to an average year during the 1970's, while from 1982 to 1987, the trade balance had typically been positive in favour of the GDR.¹⁶¹ The decrease in East Germany's export profitability was primarily related to the drop in oil prices on the world market which had an adverse effect on the GDR's hard currency reserves and subsequently on its ability to make purchases on Western markets. As was stated previously, this change manifested itself in an increase in inter-German trade. The more difficult conditions for purchasing goods at world market prices made the special arrangements provided for in German-German trade arrangements more attractive from East Berlin's point of view.

¹⁶¹ Ibid., p. 105

**TABLE XII - GDR TRADE WITH 17 INDUSTRIALIZED WESTERN (IW)
COUNTRIES AND THE UNITED STATES, 1974-1979**
[Dollar amounts in millions of US dollars]

	1974	1976	1977	1978	1979
Imports from 17 IW	2,543.8	3,278.0	3,213.3	3,727.1	4,900.0
- US	218.0	418.0	245.0	203.4	402.8
- US share (%)	8.6	12.8	7.6	5.5	8.2
- EC	1,925.9	2,314.4	2,435.8	2,960.6	3,591.6
- EC share (%)	75.7	70.6	75.8	79.4	73.3
- of which:					
Foodstuffs	427.3	701.4	510.8	605.8	837.6
- US	215.0	411.5	240.0	187.3	370.1
- US share (%)	50.3	58.7	47.0	30.9	44.2
- EC	194.6	203.3	220.1	340.1	381.5
- EC share (%)	45.5	29.0	43.1	56.1	45.6
Manufactured	1,919.3	2,123.8	2,253.8	2,701.8	3,353.2
- US	2.8	5.6	4.1	14.3	23.4
- US share (%)	.1	.3	.2	.5	.7
- EC	1,588.1	1,799.3	1,838.3	2,250.9	2,667.7
- EC share (%)	82.7	84.7	81.6	83.3	79.6
High Technology	54.4	74.9	83.8	103.5	202.9
- US	1.6	1.9	1.2	3.2	7.1
- US share (%)	2.9	2.5	1.4	3.1	3.5
- EC	25.2	30.7	42.8	45.1	47.7
- EC share (%)	46.0	41.0	51.0	43.6	23.5
Exports to 17 IW	2,150.2	2,524.9	2,752.1	3,237.2	4,008.0
- US	14.1	13.6	16.8	38.3	39.8
- US share (%)	.7	.5	.6	1.2	1.0
- EC	1,792.0	2,171.9	2,385.4	2,744.0	3,470.8
- EC share (%)	83.3	86.0	86.7	84.8	86.6
Turnover with 17 IW	4,694.0	5,802.9	5,965.4	6,964.3	8,908.8
Balance	-393.6	-753.1	-461.2	-489.9	-892.8
- Balance with US	-203.9	-404.4	-228.2	-165.1	-363.0
- Balance with EC	-133.9	-142.5	-50.4	-216.6	-120.8 ¹⁶²

¹⁶² Oechsler, Ronald G. "GDR: Performance and Prospects in Trade with the West", East-West Trade: The Prospects to 1985, Washington, DC: US Senate Joint Economic Committee, 1982, p. 154

TABLE XIII - FRG AND GDR TRADE WITH THE EC COUNTRIES (1987)

Yearly Average	Exports [in billion DM]		Imports [in billion DM]	
	GDR	FRG	GDR	FRG
1980	2.4	167.6	2.2	158.5
1985	4.0	253.1	2.2	227.0
1986	3.4	255.2	2.3	209.2
1987	2.9	266.4	2.3	208.6
1988	2.8	294.9	2.6	222.3 ¹⁶³

The calculations of GDR-EC trade by the German Institute for Economics are congruent with statistics provided in studies of the GDR's overall foreign trade. Table XII illustrates the comparative share of GDR-EC trade by sectoral break-down during the 1970's. Against GDR-US trade, the level of trade between East Germany and the Common Market was significantly lower, on both the import and export side.¹⁶⁴ This supports the argument in favour of the relative insignificance of GDR-EC trade, seen not only in the context of overall Common Market trade, but also from the GDR's vantage point. The trend towards increased purchases from the West could already be detected in the 1970's, but became more emphasized during the 1980's.¹⁶⁵ This related to growing economic pressures

¹⁶³ Deutsches Institut für Wirtschaftsforschung. "Handelsbeziehungen der DDR zum Gemeinsamen Markt", Wochenbericht 9/1990, p. 105. In both TABLE XII and TABLE XIII, GDR-EC trade excludes the inter-German trade portion.

¹⁶⁴ Ibid., p. 154

¹⁶⁵ Deutsches Institute für Wirtschaftsforschung. Wochenbericht 9/1990, op cit., p. 105

experienced by the GDR due to changes in fuel and raw material prices, a mounting labour shortage, rising consumer demands, and sizeable debt repayment obligations.¹⁶⁶ The situation represented a wide-spread trend in economic development of the socialist countries. As will be discussed shortly, the GDR chose to react to its economic malaise differently than other East European CMEA countries facing similar problems.

The structure of EC-GDR trade was not dissimilar to the sectoral break-down for inter-German trade. The GDR's main exports were chemicals, textiles and agricultural products,¹⁶⁷ while imports from the Common Market countries other than the FRG characteristically comprised a high share of consumer products.¹⁶⁸ During the 1980's, apart from sectoral fluctuations, the broad pattern persisted. As a result of a comparative analysis of detailed lists of goods and products delivered to and from the GDR, it appears that intra-sectoral specialization took place to a limited degree only.¹⁶⁹ Much like in the case of inter-German trade, consumer goods were exchanged for a narrow list of export products, indicating that exchanges were made across product

¹⁶⁶ Oechsler, Ronald G., op cit., p. 136

¹⁶⁷ Garland, John, op cit., p. 204

¹⁶⁸ Cornelsen, Doris. "The GDR in a Period of Foreign Trade Difficulties: Development and Prospects for the 1980's", East European Economic Assessment, Part 1-Country Studies, Washington, DC: US Congress Joint Economic Committee, 1981, p. 312-13

¹⁶⁹ Deutsches Institut für Wirtschaftsforschung. Wochenbericht 9/1990, op cit., p. 106

sectors rather than within them, as is the case with trade relationships among highly industrialized countries. The trade pattern reflected a low degree of specialization, non-integration into the international division of labour and subsequent limits on market competitiveness.

(c) THE GDR: INTERNAL/STRUCTURAL ECONOMIC PROBLEMS

Economic autarky had formed part of the GDR's model of economic development. In the long run, the policy adversely affected the GDR because it deprived the economy of the impulses that normally result from external competition.¹⁷⁰ For instance, the formerly discussed and potentially lucrative option of having West German goods produced in the GDR, for the purpose of taking advantage of the cheaper cost of labour and simultaneously receiving the tax breaks provided by the FRG government as an incentive for increased FRG-GDR economic cooperation, clashed with the autarkic tendencies in the East German government. It was feared that the GDR would develop into an "extended work-bench" for West Germany.¹⁷¹ Moreover, it would have implied having to make structural economic adjustments, an option that was politically unacceptable to the government in East Berlin.

Consistent with the principle of central planning, external

¹⁷⁰ International Monetary Fund. German Unification - Economic Issues (Occasional Paper No. 75), edited by Leslie Lipschitz et al., Washington, DC: IMF, December 1990, p. 52

¹⁷¹ Stahnke, Arthur A., op cit., p. 367

trade was subject to a state monopoly as prescribed by the East German constitution that came into effect in 1968. Monopoly power was traditionally exercised by the Ministry of Foreign Trade and its subsidiaries, although it was weakened in the 1980's with the Ministry having to share control over exports with the so-called combines [Kombinate]. Similar to other socialist countries, foreign trade activities in the GDR were assigned to special foreign trade companies [Aussenhandelsbetriebe]. Detailed plans determined domestic prices and quantities of exports and imports. In addition to domestic requirements, obligations vis-à-vis the other CMEA countries, in particular the Soviet Union, had to be taken into account.¹⁷² This system left very little room for manoeuvre in the conduct of foreign trade with Western countries.

Thus, based on the systemic factors, foreign trade, and inter-German and GDR-EC trade in particular, did not develop to a point where it could have saved the GDR economy from decline. By the late 1970's, the dilemmas created by the centrally-planned economies had already become apparent. In the GDR, the official response manifested itself in the 1981-1985 Plan. A policy of accelerated economic growth was adopted. However, in contrast to the Hungarian model, which favoured decentralization as a means of achieving higher economic growth, the GDR opted for intensification, that is, "improvements in efficiency and productivity leading to increased production from the same or reduced quantity of fuels and raw

¹⁷² IMF Occasional Paper No. 75, op cit., p. 60

materials".¹⁷³ The East German government chose to rely on administrative measures to achieve its goal, which mainly meant an attempt to refine the system of industrial combines in order to boost economic performance.¹⁷⁴ In reaction to an unfavourable international trade climate and efficiency problems experienced in the domestic economy, combines represented East Germany's effort to reform the economy.¹⁷⁵

In combines, factories in compatible industries were grouped together and made subordinate to one of the industrial ministries. Each combine was responsible for everything from research to design to foreign trade.¹⁷⁶ The following results were generally expected of the combines.

Growth of productivity through better coordination; a better solution of supply problems, especially by the affiliation of the enterprises in question; acceleration of scientific-technical progress by incorporating research facilities; more efficient investment through better adaptability; and increased exports through reorientation of foreign trade administration.¹⁷⁷

¹⁷³ Oechsler, Ronald G., op cit., p. 136

¹⁷⁴ Ibid., p. 136

¹⁷⁵ Melzer, Manfred. DDR: Reformpolitik mit erkennbaren Erfolgen, Berichte des Bundesinstituts für ostwissenschaftliche und internationale Studien, Vol. 35, 1984, pp. 9-11

¹⁷⁶ Dawisha, Karen and Jonathan Valdez, "Socialist Internationalism in Eastern Europe", Problems of Communism, March-April 1987, p. 8

¹⁷⁷ Doris Cornelsen, US Congress Joint Economic Committee study, op cit., p.317

During the late 1980's, this effort was much quoted by the Honecker régime as East Germany's "successful" response to economic problems, making Soviet-style 'perestroika' unnecessary in the GDR. However, the goal of increased efficiency was not attained. Trade statistics above have shown that, as already anticipated during the 1970's by a number of Western analysts of the East German economy, despite the creation of combines export growth declined during the 1980's, while the importation of Western goods increased, leaving the GDR with a negative trade balance.¹⁷⁸

In other words, the reasons behind East Germany's difficulties in making effective use of its foreign trade relations were internal and systemic in nature.¹⁷⁹ The framework agreements governing both inter-German and GDR-EC trade did not directly place limits on the intensity of economic cooperation between the respective two sides. On the contrary, greater political commitment on the part of East Berlin to a process of efficiency-inducing reforms, coupled with increased integration into the international division of labour, could have stimulated higher growth rates.¹⁸⁰ The GDR-EC trade arrangement could have served as one possible framework for East Germany to work within, in order to alter the international aspects of its economic dilemma. More intensive

¹⁷⁸ US House of Representatives. Committee on Small Business. East Germany's Time of Crisis. Washington, DC: US Government Printing Office, 1990, pp. 6-11

¹⁷⁹ Ibid., pp. 6-11

¹⁸⁰ Oechsler, Ronald G., op cit., p. 338

economic cooperation, based on a more increased level of structural reform of the domestic economy and subsequent product specialization, could have helped alleviate some aspects of the economic crisis experienced by the GDR.¹⁸¹

The non-responsiveness of the SED government to the East German economic crisis had political repercussions which ultimately led to its downfall and the subsequent merger between the two Germanys. These developments formed part of a larger political context in European politics. While internal factors led to the collapse of régime legitimacy in the GDR, their manifestation was largely influenced by external developments, both in the Soviet Union and the rest of Central and Eastern Europe. The discussion in the following part will show that German unification and the GDR's full integration into the European Community were only possible as part of more international developments which had been initiated prior to the breakdown of the SED régime.

¹⁸¹ US House of Representatives, *op cit.*, p. 9

3.4. CHANGES IN THE EUROPEAN ORDER

The membership of the Federal Republic of Germany in the community of European democracies is a denunciation of national single-handedness, a denunciation of illusionary neutralist policies which would again make us a factor of uncertainty in Europe and an object of rivalry between West and East.

True, the European Community, if we take Europe as a whole - that is to say from the Atlantic to the Urals - does not constitute that whole but it is a basic element of the present and tomorrow's European structure ... The task now is to plan the architecture for the whole of Europe, the common European house. The ensuing interdependence will enhance mutual confidence and make for new stability. This new order must not be characterized by fences but by open doors, by freedom of movement for people, ideas and goods, as well as respect for human rights.¹⁸²

Speaking exactly two years prior to German unification, Hans-Dietrich Genscher, Germany's long-time Minister for Foreign Affairs, in his typical visionary manner, was anticipating changes that were about to take place in Europe. Clearly he could not have known how dramatic and fast-paced these changes would be. At that point, while the impact of the Gorbachev approach both on domestic and international politics was becoming apparent and could be taken into account as a factor bringing about change, at the end of 1988, nobody could foresee the drama of the East European revolutions, and ever less so the speedy unification of Germany. And yet, even in late 1988, some basic developments could be anticipated or at least speculated on because unless obstructed overtly, they would grow naturally out of post-war European history.

¹⁸² Genscher, Hans-Dietrich. "Gerold von Braunmühl Memorial Lecture", Johns Hopkins University, Bologna, Italy, 3 October 1988

When Genscher was espousing the vision of a New Order and a Common European House, he took into account a number of ideas which implied a new conceptual framework for the idea of Europe itself. At that point, the EC Commission's White Paper had been adopted and with it the commitment to creating a single internal market, "an area without internal borders allowing the free movement of goods, persons, commercial services and capital."¹⁸³ The deadline was set at December 31, 1992. The so-called "Project 1992" was thus on its way. A related development was the movement towards the creation of a European Economic Space, based on the June 1988 Luxembourg Declaration and intended to comprise 18 countries, thereby bringing together the EC and EFTA countries in a free-trade zone. In addition, the notion of a Common European House, which would bring under an as yet undefined umbrella all European nations in East and West, had been brought forward by Gorbachev and indicated a decision on the part of the Soviet Union as well as its CMEA partners that they did not intend to be excluded from the opportunity of economic development by way of cross-border cooperation.

The three parallel developments signalled a renewed energy among the Europeans to commit themselves to the creation of cooperative structures going beyond the nation-state, with a commitment to change being implicit. They also represented a new

¹⁸³ Ungerer, Werner. "The Development of the EC and its Relationship to Central and Eastern Europe", Aussenpolitik, No. 3, 1990, pp. 225-26

mind-set that has evolved over the past years. If compared, the three concepts differ in terms of magnitude and precision. The larger the circle of intended membership, the fuzzier the ideas about practically applying the concept to create an international structure. For instance, compared to the advanced regulations designed to govern the EC's internal market and their on-going implementation, the concept of a Common European House seems highly abstract. The definition given in form of a German-Soviet Joint Declaration runs as follows:

The FRG and the USSR consider it a paramount objective of their policies to continue Europe's historical traditions and thus contribute towards overcoming the division of Europe. They are resolved to jointly elaborate concepts for attaining this goal through the development of a Europe marked by peace and cooperation - a peaceful European order or a common European home - in which the USA and Canada also have their place. THE CSCE Helsinki Final Act in all its parts as well as Madrid and Vienna concluding documents chart the course for the realization of this goal.¹⁸⁴

According to this definition, the Common European House is not meant as an extended European Community. Rather, it takes into account the requirements of the current security structure in Europe by including both superpowers in the geographic contours. And, by addressing the principles of the CSCE process, it creates a framework going far beyond economic cooperation. However, the realism of including the requirements of the current world order defeats the requirements of a working definition that can be put into practice. That is not to say that the impact should be

¹⁸⁴ German-Soviet Joint Declaration of 13 June 1989, Europa-Archiv, No. 13, 1989, p. D382

minimized or disregarded.

Taken together, the various developments signify a new confidence in Europe. Particularly now, faced with altered political realities, Europe has a chance to prove that it is capable of overcoming traditional antagonisms, and that states with differences in cultural heritage, and in the status of power, are able to cooperate. In essence, it could be viewed as the project of restructuring Europe, integrating what has become political reality in the recent past, that is, since the revolutions started unfolding in Eastern Europe, as well as building upon the foundations of what has been there before, namely a community of nations which share certain interests in common and feel that they are in a better position to achieve their goals together than alone, even at the cost of having to give up a certain amount of their sovereignty.

Most of all, Germany is affected by this new scenario. Jochen Thies has put it succinctly by saying, "we are presented with what is perhaps a unique historical opportunity in which the Germans, as well as the West Europeans must prove that the old borders of the nation-states are less important than the new supranational tasks".¹⁸⁵ For the united Germany, the idea of Europe takes on a special importance. The artificial division of Europe and Germany

¹⁸⁵ Thies, Jochen. "What Now, Germany?", European Affairs, No. 4, Winter 1989, p. 16

is gone. This fundamentally alters a number of premises on which post-war European politics were based. Some critics interpret changes in the status quo as a threat to peace. This view is based on the assumption that change automatically implies upheaval in the negative sense. However, the opposite argument can be made as well. Change creates windows of opportunity to implement new ideas. In many ways, history is at a cross-roads and Germany can play a significant role.

The reality of historical and political change is not entirely fluid however. Structures and institutions exist that will create a firm foundation for change, thereby preventing what some people fear as an ad hoc upheaval. One of the most significant of these institutions is the European Community. The EC is the main coordinating point for economic integration in Europe.¹⁸⁶ Assuming that a united Germany will base its influence on the economic dimensions of power, an assumption that is justified given Germany's post-war history, Germany has strong incentives to work within the framework of the EC.¹⁸⁷ It is not by accident that Chancellor Helmut Kohl has continued to propose an intensified vertical integration within the EC by pressing for monetary and political union. However, critics have wondered whether unification will not absorb Germany's political and economic energies, thereby

¹⁸⁶ Nötzold, Jürgen. "On the Way to a New European Order", Aussenpolitik, No. 3, 1990, p. 221

¹⁸⁷ Szabo, Stephen F. "Reunited Germany", Current History, November 1990, p. 388

reducing its commitment to European integration.¹⁸⁸

The critics have brought forward other concerns as well. Berndt von Staden, a former state secretary in the Bonn Foreign Office, has made the argument that "the German discussion on Europe today is indeed often out of touch with reality and occasionally marked by hypocrisy".¹⁸⁹ Drawing on studies of centuries of European history, he arrives at the conclusion that Europe will continue to be plagued by its heterogeneity. In his assessment, institutions such as the EC will not be able to overcome the European heritage of diversity. He takes into account visions of an enlarged EC, whereby membership is extended beyond the Community of Twelve to all European states willing to join, including the East European countries once they have adopted a democratic and pluralistic form of government and social system.¹⁹⁰ On that basis and taking into consideration the past experiences of the EC, he concludes: "The EC cannot have the task of reuniting Europe within itself. An unrestrained enlargement would rob the Community of its freedom of action as well as of its political finality."¹⁹¹

His argument is flawed in that there are no concrete proposals

¹⁸⁸ Stent, Angela. "The One Germany", Foreign Policy, No. 81, Winter 1990-91, p. 67

¹⁸⁹ von Staden, Berndt. "Nothing less than the whole of Europe will do...", Aussenpolitik, No. 1, 1990, p. 25

¹⁹⁰ Ibid., p. 25

¹⁹¹ Ibid., p. 24

to re-direct the EC to such an extent. Although the Central European countries have indicated their desire for EC membership, horizontal expansion of the Community remains an unresolved issue for now. Proposals for expanding the mandate of the Community are much more moderate in character than von Staden assumed. The less concrete and more visionary proposals are intended to represent possibilities for the long-term rather than the immediate future of the EC.

(a) VERTICAL INTEGRATION

Commentators on European affairs admit that the role of the EC is very significant in shaping the future of Europe. However, there is an awareness of its limitations as well. Although alternative approaches are emerging, some prove incompatible. One commentator concluded that "if the EC wants to incorporate all of Europe, then its political cohesion will be in flux for a long time to come; if it wants to become a cohesive, political actor, then membership will have to be restricted and integration brought forward."¹⁹²

The key issue facing the EC at this historic juncture is whether to develop horizontally or vertically. In this context, horizontal integration implies an extension of EC membership, while vertical integration presupposes a functional extension, that is, an increased movement towards intensified economic, political and

¹⁹² Bertram, Christoph. "The German Question", Foreign Affairs, Vol. 69, No. 2, Spring 1990, p. 54

social integration.¹⁹³ The choice in the short-run will probably be in favour of vertical integration which does not contradict the requirements of accommodating a united Germany.¹⁹⁴ In order to intensify the process of integration, the Community will have to increase its areas of responsibility, implying that the member states more than ever must be willing to let go of facets of their respective sovereignty. Among others, this will have to take place in the areas of monetary coordination, foreign relations, security and development matters, as well as in the spheres of energy management, transport, the environment and social issues.¹⁹⁵ On the one hand, this is necessitated by calls for more in-depth integration, on the other by the newly arisen need to deal with changes in European politics overall.

In the new Europe, security will not exclusively be based on the military role of NATO or the arms control and confidence-building measures as undertaken by the CSCE. Both institutions will be increasingly supported by EC policies and more directed towards establishing economic, ecological and technological interdependence which, by way of its mechanisms of conflict resolution, will ensure a more peaceful order in Europe. Although these principles formed

¹⁹³ Dicke, Hugo. "Europe '92: An Obsolete Integration Concept?", Aussenpolitik, No. 2, 1991, pp. 162-63

¹⁹⁴ Blumewitz, Dieter. "Europäische Einigung und Wiedervereinigung Deutschlands - Ein Konzept im Widerspruch?", Politische Studien, Vol. 40, March/April 1989

¹⁹⁵ Hänsch, Klaus. "Aspekte der Europäischen Integration in einem ungeteilten Europa", Europa-Archiv, No. 19, 1990, p. 564

the basis for the creation of the EC from the outset, they have now taken on a new relevance, with the additional factor of increased urgency. In a divided Europe and a bi-polar world structure, the EC had the option of de-emphasizing its political role, despite its growing influence in the world economy. This will have to change if the EC wants to avoid internal contradictions, such as those illustrated by the debates over Europe's role in the Gulf War and the EC's reaction to Gorbachev's crack-down in Lithuania.¹⁹⁶

Moving towards intensified coordination will not only mean an increase in the EC's sphere of authority, but also institutional reform in the shape of a greater balance between the individual EC organs and further democratization of decision-making processes. In July, 1990, the European Parliament made detailed proposals in this direction. First, it suggested a more equal share of the legislative capacity for the European Parliament vis-à-vis the Council of Ministers. Second, it proposed an increased authority and political mandate to be transferred to the Commission in Brussels. If these suggestions were to be followed, it would imply a transformation of the EC from an "executive-intergovernmental" to a "parliamentary-federal" structure.¹⁹⁷ It would also mean a greater guarantee of political legitimization, since for instance, the European Parliament is voted into power by the citizens of the individual member countries.

¹⁹⁶ Economist, January 15, 1991, p. 48

¹⁹⁷ Hänsch, Klaus, op cit., p. 566

Thus far, greater equality between the Council of Ministers, the Commission and the European Parliament is being interpreted by some members as a concession as far as their respective sovereignty is concerned. This is due to an anxiety on the part of the individual governments that they could lose part of their direct influence as exercised now via the Council. Ultimately, the debate that is presently on-going indicates that the commitment to political union is not as advanced as agreement on economic and monetary union. However, the issue is on the table and will be addressed, partially because developments in Europe will force the EC to adapt.

(b) HORIZONTAL INTEGRATION

Parallel to continuing on the course of intensified integration, the EC will engage in defining its approach to the outside world. Of particular importance is the EC's approach to the East European countries. As argued above, the Community is not likely to extend membership to the new democracies in the immediate future. Even though the division of Europe has come to an end, the shadow of history is long. The two European halves have developed along very different lines which will not converge easily. Stanley Hoffmann, a keen observer of European affairs, has summarized the situation as follows.

Today, a liberal and capitalist Europe no longer faces a communist one. In their places are a settled Europe and an unsettled one. In the former, nations are either governed by consensus or have well-established procedures, as well as a host of cooperative channels for interstate interactions. The latter resembles the post-liberation scene in Western Europe

45 years ago. Thus the priorities there are widely different. In the West, the hidden agenda is the digestion of the new Germany; the open agenda is, in Germany, the digestion of the former GDR, and everywhere, the further development of cooperation along well-laid tracks. In the East, the priority is national reconstruction and reform. One side looks toward the future, the other rediscovers its past.¹⁹⁸

The East European fledgling democracies, in order to stabilize their countries economically and politically, will probably require large amounts of economic assistance, not unlike Western Europe and Germany required the aid offered by the Americans in the form of the Marshall Plan just after the war. Much of the burden will fall on the EC. The Community's approach to Eastern Europe will probably go through a process of re-definition. Since the mid-1980's, there has been agreement that the Community's policies towards Eastern Europe should take the countries' individual economic, social and political systems into account. Despite the joint communiqué between the CMEA and EC signed in June 1988 in Luxembourg, which was intended to normalize relations between the two trading blocks, Brussels did not favour a comprehensive approach to providing economic assistance to Eastern Europe or the Soviet Union. The joint declaration was meant to function as a negotiation framework, on the basis of which bilateral agreements between the EC and individual East bloc countries were to be created. Depending on what stage of economic reform a particular East bloc country found itself at, the EC Commission was either more or less willing to

¹⁹⁸ Hoffmann, Stanley. "The Case for Leadership", Foreign Policy, No. 81, Winter 1990-91, p. 27

make substantial economic concessions.

Interestingly enough, at that point the Commission did not commit itself to far-reaching negotiations with the GDR, though in the context of other East bloc economies, the GDR was one of the economically more advanced countries. This was due to the special arrangements provided to the GDR by the Community. The opening of the Berlin Wall altered the EC's approach. The European Council in Strasbourg asked the EC Council of Ministers for a mandate to work out a trade and cooperation agreement with East Germany as soon as possible. The mandate was granted on 21 December 1989, and negotiations resumed shortly afterwards.¹⁹⁹ In the wake of German unification, they have lost their significance. However, the process illustrated that despite its commitment to institutional cohesion, the EC has the capacity to adapt to changing circumstances in its external relations. This is important both in relation to absorbing a unified Germany and coping with the far-reaching implications of the cancellation of the division of Europe. A number of initiatives illustrate the EC's willingness and, more importantly, its ability to adapt.

3.5. THE EUROPEAN COMMUNITY: REACTIONS TO GERMAN UNIFICATION

Very shortly after the fall of the Berlin Wall, in line with a decision made by the European Council to approve German unity on the basis of the right to free self-determination, in January 1990,

¹⁹⁹ Ungerer, Werner, op cit., p. 229

the Commission officially offered the GDR government three options for defining its relations to the EC: links by association, admission as the 13th member-state, or integration by way of German unification. Under the first option, the GDR would have remained an independent state but linked with the FRG by way of an economic and monetary union.

The second option would have implied accession by the GDR to the EC. The approach itself was well thought out and included three distinct phases. First, transitional arrangements were to be made with the two goals of freeing the GDR from its CMEA trade obligations and granting it a grace period as far as implementation of EC regulations were concerned. This first phase would also have included access for the GDR to the EC's structural fund which would have helped alleviate some of the initial problems, including high inflation and unemployment. Second, the GDR was to be given the opportunity to draw on EC aid. This phase was envisioned to last until December 1992, and thus coincide with the deadline for Project 1992. Third, the GDR was to be granted full EC membership with some transitional regulations remaining in effect in order to ease integration.²⁰⁰ The proposal ran into opposition, however, because it would have meant 39 additional seats in the European Parliament, five new votes in the EC Council and an additional EC Commissioner, thereby forcing the issue of vertical versus horizontal integration to be resolved. In effect it also would have

²⁰⁰ Ibid., p. 232

prolonged the division of Germany - and therefore would have not likely met with German approval. In addition, it would also have also been difficult to imagine a Warsaw Pact member state being able to join the EC, whereas the neutral Austria was denied membership.²⁰¹

The third alternative, namely full integration of the GDR by way of German unification, was much supported by EC President Jacques Delors. It seemed the least difficult alternative from the point of view of EC legislation.²⁰² Simultaneously it developed as the only possible option in light of developments taking place between the two Germanys.

3.6. THE EUROPEAN COMMUNITY ABSORBS THE GDR

With unification, East Germany's trade relations with the Federal Republic were surpassed by full integration of the two economies. Naturally, this development also fundamentally altered the relationship between the EC and East Germany. As discussed above, from the EC's point of view, of the available options, full-scale integration through German unification, was the most manageable solution.²⁰³ It did not threaten the body of laws that

²⁰¹ Langguth, Gerd. "Germany, the EC and the Architecture of Europe. The German Question in the Context of the EC", Aussenpolitik, No. 2, 1991, pp. 139-40

²⁰² Ibid., p. 139

²⁰³ Commission of the European Communities. "The European Community and German Unification", Bulletin of the European Communities, Supplement 4/90, 1990, p. 9

govern EC matters;^{204 205} it did not throw open the conflict over vertical versus horizontal integration which had been going on for quite some time within the EC;²⁰⁶ and furthermore, it did not detract from the process of more intensified integration, as some critics had initially feared^{207 208}.

The existing degree of integration in the EC invalidates real or potential anxieties about a revival of Germany's "special course" [Sonderweg] tendencies.²⁰⁹ Already at the end of 1989, the German historian Michael Stürmer effectively argued that the constellation of political and economic forces in Western Europe made the emergence of an all-powerful Germany, even if unified with its Eastern half, impossible.²¹⁰ Since the initial speculations

²⁰⁴ Langguth, Gerd, op cit., p. 139

²⁰⁵ The EC Commission emphasized from the start that it favoured the Article 23 route to German unification because that mechanism was more compatible with EC law. See: Bulletin of the European Communities, Supplement 4/90, op cit., p. 9

²⁰⁶ The EC Commission made the following statement: "The integration of the territory of the GDR into a unified Germany and hence into the Community constitutes a 'special case'. For this reason Article 237 of the EEC Treaty - which relates to the accession of other States - does not apply", in Bulletin of the European Communities, Supplement 4/90, op cit., p. 9

²⁰⁷ Beise, Marc, op cit., p. 149

²⁰⁸ House of Commons. Standing Committee on External Affairs and International Trade. Report on the Committee's Visit to the Soviet Union and the Germanies, Ottawa: June 1990, pp. 22-23

²⁰⁹ Langguth, Gerd, op cit., p. 146

²¹⁰ Stürmer, Michael. "Die Deutschen in Europa - Auf dem Weg zu einer zwischenstaatlichen Innenpolitik", Europa-Archiv, No. 24, 1989, p. 727-28

about Germany's and Europe's future, a number of EC commentators and analysts of European affairs have come to the conclusion that German unification can in fact be seen as strengthening the process of European integration, both within the Common Market itself and in an extended framework of increased East-West European integration.²¹¹ Foreign Minister Genscher phrased it in terms of government policy:

Rather than creating new problems for Europe, German unification will play part in ensuring a new and lasting stability. We consider the transformation of this insight of European history into a policy for Germany and for a gradually uniting Europe to be Germany's European mission as we approach the end of this century.²¹²

President Richard von Weizsäcker made a similar statement:

A new Germany will have new responsibilities as well, not only to help Eastern Europe build market economies, but to push for the economic and political integration in Europe. Only through a united Europe can Germans finally be freed of international fears of a Germany that goes its own way and tries to drag the rest of the world along.²¹³

The EC Commission took a similar stand. It noted:

The macroeconomic impact of German monetary, economic and social union on the rest of Europe will be significant and positive. The changing balance between demand and supply within the Union will affect trade flows and savings in partner countries... In the longer run, it can be expected that the beneficial effects anticipated from the single market will be reinforced... Given the relatively high integration of the GDR economy into the East European economies, the GDR can

²¹¹ Langguth, Gerd, op cit., p. 137

²¹² Hamilton, Daniel. "A More European Germany, A More German Europe", Journal of International Affairs, Vol. 45, No. 1, Summer 1991, p. 131

²¹³ The Washington Post, April 1, 1990, p. 1

act as a bridge between the Community and Eastern Europe.²¹⁴

The European Community has acted on this premise by making every effort to digest the GDR into the Common Market as effectively as possible. In line with the EC's basic approval of German unification during the special session of the European Council in Dublin on 28 April 1990, and based on Bonn's commitment to keep the Community informed about progress in negotiations towards unification, the EC created an ad hoc committee with the mandate to review in a step-by-step process the entire EC legislation in order to determine how a unified Germany can be accommodated.²¹⁵ During the process, the European Community familiarized itself in as much detail as possible, based on available data, with the economic, political and social situation in East Germany and determined how mutual adjustments could best be achieved in practice. In the sphere of economics, a sector-by-sector analysis took place.²¹⁶

Ultimately, the following decisions were arrived at:

The territory of the former GDR is to be integrated into the Community's legal framework by 31 December 1992 at the latest, in other words before the scheduled deadline for the

²¹⁴ Welfens, Paul J.J. "International Effects of German Unification", Intereconomics, January-February 1991, p. 12

²¹⁵ Commission of the European Communities. Bulletin of the European Communities, Supplement 4/90, 1990, op cit., pp. 7-193

²¹⁶ European Parliament. Directorate General for Research. The Impact of German Unification on the European Community, Luxembourg: Office for Official Publications of the European Communities, 1990.

completion of a single EC market. The EC allows only for transitional deadlines - in some cases up until 1995 - wherever transition involves particular problems. The majority of regulations, directives and other stipulations, however, become immediately applicable following the GDR's accession to the Federal Republic of Germany after 3 October 1991. Roughly 80 percent of the technical regulations are applied straight away as well as the EC legal instruments on the free movement of capital and of labour, the freedom to supply financial services, and indirect taxes. In the important field of competition policy, the EC regulations have already been applied since the German economic, monetary and social union was established in July 1990.²¹⁷

In effect, the EC reacted to German unification by treating it as a special case, much like it had done in relation to inter-German trade from the outset. Based on that, Brussels found itself in a position of being able to make speedy determinations as to the process of accommodating changing realities. The debates were short and the resulting decisions practical. Like inter-German trade, German unification did not challenge the premises on which the European Community is based and could therefore be dealt with more readily.

²¹⁷ Langguth, Gerd, op cit., p. 140

CONCLUSION

The foregoing case studies were conducted with a view towards determining whether the evolution of relations between the two Germanys, and the responses by the European Community to the existence of a divided Germany in the centre of Europe, created a legacy capable of making a contribution to the process of German unification. In alternative terms, the question was raised as to whether the long-term practice of the policy of rapprochement had the desired results, in that it furthered the goal of German unification.

Specifically, two instances of economic cooperation were surveyed over a substantial period of time - trade between the two Germanys and trade between the GDR and the Common Market. The area of trade was chosen because it provided the opportunity to quantify the indicators which determine economic interdependence. Simultaneously, the nature of the trade issue allowed for the application of concepts derived from theories of international relations which directly focus on the notions of economic and political interdependence.

The case studies do not confirm that economic interdependence developed, either between the two Germanys or between the GDR and the EC. The trade relationships were conducted in a highly controlled environment, that is, directly and closely monitored by

the respective governmental actors. This implied that political considerations entered into the decisions-making processes which were intended to determine economic activity. The emerging trade relations therefore did not represent a natural outcome in terms of economic engagement.

The trade figures indicate that trade, both in the case of inter-German trade and GDR-EC trade, remained on a structurally superficial level. It represented a straightforward merchandise exchange system, based on bilateral clearing arrangements. More intensified forms of economic cooperation, such as joint ventures, were the exception rather than the rule. Political concerns on the part of the GDR government placed limits on the type of trade in which it was willing to engage with Western economic partners. Its political sensitivities towards Western exposure showed that régime legitimacy from the point of view of East German society was very weak. As a result, the SED government refrained from integrating the GDR into the international division of labour. It hoped that a policy of economic autarky would prevent political disturbances. The limited engagement in trade with the West, as represented by trade relations with the FRG and other EC member states, was continuously evaluated in terms of acceptable political levels.

The evolution of the trade relations illustrate that the spheres of politics and economics were inseparably linked together. In fact, the ultimate benefits derived from the relationships lay

in the area of political rapprochement. The following examples illustrate the point.

Many were expecting inter-German relations to deteriorate when the CDU/CSU and the FDP formed a new coalition government in October 1982, with Helmut Kohl as Chancellor. However, practical experience showed that continuity rather than change became the general rule. In fact, a broad consensus on inter-German relations developed among all the major parties in West Germany. They agreed that unity of the nation must be maintained with as much human contacts with the GDR as possible. The practical implications of that policy manifested themselves in increased transfers of para-economic payments to East Berlin.

The GDR government did not remain immune to Bonn's wishes. Although not reacting consistently, East Berlin gradually liberalized travel restrictions, with the result that a mounting number of GDR citizens were able to travel to the West. In 1987, a record high number of 3 million East Germans legally visited West Germany. Of those, more than 1 million were under the retirement age of sixty-five.²¹⁸ As a result, exposure to West German society became more intense than was previously the case. That implied a qualitative change in contact with the FRG, by comparison with access to West German television channels which had been available

²¹⁸ Griffith, William E. "The German Democratic Republic", in Central and Eastern Europe: The Opening Curtain, edited by William E. Griffith, Boulder, CO: Westview Press, 1989, p. 314

since the late 1960's. Now, more than previously, East Germans compared themselves with their West German counterparts, always to their own disadvantage, both in socio-political and economic terms. That increased the level of dissatisfaction in East German society and, in turn, contributed much to the break-down of support for the government.

German-German political rapprochement was best illustrated at the end of the 1970's, when the East-West controversy broke out over the planned NATO deployment of intermediate-range nuclear force (INF) missiles. During the ensuing East-West crisis, the GDR resisted Soviet pressure on the issue. The Soviet government, initially under Brezhnev, and then under Andropov and Chernenko, was determined to stop the INF deployment by NATO. Moscow was encouraged in its endeavour by the emergence of a large-scale peace movement in Western Europe, particularly in Britain, the Netherlands, and West Germany. Incidentally, the West German peace movement inspired a small equivalent response in the GDR which centered around the Protestant Church, but which was subject to repressive measures by the government.

In 1983, after much political debate, the West German Parliament endorsed the INF deployment, which began immediately after. In response, Moscow counter-deployed more intermediate- and short-range missiles in East Germany and Czechoslovakia. Honecker reacted by declaring that the GDR did not favour this counter-

deployment and that there was a "community of responsibility" between the two German states ensuring that war should never again begin on German soil. Soviet anti-German sentiments were strong during that period and in September 1984, Moscow induced Honecker to postpone, if not cancel altogether, his planned visit to West Germany. Honecker's visit did not take place until September 1987. Nevertheless, the example illustrates that the SED government persisted in pursuing inter-German détente, even in the face of pressures from the Soviet Union.

Underneath the official government level, the SED was negotiating with the SPD on arms control and disarmament issues. This occurred within the context of the SPD's "second phase of Ostpolitik". Picking up on the notion of a "community of responsibility" as espoused by Honecker, the two parties jointly declared that the preservation of peace must take priority over social change. Some of the proposals developed by the SED/SPD working groups later formed part of the discussions at arms control negotiation forums where they were seriously scrutinized for their practical applicability.

Thus, from the Western point of view, and particularly from Bonn's perspective, the benefits derived from inter-German and GDR-EC trade lay in the political arena. Inter-German trade is an example of economic cooperation which is politically motivated. In purely economic terms, that is, in terms of the profitability of

the exchange of goods, inter-German trade did not represent a natural situation. Conversely, the GDR viewed the benefits emerging from trade with the West from a more economic vantage point, but was restrained by political factors in terms of accepting only limited trade engagement.

Despite the incongruence in results sought in the trade relationship, the respective negotiating positions of the involved actors were not adversely affected. Both the FRG government and the GDR régime were able to maintain their positions, without being forced into compromises based on linkage politics. Over time, the process of interaction solidified, as indicated by the fact that inter-German trade managed to establish itself beyond the influence of political crises in East-West relations. Thus, inter-German trade can be evaluated as a political success. It managed to maintain links between the two German states and at the same time, it kept the German Question from being foreclosed. In that limited sense, that trade can be viewed as contributing towards German unification. While not directly leading towards unification, due to the fact that it operated within the confines of the existing order, inter-German trade created a mind-set which kept the issue of unification alive. Once the international political situation allowed for unification to become reality, the mind-set manifested itself in helping to support a speedy process towards accomplishing unification. Thus, rapprochement ultimately increased the momentum once the decision in favour of unification was taken.

From the perspective of the European Community, accommodating a unified Germany did not present a particularly difficult challenge to the EC. On the contrary, when compared to other options, such as German confederation for instance, absorbing a unified Germany turned out to be more easily accomplished. That option did not challenge any of the premises on which the EC operates. The comparison between GDR-EC trade on the one hand, that is, the EC's handling of Germany as a divided country, and on the other hand, the EC's approach to Germany as a unified country, shows that Brussels essentially managed to create a special case scenario in both instances, thereby circumventing many legal and political problems that would have had to be otherwise addressed. The fact that German unification did not require a resolution of the vertical versus horizontal integration debate implied that German unity did not presuppose a change in EC structures, or in any way influence the EC's movement towards monetary and political union. Although the pace of accepting the GDR into the EC was set by Germany, Brussels did not make itself vulnerable politically. The fears emerged at the outset of the unification process that German unification would threaten the process of intensified integration in the EC, while simultaneously diverting Germany's energies eastward. In fact, to the contrary, the full-scale integration of Germany into the European Community provides a stimulus for further growth, while at the same time anchoring Germany in Europe.

APPENDIX I. A CHRONOLOGY OF THE DISSOLUTION OF THE GDR¹**1989****Phase I: The Dictatorship Comes to an End**

August-September: Large numbers of GDR citizens occupy FRG embassies in several Eastern European countries in order to obtain permission from the GDR Government for emigration.

September 10: Hungary opens its border with Austria to GDR citizens, suspending a 1968 agreement with the GDR Government that required Eastern European countries to block travel of GDR citizens to the West.

September 11-14: More than 13,000 GDR citizens leave Hungary en route to the FRG via Austria - the largest exodus from the GDR to the West since the Berlin wall was built in 1961. The GDR closes its border with Hungary.

September 30: With permission from the GDR Government, more than 17,000 refugees from the GDR emigrate to the FRG via Czechoslovakia and Poland.

October 3: The GDR closes its border with Czechoslovakia.

October 7: Fortieth anniversary of the founding of the GDR. Soviet President Gorbachev visits East Berlin and draws cheers from demonstrators.

October 9: Seventy thousand people demonstrate in Leipzig. General Secretary Honecker orders the demonstration to be stopped, if necessary by force, but security forces do not intervene.

October 16: About 100,000 people demonstrate in Leipzig, the largest unauthorized demonstration in the GDR since 1953.

October 18: Erich Honecker is replaced by Egon Krenz as General Secretary of the ruling SED.

October 24: Egon Krenz is elected Chairman of the State Council [Staatsrat], the second governing body of the GDR.

¹ Lipschitz, L. et al. German Unification - Economic Issues, IMP Occasional Paper No. 75, Washington, DC: International Monetary Fund, December 1990, p. 50

November 7: The Council of Ministers [Ministerrat], the de facto GDR Government resigns.

November 9: Borders with the FRG open for all GDR citizens. After 167,000 emigrants in January-October 1989, another 177,000 emigrate to the FRG in November-December, bringing the total for the Year to 344,000. In 1988, 40,000 people had emigrated to the FRG.

November 13: Hans Modrow is elected Prime Minister. He proposes a "treaty community" between the FRG and the GDR.

November 18: A new government is sworn in.

November 23: Tighter customs and currency controls and buying restrictions on foreigners in the GDR are announced, triggered by activities of "arbitrageurs" who bought highly subsidized GDR goods for sale in the FRG and Poland.

November 28: Chancellor Kohl proposes a ten-point plan for unification. Its main elements are as follows:

- Providing humanitarian aid to the GDR, in particular for the health sector where severe shortages emerged after the emigration of a great number of doctors and nurses.

- Establishing a DM 2.9 billion currency fund (with a DM 2.2 billion contribution by the FRG) allowing GDR citizens, with effect from 1 January 1990, to acquire Deutsche Marks for travel purposes once a year, at exchange rates of DM 1 - M 1 for the first DM 100 and at DM 1 = M 5 for the second DM 100.

- Undertaking joint projects with a view to reducing pollution, improving the railway system, and modernizing the telecommunications system in the GDR.

- Establishing linkages in all areas of public life based on intergovernmental treaties after free elections had taken place in the GDR.

- Developing confederative structures between the FRG and the GDR.

- Creating a FRG-GDR confederation in the context of European integration and in line with the Helsinki agreements on human rights.

December 1: The parliament [Volkskammer] in the GDR deletes the guarantee of a "leading role for the SED" from the Constitution of the GDR.

December 3: After revelations of widespread corruption among the former SED leadership, party chief Krenz resigns, together with the Politburo and the Central Committee of the SED. General elections are scheduled for 6 May 1990.

December 9: Gregor Gysi, a lawyer who had defended dissidents, is elected SED chairman.

December 20: Chancellor Kohl visits the GDR and an agreement is reached on economic cooperation in several areas.

1990

Phase II - On the Road to Free Elections

January 12: The GDR Constitution is changed to allow the establishment of a market-oriented economy. Specifically, in addition to state, cooperative, and mixed ownership, private ownership of production facilities and joint ventures with foreign companies are made possible, although many restrictions apply.

End January: Emigration continues at a rate of 1,500-3,000 people a day. The Modrow Government, fearing economic and political collapse, advances the date of elections to 18 March and includes members of the major opposition groups in a grand coalition.

February 1: Prime Minister Modrow proposes a plan for German unity after talks in Moscow.

February 6: Chancellor Kohl offers negotiations on a currency union of the FRG with the GDR.

February 12: Talks involving the two German states and the four Allied powers with rights in Germany (France, the United Kingdom, the United States and the USSR), the so-called 2+4 talks, begin in Ottawa.

March 18: In the parliamentary elections, the Conservative Alliance for Germany wins a surprise victory with 48 percent of the vote (CDU-41 percent; German Social Union (DSU)-6 percent; and Democratic Awakening (DA)-1 percent). The Social Democratic Party (SPD) receives 22 percent, the Party of Democratic Socialism (PDS, formerly SED) 16 percent, and the Liberal Party 5 percent of the vote.

Phase III - Establishing Economic, Monetary, and Social Union

April 2: The Bundesbank publishes its proposal for a conversion law to become part of a treaty on German economic, monetary, and social union (GEMSU) between the FRG and the GDR. The proposal consists of six basic points:

- On the designated day, all domestic liabilities in the GDR and payments for current transactions (e.g., wages and pensions) would be converted into Deutsche Mark at a rate of M 2 = DM 1. Wages and pensions would, however, be adjusted to compensate losses of purchasing power as a result of price reform prior to conversion. Preferential treatment would be given to individual bank accounts of up to M 2,000 a person, which would be converted at a rate of M 1 = DM 1.
- In light of the less favourable treatment for accounts larger than M 2,000, the Government of the FRG would suggest in negotiations with the GDR that savers be guaranteed a stake in assets held by the State in trust for the people.
- The accord between the FRG and the GDR would also guarantee that in regard to monetary policy in the GDR, only the Bundesbank law and Bundesbank regulations would apply. Moreover, the Bundesbank would be able to implement in the GDR all monetary policy decisions made by its central council.
- To fulfil its responsibilities, the Bundesbank would open a provisional administrative office in East Berlin and about 15 other branch offices in the GDR.
- The commercial banking law of the FRG would be introduced in the GDR, allowing FRG banks and foreign commercial banks to open offices. Regulations on interest rates and foreign exchange limits in the GDR would be removed.
- Borrowing by the GDR public authorities would be limited.

April 12: A grand coalition government between the CDU, SPD, DSU, DA, and the Liberals is formed in the GDR with Lothar de Mazière (CDU) as Prime Minister. The Government opts for economic, monetary, and social union (GEMSU) with the FRG by mid-1990 and political accession, at a later date, under Article 23 of the FRG's Basic Law.

April 23: The FRG Government publishes its proposal for the terms of GEMSU. Savings up to M 4,000 a person (M 2,000 for those under 14 years of age and M 6,000 for those above 58 years of age) would be converted at parity to the Deutsche Mark; savings exceeding these limits and other financial assets and liabilities would be converted at DM 1 = M 2. Wages and other current payments would also be converted at parity. Pensions would be linked to net wages, with a pension after 45 years of employment typically reaching 70 percent of average net income.

May 18: The Finance Ministers of the FRG and the GDR sign the State Treaty establishing GEMSU.

June 22: The State Treaty is ratified by the parliaments of the FRG and the GDR.

July 1: GEMSU takes effect.

Phase IV - Approaching Political Union

July 15-16: A meeting in the Caucasus between President Gorbachev and Chancellor Kohl results in approval from the USSR for German unification, with the united Germany a member of the North Atlantic Treaty Organization (NATO).

August 3: An election treaty is signed, stipulating accession of the GDR to the FRG before all-German elections on 2 December 1990.

August 31: The Unity Treaty is signed, providing the legal basis for unification and the transition rules.

September 12: The 2+4 talks end; a treaty is signed terminating the rights of the Allied powers in Germany.

October 3: The five GDR states - Brandenburg, Mecklenburg, West Pomerania, Saxony, Saxony-Anhalt, and Thuringia - accede to the FRG under Article 23 of the FRG Constitution; the GDR ceases to exist.

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