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NEW HORIZONS IN EUROPE

Arthur Burns Memorial Lecture  
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## I.

To meet Arthur Burns personally - and I had that privilege - was always a rewarding experience. His incomparable grasp of public affairs, mature wisdom and warm humanity made him an outstanding figure in any circle. For that reason, it is an honour for me to deliver this third Arthur Burns Memorial Lecture.

Arthur Burns was no stranger to the burden of office. A distinguished economist, his advice was sought by both President Eisenhower and President Nixon. As Chairman of the Board of Governors of the Federal Reserve System, he piloted the Fed through the difficult and tempestuous period which saw the demise of the Bretton Woods system of fixed exchange rates and - as an overture of things to come - the first oil price explosion.

During his chairmanship, he was, naturally, in close - sometimes daily - contact with other central bankers of the day including Switzerland's Fritz Leutwiler and Karl Klasen of the Bundesbank, who, prior to his nomination as president there, was one of my predecessors on the Board of Deutsche Bank. As some of you are no doubt aware, Karl Klasen was later to become Chairman of the Atlantik-Brücke which, together with the American Council on Germany, sponsors this memorial lecture. An admirable degree of rapport existed between Arthur Burns and Karl Klasen, a relationship which Fritz Leutwiler aptly illustrated when he recounted, "In Basle whenever we had a problem, we would get Karl Klasen to call Arthur Burns and that would usually produce a solution".

In 1981, at an age when most other men are definitely thinking of retirement, Arthur Burns, then 77, embarked upon a third career as a diplomat, having been appointed U.S. Ambassador to the Federal Republic of Germany by President Reagan. The President could not have made a better choice. When Burns relinquished his post in 1985, former chancellor Helmut Schmidt wrote that Burns was "a patriot and a friend of the Germans". This was much more than a friendly farewell phrase. It conveyed the sentiments of all who had observed Arthur Burns at work as a mediator fostering better understanding not only between the governments but also between the people of our two countries.

Having been born in a part of Eastern Europe which belonged to Austria at the time and which is now part of the Ukrainian Soviet Socialist Republic, Arthur Burns was always very conscious of the tragic division of Europe and of Germany. Speaking in West-Berlin in November 1984, he said, "We (i.e. the Americans) regard our function here as being, in effect, trustees of the German nation. We do not consider present divisions of this city as permanent". Five years later, the Berlin Wall - to the elation of people round the world - has effectively fallen. What a pity that Arthur Burns did not live to see this momentous event which, symbolically, marks the end of the post-war order in Europe.

## II.

In what I have to say, I wish to focus on the topic of integration as a sort of leitmotif and by "integration" I mean

the fundamental reshaping of Europe and the economic implications thereof. This reshaping has two interconnected features, these being

- Economic and political integration in the West and
  
- Reform in Eastern Europe

Let me begin with a short summary of developments in Western Europe. Here, the process of integration which began about 40 years ago has been given new impetus. After a long period of stagnation, the European Community has finally aroused itself and is now energetically addressing the many challenges facing it. The Single European Act of 1987 has provided an explicit framework for the completion of the single European market and for the establishment of an economic and currency union.

The program for the completion of the single market in 1992 is proceeding much faster than pessimists had expected although the pace is slower than that which optimists had hoped for. By and large, the envisaged time schedule will be adhered to. And, meanwhile, it has transpired that the growth and employment impulses of 1992 are going to be even stronger than originally predicted in the so-called Cecchini-Report. In addition, they are materialising sooner. There are good prospects for strong growth in EC countries on into the early nineties. As a result, Europe is now in a much better position to cope with a recession in North America, should it occur, than was the case in the seventies or early eighties.

Next on the EC priority list is the gradual implementation of the European Monetary Union. Obviously, a single market calls for a single currency. Experience with the European Monetary System has, on the whole, been positive and the EMS will form the nucleus of the envisaged monetary union. There are, of course, a number of difficult problems still to be solved. Monetary Union means that participating countries will have to sacrifice much of their previous autonomy in the field of economic policy making. This concerns areas such as the exchange rate and monetary policy and, to a certain degree, will probably also extend to fiscal policy. I admit, the issues involved are thorny but, nevertheless, I am convinced that they can be resolved and that the year 2000 is a realistic goal for the implementation of monetary union.

EC integration is of manifest importance for third countries, too. They should perceive "Europe 1992" as part of a wider phenomenon, namely the world-wide interlocking of economies which is now called the globalization of business activities. European integration and that taking place between The United States and Canada under The Free Trade Agreement are not discrete phenomena. Rather, they are manifestations of a truly global process to which the ongoing efforts to make the Uruguay round of GATT negotiations a success are a further pointer. Against such a background, fears that the EC - fortress-like - will cordon itself off are obviously unfounded. Europe has to remain open and it will remain open for third countries in general and for its European neighbours in the East in particular.

The European Community of twelve different nations has gained new respect internationally. In addition, the progress achieved in implementing EC integration has proven that free nations can pool their energies on a voluntary basis without the emergence of a hegemonial power. This insight has been a source of inspiration for Eastern European countries and has prompted them to press courageously for self-determination - that is, for the right to develop their own models for political and economic reform.

### III.

Currently we are witnessing a series of developments in Eastern Europe which signify a genuine rupture with the past. Events are unfolding with breathtaking rapidity. "Glasnost" and "Perestroika", initiated by General Secretary Michael Gorbachev, have convulsed the Soviet Union. In other Eastern European countries, we are witnessing a peaceful revolution "from below" so to speak. Hungarians, Poles, Czechs and East Germans are all standing up and demanding freedom: freedom of opinion, freedom of speech, freedom to travel, self-determination including free elections. In short, they are demanding democracy, that is: "government of the people, by the people, for the people". At the same time, they are demanding a standard of living hitherto refused them. They are sick and tired of the disasters of socialist planning which has reduced potentially affluent societies to near-poverty.

Fundamental reform of the existing economic system, such as has already been initiated in Hungary, Poland and in the Soviet Union and which is in the offing for East Germany (and presumably for Czechoslovakia), with a view to putting greater emphasis on market mechanisms has its dangers. And whatever happens, reform is likely to be a long and arduous process. Major adjustment problems will be unavoidable and will have to be surmounted if transition to market mechanisms is to work, economic efficiency to increase and the standard of living to be raised. One is reminded of Alexis de Tocqueville's shrewd observation that authoritarian regimes run into difficulties precisely then when they begin to change for the better. My personal conviction is that political and economic reform will have to go hand in hand in order to achieve enduring success. The setback in China this summer, where reform had been restricted to the economy and where the old political structures had remained unchanged shows only too clearly that freedom is a comprehensive concept and cannot be confined to just one sector of national life.

The Soviet leadership has thus far declined a Western-style pluralistic democracy for the U.S.S.R. . But with glasnost, a new election system and more autonomy for the individual republics, important steps have been taken in the direction of democracy. At any rate, political change has advanced much faster than economic reorganisation. If the government does not succeed in eliminating, or at least easing, bottlenecks in supply, the resulting disaffection could interact with inveterate, latent ethnic antagonisms and possibly erupt in

increasingly bitter conflicts. To cope with the probable hardships of this winter may turn out to be particularly difficult.

Success with perestroika is, however, necessary and very much in the West's interest as well. It would also give other countries in Eastern Europe more scope to restructure society and the economy. Such success can even be seen as the precondition for further progress in reforming countries.

#### IV.

Let me expand a little on the specific case of Poland. In addition to the patent shortcomings in the way its domestic economy is organised, Poland is also grappling with an exceptionally large external debt of almost \$ 40 bn. For domestic reforms to have at least a chance of success, the debt problem needs to be solved promptly. In the past, the banks have agreed to regular reschedulings, but now the onus is on government lenders assembled in the Paris Club to come up with a helpful contribution. They account for roughly two-thirds of the country's external debt. If there is to be a permanent solution, this will require enlarging the strategies hitherto adopted to include a reduction of debt or debt service. However, such support can only make a meaningful contribution to reform policy if it is used sensibly and efficiently, as was



the case with the Marshall plan funds in shattered postwar Western Europe.

But this - vital - precondition still has to be fulfilled, given the dominant role of the state sector whose bureaucratic structures have remained largely intact so far. What, then, is to be done? The indispensable aid from outside should, I feel, be supplemented by a temporary scheme whereby external donors also have a say in the application of funds provided. The task here is to ensure that new loans are channelled into promising projects. It is, therefore, to be commended that the export credit guarantees which the West German government is prepared to extend are largely project-oriented. In fact, it was a Polish idea that a committee of experts drawn from both countries evaluate likely projects in order to make sure that the costly mistakes of the seventies are avoided.

In this context, I proposed - on the occasion of this year's Annual Meeting of the World Bank and the IMF in Washington - the establishment of a development bank on the spot, that is in Warsaw. Its job would be to bundle incoming aid and deploy it in accordance with strict efficiency criteria. I could well imagine that such an institution might be set up along the lines of the German Kreditanstalt für Wiederaufbau, the Reconstruction Loan Corporation, whose origin goes back to the Marshall plan.

Representatives of the creditor countries should hold the majority in the management board of this new institution. Such a Polish "Institute for Economic Renewal" (IER), as it could be called, would have two functions: it should help and monitor. Since both these functions can only be exercised in close cooperation with the Polish authorities and with Polish trade and industry, genuine involvement on the part of the Institute in the Polish economy and the country's development process would be absolutely essential. It could be set up "until further notice" or come under Polish control after a transitional period. By channelling Western "help towards self-help" in the right directions, the Institute could play a constructive role in economic reform.

Similar institutions could of course be established for other countries. As an alternative to specific Institutes for each single country, France has proposed the creation of a European Development Bank in analogy to existing institutions for Africa, Asia and Latin America. The EDB would serve all Eastern European countries and operate in much the same way as the envisaged "Institute for Economic Renewal". The proposal which is very much in line with my ideas is presently under further consideration. I have, however, three specific pleas in this context: Firstly, funds provided for a European Development Bank should not be deducted from aid destined for the less developed countries in the Third World. Secondly, the bank should be established very rapidly. In today's situation, speed is of the essence. Thirdly, it should extend project loans to

every East European country interested and which is prepared to accept some form of conditionality along the lines of that practised by the IMF. Membership in the IMF would be welcome, but must not be made a prerequisite for access to lending. Otherwise, of the reforming countries, only Hungary and Poland would be eligible, but not the GDR or Czechoslovakia. That would certainly be unfortunate.

V.

How should we appraise the current situation in the two German states? Germany is at the very center of recent European developments. As a consequence of the Cold War, our country has been - unnaturally - divided since 1948. For 28 years the Berlin Wall prevented East Germans from moving freely. In the course of the last two months, with a lot of courage, the East Germans have forced upon their government tremendous political changes which nobody, until today, would have thought possible. They culminated in the opening of the Wall - a development whose powerful symbolism captivated world opinion. Despite the general euphoria, one could not miss the irony: The Wall was built in an attempt to keep people in the country, and now it had to be opened for exactly the same reason. Of course, East Germany's position is different from that of Hungary or Poland and is much more difficult in certain respects. It is the "front-line state", if that expression is still admissible, of the Warsaw Pact. And it borders on the other German state with which it has always to compare.

The opening of the Wall has raised the question of German reunification. Preferably, we should speak about "unification". In my opinion, a single, united German state is clearly desirable, not because of the attraction of sheer size or any power that size might confer, but because - historically, culturally and in human terms - it is a natural aspiration. We in Germany are very grateful that the Bush Administration and the American people have considerable understanding for this view.

In some quarters in the West, there is concern that a unified Germany might withdraw from NATO and adopt neutrality in order to gain reunion. It is pointed out by some observers that this may now be all Mr. Gorbachev can hope to rescue from the present political upheaval in Eastern Europe. In my opinion, such a demand would nevertheless be ill-advised. Nobody, and not even the Soviets, can be interested in having a large country of nearly 80 million people isolated in the middle of Europe, uneasily veering between East and West. As far as my fellow countrymen are concerned, I am convinced that, confronted with that sort of choice, they would say: "No, thank you". It would certainly be illogical for us to loosen our ties with the Western community exactly at a juncture when our neighbours in Eastern Europe are becoming receptive to the Western ideas of democracy and market-oriented systems. Our government and our parliament have made it abundantly clear for anybody who cares to listen that the Federal Republic is not contemplating a "solo run".

It is not premature to analyse the possibilities and consequences of German unity. Two things, however, should be kept clearly in mind. Firstly, it is up to the people to decide where they belong, i.e. in the first place to the East Germans. That East Germans be given freedom and self-determination is more important than a united Germany. If, later, the attainment of liberty were to be followed by a decision on their part to have a closer relationship with the West or even unity that would certainly be welcomed in the Federal Republic. At this point, the question is still very much an open question.

Secondly, such an endeavour would be a difficult and certainly a long process in view of the large economic and social differences that exist today. Whereas East Germany has the highest standard of living in Eastern Europe, the gap to West Germany is considerable. Now that travel between the two parts of Germany in an East/West direction is unrestricted, the GDR will have to do its utmost to overcome economic stagnation, to increase efficiency, to improve the standard of living for its citizens and to take environmental issues much more seriously in order to remain attractive as a place of abode for its citizens.

How could this be tackled? It is clear that the present rigid and bureaucratic planning system has failed. The economy has certainly been badly mismanaged in the past but the system as such can probably be improved, at least to a limited extent. For example, prices could reflect production costs more

closely; planning could be less rigid and allow more responsibility to the large concerns; foreign trade and foreign exchange rules could become more flexible. This is obviously what Mr. Modrow, the new prime minister, has in mind when he uses the formula: "No planning without market, but no market economy in place of a planning system." The precise meaning of this - somewhat equivocal - principle still has to be worked out, however.

While economic improvements within the system seem possible, I doubt that they will be sufficient to enable the large leap forward which is necessary. In my opinion this cannot be achieved without fundamental reform. A model which has been proposed by some people in both East and West Germany is the so-called "third way". This means a sort of "via media" which combines market prices with socialism, socialism being conceived of as public ownership of the means of production. In my view, that idea is pure illusion. You can have either method of coordination: central planning or free competition with moves in prices conveying signals to independent entrepreneurs. And for the price mechanism to work effectively, you need private ownership with a readiness to take risk and responsibility. Any unholy union such as a socialist market system based on the competition of enterprises under public ownership is doomed to failure. The examples of Yugoslavia or Israel have made this very clear. And of course, this line of reasoning applies not just to the GDR, but to other countries in the East as well.

I believe the performance gap cannot be closed without introducing a Western-style market-economy system, based on market prices and on private ownership. What the GDR needs is a combination of three reforms, price reform, currency reform and a reform of ownership, namely the reintroduction of private property rights in the most important parts of the economy. West Germany had it easier in 1948. Then, we only needed two measures, namely the currency reform, introduced by the Allies, and Ludwig Erhard's lifting of price controls, in order to pave the way to what became known as the German "economic miracle". A reform of ownership was not necessary. So it must be conceded that the task confronting Eastern Germany now is compounded by an additional, weighty factor.

Property reform will probably be the most difficult of the three fundamental changes. There are hardly any historical precedents for such an exercise. How should one approach such an issue? In my view there are two main strategies which could be combined. The first is to allow private enterprises to set up facilities without let or hindrance. Private companies could quickly expand in sectors hitherto neglected such as services and new technologies. They could also fill the gaps when state-owned concerns withdraw from some activities. This approach has the advantage that it could be put into practice immediately.

The second avenue would be the comprehensive privatization of government-owned companies. Technically, the easiest way would

be to convert large concerns into public corporations and offer their shares to private investors. Employees could be given preferential treatment. Maybe management-buy-outs could also be used. I am well aware that it is a very difficult attempt to transform a society which has lived under thorough-going socialism for forty years into a society of profit-minded shareholders. Of course, the process could and should be managed in stages and it should be closely coordinated with price and currency reform.

Price, currency and property reform would mean profound changes throughout society in Eastern Germany. Many people in the East, including some of the leaders of the present opposition groups, are already worried about the social costs of such adjustment. The rewards would certainly not accrue instantaneously. However, I am convinced that, given an adequate economic environment in the East and pertinent support by the West, the East German as well as the other Eastern economies could achieve impressive growth. I believe the GDR in particular could then catch up on the Western standard of living in about ten years or so.

## VI.

As a consequence of change in the East, the Federal Republic itself is also facing a number of problems, in particular that of integrating the large inflow of people from East Germany and of ethnic Germans from Russia, Poland and other parts of



Eastern Europe. It is estimated that in 1988 and 1989 850.000 Germans from the East will have come to the Federal Republic. This is a large number corresponding to nearly 1,5 % of total population. It must be recognised that such an influx has generated concern in some quarters. Especially those in search of work or housing are afraid that the newcomers will reduce their chances. Such attitudes are understandable to some extent, but nonetheless they are unjustifiably pessimistic. They have their origin in static thinking and fail to comprehend the stimulus that population growth and an enlarged labour force will have on the economy.

Fortunately, the inflow could not have occurred at a better point in time as economic growth is currently very strong. It is already difficult to fill existing Job vacancies in a number of regions. The immigrants will step in as they are mobile and motivated. They are, on average, much younger than our population. Those from East Germany, in particular, have a good standard of education. They are ready to work hard in order to make a living. In addition, they usually arrive here with very few assets and are, virtually, in need of everything. In short, the inflow will bring a stimulus to both the supply and demand side of the West German economy. It has been estimated that immigration will boost growth by nearly 1 % in 1990. So I think the influx of new citizens will - notwithstanding temporary friction in some parts of the economy, such as the housing market - be as much a boon as it is a challenge.

VII.

Now, how should Western countries including Western Germany react to change in Eastern Europe? In my opinion, there should be consensus that the success of perestroika is also in the interest of the West. It will make the Earth a more peaceful planet. It will liberate tied resources from armaments to more useful and pacific purposes, such as environmental policies and aid for the less developed countries.

Therefore, the West should support the Eastern reform process. The investment will be worth it. I use the word "investment" because all help should be inspired by the guiding idea of the Marshall plan which was to stimulate initiative on the part of recipient countries in order to put such countries in a position to achieve growth "under their own steam" in due course. And a second proposition is self-evident: we can give support only when the receiving countries actually request it.

I already mentioned some possible support measures such as export credits and the setting up of development banks. What else could be done by the EC and other Western countries? I would like to pinpoint three aspects:

- The short-term priority should be to overcome food shortages. At the world economic summit, the EC was given the task of coordinating such help. Governments should also be prepared

to provide short-term balance-of-payments loans in order to bridge the time between now and the point when reforms begin to make themselves felt.

- Secondly, the Community should open its markets to the East. The EC has already concluded trade agreements with Hungary and Poland. Other countries should follow. In the final analysis, trade is certainly to be preferred to aid.
- Thirdly, companies should be encouraged to seek cooperation with partners in the East. This would imply inter alia greater use of the joint-venture approach, something which is already possible in all Eastern countries with the exception of the GDR.

#### VIII.

As far as the entry of countries such as Hungary or Poland into the EC is concerned, I think the question is premature. EC-membership presumes a certain degree of homogeneity - particularly in terms of the economic system, but also in terms of infrastructure and - to some extent - of income levels.

We should also keep in mind that the EC is not just an economic, but very much a political endeavour. I am an avowed advocate of political union as a long-term EC target. Developments in the East should not beguile us into losing sight of this target. To grant access to every country which

applies would certainly mean postponing or even abandoning political union as the ultimate goal of EC integration. Obviously, there are choices to be made. In my view, a thorough discussion of these issues over coming months is called for as a basic decision will have to be taken soon.

Emphasis on ultimate political union should not be misunderstood as a policy to close the EC to Eastern Europe. I have already stressed that markets have to be kept open. A realistic alternative to membership could be to negotiate some form of association similar to the agreements which the EC already has with a number of Mediterranean countries.

An interesting idea put forward by a German think-tank is that the Eastern European countries could Join EFTA, the European Free Trade Agreement. This probably implies that EFTA would change in the direction of a more supranational structure. The EC is keen to improve relations with EFTA in order to create a large and dynamic European economic area.

Seen in this perspective, we could end up with three concentric circles in Europe. The EC would be the core, the second circle would consist of a possibly enlarged EFTA and the third would comprise other European countries which choose to stand on their own.

IX.

Ladies and Gentlemen, as we approached 1989 many of us may have thought that it was going to be just one of those ordinary years despite the fact that exactly 200 years ago we had the storming of the Bastille which ushered in the French Revolution, 75 years ago the outbreak of World War I and 50 years ago Hitler's reckless plunge into World War II. It is, already now, clear that 1989 will be perceived by history as the most important year since the outbreak of the Cold War between the East and the West. The ongoing - perhaps epochal - changes in Europe will have important consequences not only for Europeans, but also for the United States and its role in Europe. At the weekend, President Bush and Soviet leader Michail Gorbachev addressed this theme in Malta (which prompted the headline "from Yalta to Malta"). Let me just add here that it is, in my view, absolutely essential that close ties between the United States and the EC continue. To borrow a phrase from Richard Burt, Arthur Burns' successor in Germany, we have to develop a "mature partnership".

For the American political planner Fukujama, the nature of events in 1989 is so striking that he publicly declared that the "end of history" had been reached. He justifies this startling affirmation with his perception that communism has reached the end of the road and that the model of the open society and of market systems based on private property has

fought and won a final victory. There are grounds to see things this way. There can be no doubt that socialism in its concrete historical form with its bureaucratic central planning and comprehensive government control of all segments of the economy and of society will have to abdicate.

Yet the struggle for open societies is not over. For one, we cannot be certain that there will be no orthodox "counter-revolution" in the East. Secondly, the intellectual fascination of a pseudo-market system based on public ownership is still great for many people and aversion to capitalism in many quarters remains intense, especially among intellectuals. Therefore, the contest between economic systems will probably continue, hopefully at a less "ideological" level. Thirdly, the market system in the West itself is by no means guaranteed forever. There is a perennial tendency to indulge in interventionist policies, to pursue levelling policies which penalise effort and initiative, for the state to encroach upon the domain of the private sector. In the eighties, supply side policies in the form of privatization, deregulation, and liberalisation combined with tax reduction and price stability have rejuvenated Western economies. But we should remain aware that this is a task which is never completed.

Freedom, and the openness that goes with it, does not simply happen. Mankind has to fight for it - time and again. The solidarity members in Gdansk, the citizens of Budapest and Prague and the peaceful demonstrators on the streets of Leipzig

have achieved a victory against formidable odds thanks to the grit and determination which comes from an overriding desire for freedom and well-being - the same desire that drove generations of Europeans before them to the New World in the legitimate "pursuit of happiness", a fundamental human right explicitly cited in no less a document than the Declaration of Independence. Let us hope that their efforts towards establishing functioning democracies will eventually be crowned with success and let us contribute all we can to that success.

History, therefore, has not ended. On the contrary, I believe that precisely now we are on the threshold of a very significant phase in human history. Vast military pacts still confront each other and we continue to think in the categories of national egoisms, defending "spheres of interest", conducting espionage and investing untold billions in armaments.

But and notwithstanding this sombre scenario, is it really such an illusion to surmise that modern history, our history, probably needs a new vision, an entirely different program - one that is geared, not to conflict and menacement, but, instead, to combating the r e a l problems of this world, be it at national level or within the context of international cooperation - real problems such as the North/South divide, the debt crisis, terrorism and crime, the scourge of drugs, aids, overpopulation and a potential ecological catastrophe! These are the issues we must address with a new sense of purpose and

dedication. That, I believe, would be very much in line with the thinking of Arthur Burns.

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**Finis vitae ejus nobis luctuosus, amicis tristis,  
extraneis etiam ignotisque non sine cura fuit.**

(We grieved at his passing and his friends were saddened. People abroad and strangers, too, were affected.)

Tacitus, Agricola, c. 43.

(2521r)