De-Socialization in a United Germany

Hans-Hermann Hoppe*

I

As a result of the defeat of Hitler's Germany in Word War II, there were 10 million refugees living on a significantly reduced German territory; 40 percent of the population was bombed-out (the population of Cologne, for instance, had declined from 750,000 to 32,000) and 60 percent was undernourished.[1]

In those territories occupied by the Western Allies, initially the economic system inherited from the Nazi regime—a command-war-economy—was retained. Almost all consumer goods were rationed, all-around price and wage controls remained in effect, and imports and exports were strictly regulared by the military administration. Black markets and barter trade were ubiquitous. Due to general price maxima and an expansionary supply of paper Reichs marks, no goods were to be found and money was largely useless.[2] Black-market prices experienced a highly inflationary development and substitute currencies like coffee, cigarettes, and butter emerged. German output in 1946 was less than one-third of what it had been in 1938. Chaos and desperation were the mark of the day.

In respone to the beginning Cold War between the Allies, in particular the United States and the Soviet Union, the Western

*Hans-Hermann Hoppe is associate professor of economics at the University of Nevada, Las Vegas..

[1]For details see Gustav Stolper, *German Realities* (New York: Reynal & Hitchcock, 1948); Frank Grube and Gerhard Richter, *Die Schwarzmarktzeit: Deutschland zwischen 1945 und 1948* (Hamburg, 1979); Theodor Eschenburg, *Jahre der Besatzung 1945–1949* (Stuttgart, 1983); Charles Kindleberger, *The German Economy, 1945–1947: Charles Kindleberger's Letters from the Field* (Westport, Conn.: Meckler, 1989) with a historical introduction by Günther Bischof.

[2]On the phenomenon of repressed inflation see Wilhelm Röpke, *Die Lehre von der Wirtschaft* (Bern, 1979), pp. 142–45; idem, "Repressed Inflation," *Kyklos* 1, no. 3 (1947); for a purely theoretical treatment of the phenomenon see Murray N. Rothbard, *Power and Market* (Kansas City: Sheed Andrews & McMeel, 1977), pp. 28–29.

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Powers in 1947 changed their policy toward Germany. While their previous goal had been the de-industrialization of Germany—the industrial production was supposed to be frozen at 50–55 percent of Germany's 1938 output level—so as to permanently impoverish the German population, it was now decided to further the economic reconstruction of the Western occupied territories in order to build up an economic power base for the new strategy of *containment* and *roll back*.[3]

From 1948 through 1952 the three Western zones received $1.5 billion in Marshall aid. More importantly, in May of 1947 the British and American occupied zones were merged, and the economic administration of the unified region was largely put back into German hands, and on March 2, 1948, Ludwig Erhard, former economic minister of Bavaria, was elected director. Erhard, whose economic philosophy had been heavily influenced by the neo-liberal Freiburg school of Walter Eucken and Franz Böhm, which had in turn been influenced by the Austrian school of Ludwig von Mises,[4] initiated a currency reform on June 20, 1948, and consequently pursued a hard-money policy. As long as the monopoly of note issue rested with the Allies—who had set up a central banking system modeled after the United States Federal Reserve—the money supply remained drastically expanded (by more than 150 percent), with almost

[3]On the Cold War and the international dimensions of Germany's post World War II development see Paul Johnson, *Modern Times* (New York: Harper & Row, 1983), chaps. 13 and 17; Paul Kennedy, *The Rise and Fall of the Great Powers* (New York: Random House, 1987), chap. 7.

[4]See Ludwig Erhard, *Wohlstand für Alle* (Düsseldorf, 1957; updated edition 1990); idem, *Deutsche Wirtschaftspolitik* (Düsseldorf, 1967). Erhard's closest direct advisor was Alfred Müller-Armack, *Wirtschaftslenkung und Marktwirtschaft* (Hamburg, 1947). Walter Eucken's most influential works are *Die Grundlagen der Nationalökonomie* (Jena, 1940) and *Grundsätze der Wirtschaftspolitik* (Hamburg, 1959); for Franz Böhm see his *Reden und Schriften*, ed. E.S. Mestmäcker (Karlsruhe, 1960) and "Privatrechtsgesellschaft und Marktwirtschaft," *Ordo* 17 (1966). The annual *Ordo* is the main organ of the Freiburg School. Of similar influence were Wilhelm Röpke: *Die Lehre von der Wirtschaft* (Bern, 1979), *Die Gesellschaftskrisis der Gegenwart* (Erlenbach-Zürich, 1948), *Jenseits von Angebot und Nachfrage* (Erlenbach-Zürich, 1957), and Alexander Rüstow: *Ortsbestimmung der Gegenwart*, 3 vols. (Erlenbach-Zürich: Eugen Rentsch, 1950, 1952 and 1957). The influence of Ludwig von Mises was mostly through his *Theory of Money and Credit*, H. E. Batson, trans. (1912; London: Jonathan Cape, 1934), *Nation, State, and Economy*, Leland B. Yeager, trans. (1919; New York: New York University Press, 1983), *Socialism: An Economic and Sociological Analysis*, J. Kahane, trans. (1922; Indianapolis, Ind.: Liberty Fund, 1981), *Liberalism*, Ralph Raico, trans. (1927; Princeton, N.J.: D. Van Nostrand, 1962), and *Human Action: A Treatise on Economics*, 3rd ed. (1949; Chicago: Henry Regnery, 1966). On the relationship between these and other strands of free market thought see Friedrich A. Hayek, *Studies in Philosophy, Politics and Economics* (Chicago: University of Chicago Press, 1957), chap. 13.

immediate inflationary consequences. However, after October 1948 a continuously tight monetary policy was put into effect (in the beginning, the minimum reserve requirements and the discount rate were actually raised, while taxes were lowered), which quickly established West Germany as one of the world's least inflationary countries and the deutsche mark as one of the hardest currencies (during this 13-year period from 1948-1961 the consumer price index rose by a 'mere' 14 percent).

More importantly, contrary to the advice of American and British economic experts, who were taken completely by surprise, and against the prevailing public opinion in Germany, on June 24, 1948, only 4 days after the currency reform, Ludwig Erhard implemented a radical—although by no means flawless[5]—free-market reform. In accordance with the precepts of the 'new' Keynesian economics and the practice of the ruling British Labor Party, foreign experts and German public opinion had favored a policy of macro-economic management, of socialized investment, and a sector of nationalized 'basic' industries.[6] Instead, with one stroke Erhard abolished almost all price and wage controls and allowed almost complete freedom of movement, trade and occupation, thus radically expanding the rights of *private*-property owners.[7]

Less than one year later, on May 23, 1949, the Federal Republic of Germany (FRG) was founded and the framework of the *soziale Marktwirtschaft* (Socialist Market Economy) created by Ludwig Erhard, became ratified as West Germany's economic constitution.[8]

From the outset, the development in the Soviet-occupied territories of Germany took a different course.[9] In 1945, with its first order,

[5]On this see p. 87 ff below.

[6]The leading American economic advisors, for instance, were the "new-dealers" and free-market foes Charles P. Kindleberger, John K. Galbraith, and Walt W. Rostow. Indicative of the German public opinion is the fact that even the newly founded conservative Christian Democratic Union, in its Ahlen Program of 1947, stated that "the capitalist economic system has not done justice to the vital interests of the German people in state and in society" and accordingly demanded large-scale socialization policies.

[7]The U.S. high commissioner, General Lucius D. Clay, reacted to Erhard's liberalization plans by saying: "My advisors tell me they are much opposed to this." Erhard replied: "Never mind, General, mine are telling me the same thing."

[8]On the development of West Germany's economic system up to the mid-1960s see the generally excellent study by Hans-Joachim Arndt, *West Germany: Politics of Non-Planning* (Syracuse: Syracuse University Press, 1966).

[9]For comparative economic analyses of East and West Germany see H. Winckel, *Die Wirtschaft im geteilten Deutschland 1945–1970* (Wiesbaden, 1974); Karl Thalheim, *Die wirtschaftliche Entwicklung der beiden Staaten in Deutschland* (Opladen, 1978);

the Soviet Military Administration nationalized all banks. In the same year, all farms of more than 250 acres were seized (50 percent of all land used for agriculture), and all property of actual and alleged Nazis and war criminals was confiscated. When on November 7, 1949,—a few months after the Western Allies had licensed the new West German government—the new East German state (GDR) received its license from the Soviet Union, the Soviet practice of large-scale expropriation was elevated to a constitutional principle: "The economy of the German Democratic Republic is a planned socialist economy."[10] By 1960, more than 90 percent of all agricultural land was in the hands of socialized producer co-ops. By 1950, more than 60 percent of all productive output was produced in socialized firms. By 1960, more than 80 percent of East German output originated from socialized production; and by the early 1970s the expansion of the socialized sector had reached 95 percent (i.e., a mere 5 percent of productive output originated in state-licensed private enterprises).[11]

In addition, from 1945 through 1953, during the Stalin era, East Germany was forced to pay heavy reparations (45 percent of the productive equipment of 1945 was dismantled and confiscated by the Soviets vs. 8 percent in the West). To facilitate centralized economic planning, a one-stage central banking system was set up. The central bank became the monopolistic note issuer and central commercial bank at the same time, with regional and local banks as its branches (rather than separating both functions and leaving the commercial banking function in private hands, as in West Germany and the United States). Three days after the West German currency reform, on June 23, 1948, a new East German currency—initially with an official 1:1 exchange rate against West Germany's deutsche mark—was introduced. However, a continuing policy of monetary expansion, combined with price maxima for all 'basic' consumer goods, quickly led back to the phenomenon of "repressed inflation," i.e., an excess supply of anesthetized money. In response, in 1957 a second currency reform was carried out: All banknotes in excess of 300 East marks per person were declared invalid. But to no avail: the excess supply

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E. Jesse, ed., *BRD und DDR* (Berlin, 1982); Hannelore Hamel, ed., *Bundesrepublik Deutschland-DDR: Die Wirtschaftssysteme* (Munich, 1983); also: E. Windmöller and T. Höpker, *Leben in der DDR* (Hamburg, 1976).

[10]German Democratic Republic constitution, para. 9, sect. 3.

[11]Interestingly, the speed of East German socialization was significantly *slower* than in all the other Soviet-licensed states of Eastern and Central Europe except for Poland, where agriculture remained largely in private hands. See Jürgen Hartmann, *Politik und Gesellschaft in Osteuropa* (Frankfurt/M., 1983), p. 169.

of money again swelled to an estimated 150 billion Marks (about 10,000 per person). The steady supply of anesthetized money entered the black, private markets, where prices drastically increased and the East German currency continually depreciated against the deutsche mark. Increasingly, the deutsche mark outcompeted the East mark as a medium of exchange on the black markets ("good money drives out bad") and soon became East Germany's second currency: its unofficial but "real" money.

From 1949, at which time the West and East German states were founded, until the dramatic events of 1989, a controlled social experiment was conducted. A homogeneous population, with a common history, culture, character structure, work ethic and above all language, was subject to two fundamentally different economic constitutions and institutional incentive structures.

II

The difference in the results has been striking. Yet no social experiment was necessary to find this out. Naturally not all empirical details, but the fundamental outcome of the German experiment could have been predicted with certainty by those familiar with the principles of economic theory, and in particular the theoretical economic analyses of socialism by the Viennese (Austrian) school, most notably Ludwig von Mises's. In his famous *Die Gemeinwirtschaft: Untersuchungen über den Sozialismus*, of 1922,[12] Mises irrefutably demonstrated what the East Germans were forced to find out the hard way: that socialism must end in disaster.

Wealth can be brought into existence or increased in three and only three ways: by perceiving certain nature-given things as scarce and actively bringing them into one's possession before anyone else has seen and done so (homesteading); by producing goods with the help of one's labor and such previously appropriated resources; or by acquiring a good through voluntary, contractual transfer from a previous appropriator or producer. Acts of original appropriation turn something which no one had previously perceived as a possible source of income into an income-providing asset; acts of production are by their very nature aimed at the transformation of a less valuable asset into a more valuable one; and every contractual exchange concerns the exchange and redirection of specific assets from the hands of those

[12]The first English translation appeared in 1936 under the title *Socialism: An Economic and Sociological Analysis*. The latest edition was published in 1981 by Liberty Fund. See also Mises's *Human Action*, chaps. 25 and 26, in which he provides a definitive answer to criticisms of his earlier work.

who value their possession less to those who value them more.

From this it follows that socialism cannot but lead to impoverishment:[13]

(1) Under socialism, ownership of productive assets is assigned to a collective of individuals regardless of each member's prior actions or inactions in relation to the owned assets. In effect, then, socialist ownership favors the non-homesteader, the non-producer, and the non-contractor and disadvantages homesteaders, producers, and contractors. Accordingly, there will be less original appropriation of natural resources whose scarcity is realized, there will be less production of new and less upkeep of old factors of production, and there will be less contracting. All of these activities involve costs. Under a regime of collective ownership the costs of performing them is raised, and that of not performing them is lowered.

(2) Since means of production cannot be sold under socialism, no market prices for factors of production exist. Without such prices, cost-accounting is impossible. Inputs cannot be compared with outputs; and it is impossible to decide if their usage for a given purpose has been worthwhile or has led to a squandering of scarce resources in the pursuit of projects with relatively little or no importance for consumers. By not being permitted to take any offers from private individuals who might see an alternative way of using some given means of production, the socialist caretaker of capital goods simply does not know what his foregone opportunities are. Hence, permanent misallocations of production factors must ensue.

(3) Even *given* some initial allocation, since input factors and the output produced are owned collectively, every single producer's incentive to increase the quantity and/or quality of his individual output is systematically diminished; and likewise, his incentive to use input factors so as to avoid their over- or under-utilization is reduced. Instead, with gains and losses in the socialist firm's capital- and sales-account socialized instead of attributed to specific, individual producers, everyone's inclination toward laziness and negligence is systematically encouraged. Hence, an inferior quality and/or quantity of goods will be produced and permanent capital consumption must ensue.

(4) Under a regime of private property, the person who owns a resource can determine independently of others what to do with it. If

[13]See also Hans-Hermann Hoppe, *A Theory of Socialism and Capitalism: Economics, Politics, and Ethics* (Boston: Kluwer Academic Publishers, 1989); idem, "Why Socialism Must Fail," in Llewellyn H. Rockwell, ed., *The Free Market Reader* (Burlingame, Calif.: Ludwig von Mises Institute, 1988).

he wants to increase his wealth and/or rise in social status, he can only do so by better serving the most urgent wants of voluntary consumers through the use that he makes of his property. With collectively owned factors of production, collective decision-making mechanisms are required. Every decision as to what, how and for whom to produce, how much to pay or charge, and who to promote or demote, is a political affair. Any disagreement must be settled by superimposing one person's will on another's view, and this invariably creates winners and losers. Hence, if one wants to climb the ladder under socialism, one must resort to one's political talents. It is not the ability to initiate, to work, and to respond to the needs of consumers that assures success. Rather, it is by means of persuasion, demagoguery, and intrigue, through promises, bribes, and threats that one rises to the top. Needless to say, this politicalization of society, implied in any system of collectivized ownership, contributes even more to impoverishment.

The German experiment provides the sad illustration for the validity of economic theory.

Erhard's free-market reforms quickly generated what has become known as the West German *Wirtschaftswunder* (economic miracle). After a short—and unsurprising—increase of unemployment, peaking at a rate of 8 percent in 1950, unemployment began steadily to decrease. By 1962, at the height of the Erhard era, the unemployment rate had fallen to 0.2 percent, and the number of employed persons had increased by some 8 million (more than 60 percent). The total wage sum tripled during the period from 1948–1960, and wage rates more than doubled in constant terms. In the same time, total industrial production increased fourfold, GNP per capita tripled, and the West German rate of economic growth far surpassed that of all other West European nations and the United States. By the early 1960s, West Germans ranked among the world's most prosperous people, and West Germany had become one of the foremost industrial nations, with products made in West Germany increasingly in demand worldwide (in 1960 West German exports made up 10 percent of world exports: nearly twice the world market share of 1937).[14]

Predictably, the economic development of East Germany took the opposite direction. After 40 years of West German *soziale Marktwirtschaft* versus East German socialism, the visitor going from West to East enters an almost completely different and impoverished world. Life is characterized by permanent shortages of all sorts of consumer goods (from meat to housing), endless mismatches

[14]See Ludwig Erhard, *Wohlstand für Alle*.

of complementary factors of production, an inferior, shoddy quality of almost everything produced, and a pervasive black market struggling to alleviate the mess created by the official economy. Indicators of misallocation and capital consumption are omnipresent. Insufficiently maintained, deteriorating, unrepaired, and rusting property is common, and vandalism of production factors, machinery, and buildings is rampant. Within the official economy, negligence, laziness, despair, cynicism and sheer incompetence abound, and widespread hidden unemployment exists. Environmental damage has at many places reached catastrophic dimensions (socialization of negative externalities). Economic illiteracy among the population is pervasive. In world export markets East Germany is reduced to the rank of a third-world country that cannot sell anything except raw materials, half-finished products, or basic, simple consumer goods.

In the mid-1950s the East German per capita consumption already lagged an estimated 40 percent behind West Germany's. In the late 1980s, average wage income in East Germany was less than half of that in West Germany assuming a 1:1 currency exchange rate, and less than 1/10th if, more realistically, the black-market exchange rate between the East mark and deutsche mark is taken as the conversion ratio. Nominally, the average wage income in East Germany was somewhat lower—and in real terms more than 5 times lower—than the typical *unemployment subsidy* in West Germany. Nominally, average old age pensions in East Germany were 3 times—and in real terms 15 times—lower than in West Germany; and East Germany's minimum welfare handouts were nominally nearly 50 percent—actually more than 7 times—less than those paid in the West.

However, most revealing is the voting-by-feet-statistic: While all socialist countries of Eastern Europe have been plagued by the emigration problem of people wanting to leave for the more prosperous West, and while they all gradually had to establish tighter border controls in order to prevent this outflow, the case of Germany is a most striking one. With language differences, traditionally the most severe natural barrier for emigrants, nonexistent and West Germany automatically granting citizenship to all East German immigrants, the difference in living standards between the two Germanys proved to be so great that East Germany was from its very inception confronted with a massive wave of emigration. Following the industrial revolts of 1953, and their suppression by the occupying Soviet military forces, emigration reached such proportions—more than 3.5 million individuals had already deserted the East and this number increased by more than 1,000 per day—that on August 13, 1961 the socialist regime in East Germany desperately had to close its borders to the West. To keep its population in, it erected a containment system the likes of which the world has never seen. A system of walls, barbed wire, electrified fences, mine fields, automatic shooting devices, and watchtowers almost 900 miles long were constructed, for the sole purpose of preventing the East Germans from running away from socialism. From 1961–1989 the problem was thus contained. However, beginning in the summer of 1989, when socialist Hungary began to open its border to Austria, and even more so since the dismantling of the East German wall in November of 1989, the wave of East German emigration immediately resumed. Since then, each day more then 2,000 East Germans have packed and left socialism behind.[15]

[15]It is interesting to note how American comparative economic systems textbooks have treated the case of East versus West Germany. Apart from ignoring migration statistics and not mentioning the "Wall" at all, or merely in passing, they rely almost exclusively on official government statistics. Based on these they reach conclusions which can only be called perverse, and illustrate at best that economic statistics have very little to do with reality as perceived by acting individuals. The most scandalous example of this is Andrew Zimbalist, Howard J. Sherman and S. Brown, *Comparing Economic Systems* (New York: Harcourt Brace Jovanovich, 1989). After mentioning that from the outset East Germany was relatively disadvantaged by having to pay heavy reparations and because of massive population losses (but why did it lose its population?) they write: "During the 1950s, the economy of West Germany grew at a rate close to 7 percent while—in spite of its initial disadvantages—the growth rate for the East German economy was around 6.5 percent. On a GNP per capita basis, between 1960 and 1979 West Germany grew at 3.3 percent per year and East Germany grew at 4.7 percent. In West Germany real GNP grew by 1.8 percent in 1980 and fell by 0.3 percent in 1981; in East Germany, real national income grew by 4.2 percent in 1980 and increased by 4.5 percent in 1981. Thus, according to CIA estimates. . . . East German per capita income had risen to 87.6 percent of West German per capita income. The gap continued to narrow during 1982 and the first half of 1983. The conclusion appears uncontestable that over the entire post-war period East Germany has experienced more rapid growth per head than West Germany" (p. 468). Further, there was "a stronger *dynamic* efficiency in East Germany. . . . in West Germany the average annual increase in total factor productivity was 3.0 percent, and in East Germany it was 3.4 percent." Moreover, "East Germany has had greater economic stability [i.e. 'absence of excessive inflation and unemployment'] throughout the post-War period" (p. 469). In addition, while the "environmental quality is superior in West Germany," East Germany has less than half of the former's income inequality and "in all areas of life [East German] women have achieved a much higher degree of equality with men than have their counterparts in West Germany" (p. 470).

After reading this one must surely wonder why people did not move from West to East, and why an economic success story such as East Germany's ended with its total collapse! But the authors have an answer to this: "Finally, although we have been concerned only with economic performance, it is difficult to overlook the more desirable democratic political system in West Germany" (p. 470). Not much better is the analysis by P. R. Gregory and G. C. Stuart, *Comparative Economic Systems* (Boston: Houghton Mifflin, 1985), pp. 402–14. Largely irrelevant is also the earlier study by Wolfgang F. Stolper, *The Structure of the East German Economy* (Cambridge: Harvard University Press, 1960).

III

While the underlying cause for the collapse of the East German socialist experiment in 1989 was economic, there is little doubt that Gorbachev's policy of *glasnost* and *perestroika* in the Soviet Union during the second half of the 1980s served as the catalyst for the revolutionary developments currently taking place in Germany and across Eastern Europe. This policy reduced the Soviet Union's pressure on its East European satellite states, in particular since from the outset Gorbachev's new internal policies had been explicitly connected to a non-interventionist foreign policy, and at the same time it dramatically uplifted the hopes and expectations of all East European people. Without this special constellation of data, created by Gorbachev, neither the peaceful anti-communist revolution in Poland nor the liberalization of Hungary would have been possible; and without the Polish and Hungarian events neither the East German nor the Czechoslovakian revolution would have followed.

Ultimately, Gorbachev must also be credited for the move towards reunification of East and West Germany. On the forever memorable November 9, 1989, steadily increasing pressures of mass emigration and civil unrest burst the East German socialist bubble, the borders to West Berlin and West Germany had to be thrown open, and the Germans of East and West reunited, moved and overjoyed, on top of the Berlin Wall. Since that date there has been no question of two separate German States. Public opinion in East and West overwhelmingly demanded reunification.

The economic dynamic set in motion by the events of November 9th succeeded in burying any remaining hopes within the East German regime of somehow restoring a separate socialist East German state. The uninterrupted mass flight of highly qualified personnel and unceasing internal unrest sharply aggravated East Germany's already desperate economic situation. Within a few days, the East mark depreciated against the deutsche mark from a ratio of 5:1 to 10:1, and only two reasons prevented it from becoming completely worthless. First, with increasingly open borders, for a short period of time holders of East marks could buy a number of maximum price controlled products in East Germany and profitably resell them in the West. Once the already sparsely decorated East German shelves were thus emptied and fewer or no new supplies were forthcoming, only one other reason remained: the public expectation that as part of the inevitable process of German reunification the West German central bank would eventually redeem East marks at some arbitrarily overvalued rate into deutsche marks.

Different but related economic problems emerged in West Germany. While during the 1950s and 1960s the West German economy successfully integrated millions of East German refugees and Southern European "guest workers," the economy of the 1980s was severely strained by the latest wave of immigration. For from 1950 until the 1980s, the West German economy experienced a gradual transformation. Over time, Erhard's free-market Germany changed into a gigantic welfare state, and the early West German economic expansionism was replaced by economic stagnation.

From the outset Erhard's free-market reforms had been far from pure.[16] He had not introduced a *Marktwirtschaft,* but a *soziale Marktwirtschaft*, and theoretical observers such as Ludwig von Mises had warned early—prophetically—that this concession to a *social* economy would ultimately lead to welfare state socialism.[17] As the successor of the German Reich, the West German state immediately became West Germany's biggest real-estate owner, capitalist, and employer. Education, traffic, communication, schools, universities, streets, rivers, lakes, railroads, airlines, mail, telephone, radio, and

[16]See also Hans-Joachim Arndt, *West Germany: Politics of Non-Planning*, chap. 3.

[17]The supporters of "the German 'soziale Marktwirtschaft'," writes Mises, "stress that they consider the market economy to be the best possible and most desirable system of society's economic organization, and that they are opposed to the government omnipotence of socialism. But, of course, all these advocates of a middle-of-the-road policy emphasize with the same vigor that they reject Manchesterism and laissez-faire liberalism. It is necessary, they say, that the state interfere with the market phenomena whenever and wherever the 'free play of the economic forces' results in conditions that appear as 'socially' undesirable. In making this assertion they take it for granted that it is the government that is called upon to determine in every single case whether or not a definite economic fact is to be considered as reprehensible from the 'social' point of view and, consequently whether or not the state of the market requires a special act of government interference."

"All these champions of interventionism fail to realize that their program thus implies the establishment of full government supremacy in all economic matters and ultimately brings about a state of affairs that does not differ from what is called the German or the Hindenburg pattern of socialism. If it is in the jurisdiction of the government to decide whether or not definite conditions of the economy justify its intervention, no sphere of operation is left to the market. Then it is no longer the consumers who ultimately determine what should be produced, in what quantity, of what quality, by whom, where, and how—but it is the government. For as soon as the outcome brought about by the operation of the unhampered market differs from what the authorities consider 'socially' desirable, the government interferes. That means the market is free as long as it does precisely what the government wants it to do. It is 'free' to do what the authorities consider to be the 'right' things, but not to do what they consider the 'wrong' things; the decision concerning what is right and what is wrong rests with the government. Thus the doctrine and the practice of interventionism ultimately tend to abandon what originally distinguished them from outright socialism and to adopt entirely the principles of totalitarian all-round planning" (*Human Action: A Treatise on Economics*, pp. 723–24).

television were in government hands and were soon complemented by a newly founded conscription army. All banks were cartelized within a government-controlled central banking system. Bismarck's compulsory social security system was resurrected and remained under government control. Housing and agriculture were largely left outside of and protected from markets. Mining, coal, steel, shipbuilding, and textiles were accorded special government protection. Beginning with the Co-Determination Law of 1951 and the Commercial Constitution Law' (*Betriebsverfassungsgesetz*) of 1952, a series of so-called labor-protection laws were introduced (including subsidies to unemployment and compulsory collective bargaining), which increasingly limited the right of freedom of contract in employer-employee relations. With the deceptive "law against restrictions of competition" (*Anti-Kartell Gesetz*) of 1957, the basic principle of market competition—of free and unrestricted entry—was largely suspended, and all 'significant' economic developments were subject to government approval.[18] All the while, the West German government could not resist the temptation to steadily increase taxes and the supply of paper money. Consequently, in 1966 West Germany experienced its first major recession, putting an end to Erhard's career, who by then had become chancellor. Economic growth fell from 9 percent in 1960 to 2 percent in 1966 and was negative in 1967. For the first time in over a decade the number of unemployed rose (to 2 percent).

In the post-Erhard era, in particular during the period from 1969-1982 under the reign of a social-democratic-liberal government coalition led by Willy Brandt and Helmut Schmidt, the welfare-statist transformation of the West German economy proceeded at an accelerated rate.[19] From 1969–1975 alone, some 140 laws were passed that entitled various 'socially disadvantaged' groups to tax subsidies. The

[18]While the Freiburg School, and in particular Röpke, recognize that in practice monopolies are almost always the creation of state power (see Wilhelm Röpke, *Die Lehre von der Wirtschaft*, p. 215; for a typical Freiburg treatment see Erich Hoppmann, *Fusionskontrolle* [Tübingen, 1972]), they admit (in agreement with neo-classic orthodoxy) the theoretical possibility of exploitative free-market monopolies and advocate a kind of compulsory anti-merger, and allegedly pro-small business legislation to combat their emergence. For a theoretical critique of the neo-classic monopoly theory and a defense of the classic view that monopolies can only exist if and insofar as free entry is restricted by legal compulsion, and that under conditions of free entry no operationally meaningful distinction between competitive vs. monopoly prices and/or output is possible, see Murray N. Rothbard, *Man, Economy, and State: A Treatise on Economic Principles* (Los Angeles: Nash Publishing, 1970), chap. 10; also Hans-Hermann Hoppe, *Eigentum, Anarchie und Staat. Studien zur Theorie des Kapitalismus* (Opladen, 1987), pp. 129–41; idem, *A Theory of Socialism and Capitalism*, chap. 9.

[19]See R. Merklein, *Griff in die eigene Tasche: Hintergeht der Bonner Sozialstaat seine Bürger?* (Hamburg, 1980); idem, *Die Deutschen werden ärmer. Staatsverschuldung, Geldentwertung, Markteinbussen, Arbeitsplatzverluste* (Hamburg, 1982).

so-called labor-protection and anti-trust laws were drastically stiffened. Taxes and social security contributions were significantly increased, in order to finance all sorts of so-called public goods and enhance 'the quality of life.' By resorting to a Keynesian policy of deficit spending (the Federal government deficit rose from 57 billion deutsche marks in 1970 to 232 billion in 1980 and 503 billion in 1989), and aided by the fact that initially inflation was not anticipated, the economic consequences of these policies were delayed for a few years—only to appear later with a vengeance. Unanticipated inflation and credit expansion had created and prolonged the malinvestment typical of a boom; yet this boom, built on nothing but paper money, would inevitably be followed by a liquidation crisis—a recession.[20] Socialist chancellor Helmut Schmidt's motto had been "rather 5 percent inflation than 5 percent unemployment." In fact, not only was there soon much more than 5 percent inflation (inflation became anticipated and the demand for money declined), but unemployment also rose steadily, with both rates simultaneously approaching 10 percent. Economic growth slowed until early in the 1980s, when GNP fell in absolute terms. For the first time in West German history, the number of employed people actually decreased. More and more pressure was put on foreign workers to leave the country, and the immigration barriers were raised.

Since 1982, at which time the socialist-liberal government (and left-wing Keynesianism) was ousted and replaced by a conservative-liberal government coalition (and right-wing Keynesianism), West Germany has proceeded on its march toward the welfare state, if only at a slower pace: Government expenditures, which had increased from about 30 percent of GNP in 1960 to more than 50 percent in the early 1980s, and government debts have continued to rise. The inflation rate has been lowered, and the rate of economic growth raised. But neither rate has fallen or risen to levels anywhere near those which had characterized the Erhard era; and after 8 years of conservative-liberal rule the number of unemployed, which reached 2.3 million in 1983, was still above 2 million (nearly 8 percent). In this situation, the arrival of large numbers of East German immigrants at once eligible for West German welfare handouts and unemployment subsidies quickly began to expose not only the bankruptcy of socialism, but that of the West German welfare state as well.

[20]On the theory of the business cycle see Ludwig von Mises, "Monetary Stabilization and Cyclical Policy," in *On the Manipulation of Money and Credit*, Percy L. Greaves, ed. (1928; Dobbs Ferry, N.Y.: Free Market Books, 1978); Friedrich A. Hayek, *Prices and Production* (1931; London: Routledge & Sons, 1935); Richard von Strigl, *Kapital und Produktion* (Vienna, 1934); Murray N. Rothbard, *America's Great Depression* (Kansas City: Sheed & Ward, 1975).

Thus, the threat of East Germany's political instability spilling over to West Germany forced the West German political power elite to act quickly and take the initiative in the inevitable process of reunification. However, contrary to the situation in the late 1940s, when Erhard had handled a similar crisis in German history by adopting an unpopular but successful strategy of free-market crisis management, some 40 years later the course pursued by West Germany's political establishment is yet another giant step toward welfare socialism and bound to further aggravate West Germany's economic stagnation (notwithstanding the popularity of the policy among the West and in particular the East German public). Rather than seeking German reunification through a quick and radical de-socialization of East Germany—and indirectly of West Germany—which alone would be in accordance with fundamental principles of justice and sound economics, and which will be outlined and explained shortly, West Germany's political power elite seeks the reunification through the complete incorporation of East Germany into the West German welfare state.

Immediately following the events of November 9, 1989, West Germany's political parties—the ruling conservative Christian Democratic Union, the liberal Free Democratic Party as its minor federal government partner, the Social Democratic Party as the major opposition party, and the national-conservative Republicans as well as the leftist Greens as the two minor opposition forces—largely in control of the West German state apparatus and essentially tax-funded (through campaign costs compensations), began to extend their presence to East Germany and establish sister organizations. In order to distract from their own steadily increasing invasion of private property rights, the East German crisis was labeled as one of non-democracy rather than non-private property.[21] The East German public,

[21]In fact the lack of democracy has essentially nothing to do with East Germany's plight. It is obviously not the selection principle for politicians that causes the problem. It is politics and political decision-making as such that are responsible. Collectively owned factors of production require collective decision-making. Instead of each producer deciding independently what to do with particular resources as under a regime of private property and contractualism, with socialized means of production each decision requires a collective's permission. It is irrelevant to the producer how those giving permission are chosen. What matters to him is that permission has to be sought at all. As long as this is the case, the incentive for producers to produce is reduced and impoverishment will continue. Privatization is as incompatible with democracy, then, as it is with any other form of political rule. Privatizing means to de-politicize society and to establish, in Marx's terms, an anarchy of production, in which no one rules anybody, and all producers' relations are voluntary and thus mutually beneficial.

familiar with the West German political system via West German government television and overwhelmingly in favor of welfare-statist ideologies (the territory of East Germany had indeed traditionally been a stronghold of social-democratic and communist support), widely welcomed the West German party 'invasion.' East Germany's first multi-party election on March 18, 1990 ended with a resounding victory for the West German party system. The formerly ruling communist party, meanwhile reconstituted as the Party of Democratic Socialism, was ousted from power (while it remained the third largest party, with a remarkable 15 percent of the vote). Instead, the East German Christian Democratic Union-equivalent, boosted by its affiliation with West Germany's ruling party and its bribe-like promise of a 'generous' exchange rate for East marks through the West German central bank—most frequently proposed were rates of 1:1 or 2:1, which made the East mark rise immediately to 4:1 against the deutsche mark—and a quick and complete incorporation of East Germany into the Federal Republic via article 23 of the West German constitution (which provides for the possibility of legal entry, or *Anschluss*), became by far the strongest political force and senior partner in a newly formed conservative-liberal-social-democratic government coalition representing more than two thirds of the popular vote. Indirectly, the West German power elite had gained control of the development of East Germany and its future course of desocialization.[22]

The date for the official beginning of the German reunification process was set for July 2, 1990, and an outline of the reunification process, including a currency reform and the extension of the West German welfare system to East Germany as its key elements, was announced.[23]

East marks up to 4,000 per person would be exchanged at a rate

[22]The elections on October 14, 1990, in East Germany's reconstituted 5 federated states, and on December 2, 1990, in the meanwhile reunited Germany, confirmed these results and added even more strength to the ruling conservative-liberal government coalition. The national-conservative Republicans were reduced to insignificance; and the Green Party did not manage to return to the Federal Parliament (Bundestag). The PDS experienced further voter losses and, although currently represented in the Bundestag due to a provisionary suspension of the 5 percent hurdle for 'genuine' East German parties during the December election, it is bound ultimately to disappear as a political power.

Indicative of the West German power elite's political 'imperialism' is the fact that almost all of the three major parties' (CDU, FDP, and SPD) leading candidates in East Germany's October state election were 'imported' from West Germany.

[23]The formal reunification took place only three months later, on October 3, and was 'democratically ratified' in the first all-German election of December 2, 1990.

of 1:1 against the deutsche mark (and at 2:1 in excess of this limit).[24] Because the East German money supply is only a small fraction of the deutsche mark supply, and because the market for non-money goods would automatically be expanded through the currency unification, the expected inflationary consequences will be relatively minor. However, the currency reform will cause a twofold income redistribution. On the one hand, it implies a compulsory redistribution of purchasing power from West German citizens onto East Germans, although the former are in no way responsible for the plight of the latter and indeed have in the past transferred massive amounts of income to East Germans on a voluntary basis. On the other hand, it implies a coercive income redistribution from West Germany's private sector onto the West German government—which will print the required deutsche marks essentially at no cost—and indirectly its East German government affiliate.

With this currency reform as its foundation, the socio-economic integration of East Germany would begin. Having supplied East Germany with 'sufficient' initial purchasing power, the East German government, directed by its Western senior partner, and as if it were the legitimate owner, would sell off state property.[25] East Germans would be given special treatment as buyers. The East German demand that West Germans be prevented for about a decade from buying land in East Germany has been defeated after a protracted battle, but other less severe restrictions are likely to remain in place. Further, among the hampered West German buyers, large established government-connected firms would enjoy a systematic advantage (in expectation of this likely event their stock market prices have already significantly increased). East Germans with valid titles to expropriated, socialized assets would be reinstated as private owners without having to pay, although only with a large number of exceptions favoring the current asset users over their original owners. On the other hand, West German holders of East German titles would be widely restricted from likewise reclaiming their property and receive instead some arbitrary sub-market price compensation.[26] Although

[24]For a detailed analysis of the currency reform see P. Bofinger, "The Germany Monetary Unification: Converting Marks to D-Marks," *Federal Reserve Bank of St. Louis Review* (July/August 1990).

[25]For this purpose a trust fund corporation (Treuhandanstalt) directed by West German establishment 'managers' was set up.

[26]In fact, the West and East German governments agreed in their reunification treaty of October 3, that all expropriations prior to the founding of the East German state in 1949 were to be regarded as "valid" (more than 50 percent of East Germany's

substantial, the reprivatization of East Germany would not include any of the state's command posts—police, courts, traffic, communication, and education—and its extent will be significantly less than the degree of private ownership in West Germany so as to raise the relative size of the government sector for the united Germany above its current level in West Germany alone.[27]

Initially, the receipts from the sale of government assets would be used to finance East Germany's welfare system. Prominent among the already accepted provisions of this new system will be the complete adoption of West Germany's social security system: retirement benefits for East Germans, to be paid in deutsche marks, would be raised quickly to West German levels (at the pre-November 1989 market exchange rate of 5:1 they had been about 1/15 of those in the West). The current East German wages would be converted 1:1 into deutsche marks (which would lift them to about 1/2 of West German rates, and to roughly the same height as West Germany's average unemployment subsidies, as compared with a market value of about 1/10). In addition, East Germany would immediately introduce the West German unemployment 'insurance' system; and West Germany's highly centralized labor union organization and collective bargaining would take hold in East Germany. Further, rents would be converted 1:1; and at least 'temporarily', severe rent controls would remain in effect. All debts, denominated now in deutsche marks, would be cut in half. Lastly, but unsurprisingly already seen as of the highest priority, in order to finance current and future government expenditures the East German government would adopt West Germany's tax structure and, no longer in control of the money printing press, would immediately begin establishing an 'effective' decentralized tax collection system, assisted by its West German counterpart and the expertise of its *Finanzämter* (equivalent to the United States Internal Revenue System).

Naturally, the political power elite responsible for this reunification program has expressed little doubt about its success. Indeed, some of its representatives such as Chancellor Helmut Kohl and Otto Lambsdorff, head of West Germany's Free Democratic Party, have gone on record saying that it would "cost West Germany nothing." However, economic logic dictates otherwise and predicts rather dis-

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land used for agriculture had been forcibly socialized before this date). This provision is currently being challenged in the government's court system.

[27]After one year of de-socialization a mere 700 out of 9,000 East German 'production units' had been privatized.

appointing results.[28]

To be sure, due to the partial re-privatization of East Germany and the lifting of most price controls, East Germany's economic performance would quickly improve over its present desperate showing. Yet the recovery process will not only be slower and much more painful than need be, it will soon be replaced by economic stagnation; and likewise, due to the relatively larger size of the government sector in the united Germany as compared to its present size in West Germany, stagnation tendencies will be strengthened within the already listless West German economy.

The full inclusion of East Germans into the West German social security system is bound to lead to increased social security taxes. Every restriction imposed on West German buyers of East German assets will also harm East Germans by not permitting them to sell to the highest bidder and will hamper the speedy transfer of assets into the most value-productive hands. Similarly, the preferential treatment accorded established West German companies will prevent the quickest breakup of the mostly oversized East German production units into efficient firms and contribute from the outset to the cartelization of East Germany's new economy. Rent controls will largely halt the reconstruction of East Germany's rental housing market from its shambled state and will lead to large-scale public housing projects (*sozialer Wohnungsbau*) and even higher taxes. However, worst of all for East Germany's economic recovery will be the combined policies of minimum wage guarantees and unemployment subsidies. For one thing, these policies will not stop the population outflow from East to the West with its higher wages and unemployment subsidies[29]; and with downwardly inflexible wage rates also in

[28]In fact, by early 1991, higher gasoline taxes, a 2.5 percent increase in the unemployment 'insurance' tax, and a 'temporary' 7.5 percent increase of the income tax had been introduced, and various other 'revenue enhancement' schemes had come under official consideration (including a road user fee, and a price increase for governmentally provided and monopolized telephone services). The money supply (M3) had been increased at an annual rate of 6 percent (as compared to 1 percent in the United States). Government debt *increases* rose from 20 billion deutsche marks in 1990 to an officially (under-)estimated 140 billion for 1991, to a total of some 900 billion, requiring nearly 10 percent of the Federal government's budget for interest payments (with an anticipated further increase to 17 percent by 1994). Due to increased government borrowing, the interest rate rose by about 1 percent (as compared to a 1 percent drop in the United States during the same period) and accordingly, private investment was 'crowded out.' In addition, some 10,000 new tenured government jobs (*Beamte*) had been 'created' in West Germany, so as to teach East Germany 'bureaucratic efficiency.'

[29]Since the currency unification and the incorporation of East by West Germany the number of emigrants has expectedly fallen (from above 2,000 per day). However, up to this day emigration from East to West continues at a rate of more than 500 per day.

West Germany the continuing migration is bound to further aggravate West Germany's already recalcitrant unemployment problem. On the other hand, even at the present East mark-wage-rates the East German economy is largely uncompetitive in world markets. By actually fixing wage rates several times higher—by requiring nominally identical deutsche mark-wage-payments—the East German labor force will be priced out of the market to an even greater extent. The 'normal' flow of capital from high to low wage areas will be drastically reduced and massive—and with unemployment insurance—lasting unemployment will result. In order to finance East Germany's large-scale unemployment, steady massive transfer payments will be required from West to East, but also from East Germany's productive sector to its unproductive one. Once again, taxes and/or paper money creation will have to be substantially increased. Whatever new productive energies were set free by East Germany's partial privatization will immediately be stifled, and within an environment of rising unemployment figures and economic stagnation nationalistic sentiments, already on the rise, will receive another boost.[30]

While the course has largely been set and German reunification has proceeded through the incorporation of East Germany into the West German welfare state, an alternative existed which would have spared the Germans the economic frustrations inevitably associated with the current planned course of reunification.

Unfortunately, this radical alternative—the uncompromising privatization of East Germany, the adoption of a private-property constitution, and reunification through a policy of complete, unilateral free trade—has so far found practically no audience. Almost all alternatives proposed are variations of the same welfare-statist theme: either somewhat more drastic (i.e., more redistributionist), advocated mostly by Eastern economic 'experts', or somewhat more moderate, as advanced mostly by the economics establishment of West Germany. Nor does there appear to be any suspicion among the German public regarding this happy uniformity of expert opinion. Is it not curious that even in 'liberal' West Germany the instruments of opinion molding are largely in governmental hands? There are practically no private schools or universities; radio and television are

[30]By the end of 1990, the unemployment rate in East Germany had risen to about 25 percent (2.5 million); and increasing animosity among East Germans toward their own foreign 'guest workers' had become a widespread phenomenon.

mostly state-owned or, in the case of a few exceptions allowed since the mid-1980s, subject to strict governmental licensing requirements; and there are almost no independent, private free-market think-tanks or foundations. Moreover, why should the West German power elite and the economic establishment on its payroll actually have the same interests as the German public? Indeed, is it not much more realistic to assume, as the Austrian school of economics long ago explained[31] and the public choice school has reiterated more recently,[32] that government officials and their intellectual bodyguards, like everyone else, pursue their own narrow self-interest rather than promoting the so-called public good? And is it not rather obvious that the interest of the West German government and its Eastern affiliate is the expansion of its own power: of tax revenue and governmentally controlled assets. The presently unfolding reunification process promotes precisely *this* goal and is indeed bound to lead to Germany's becoming Europe's foremost political power: and that what might appear as an ill-conceived strategy from the point of view of the German public, then, is actually the successful accomplishment of the German government's own different, even antagonistic interests?[33]

The German public today is too authoritarian minded to ask any such questions seriously. Much learning the hard way will be required, and much damage done, before the radical privatization alternative is to receive its chance, if ever it does. Only then may the German public begin to realize that the complete neglect of this option among the presently discussed reunification strategies may not be an accident, but have a systematic explanation.

The solution of the present crisis must begin with the recognition that while it may not be the East Germans' fault that they are as bad off as they are, it is also not the fault of the West Germans. As a matter of fact, the millions of people who left East Germany for the West, in many cases risking their lives, actively contributed to the undermining of the East German regime and in any case demonstrated *correct*

[31]See Ludwig von Mises, *Bureaucracy* (New Haven: Yale University Press, 1944).

[32]See James M. Buchanan, *What Should Economists Do?* (Indianapolis, Ind.: Liberty Fund, 1979); Gordon Tullock, *The Politics of Bureaucracy* (Washington, D.C.: Public Affairs Press, 1965).

[33]On the theory of the state see Franz Oppenheimer (one of Ludwig Erhard's teachers), *System der Soziologie, Vol. 2: Der Staat* (Stuttgart, 1964); Albert J. Nock, *Our Enemy the State* (Delevan: Hallberg Publishing, 1983); Murray N. Rothbard, *For A New Liberty*, (New York: Macmillan, 1978); idem, *The Ethics of Liberty* (Atlantic Highlands: Humanities Press, 1982); Hans-Hermann Hoppe, *Eigentum, Anarchie und Staat*; idem, *A Theory of Socialism and Capitalism*; Anthony de Jasay, *The State* (Oxford: Blackwell, 1985).

entrepreneurial judgment, whereas millions of East Germans collaborated with the regime—socialist party membership was above 2 million, or some 15 percent of the population, and many more willingly participated by looting the property left behind by emigrants. Even those who did not do so obviously displayed *poor* entrepreneurial foresight. To compel the West German populace to give wholesale financial support to East Germans, then, not only constitutes a moral outrage, but is a counterproductive measure as well. Justice and economics require instead that East Germany solve its problems alone, without anything but voluntary West German assistance. Accordingly, any form of compulsory redistribution should be rejected outright. There should be no currency reform of the sort already inaugurated, but exchange at market rates[34]; and likewise, there should be no incorporation, but a decidedly *separatist* reunification course chosen.

Since the ultimate cause of East Germany's economic misery is the collective ownership of factors of production, the solution and key to a prosperous future is privatization. Yet how can socialized property be privatized justly?[35] There is a second moral observation at the beginning of the answer to this question. The former East German government was, and is by now largely recognized by the East German population as a criminal organization, guilty of murder, robbery and, in erecting an impenetrable wall around the country responsible for the enslavement of an entire people. Not only should those directly responsible for these activities be prosecuted far beyond the current timid attempts in this direction, but all government property, ill-begotten from the very start, should be forfeited. The new government, even if freely elected, cannot be considered the owner of any property, for a criminal's heir, even if himself innocent of any crimes, does not become the legitimate owner of illegitimately acquired assets. On account of his personal innocence he remains exempt from prosecution; but all of his 'inherited' gains must imme-

[34]Temporarily—until the East Germans were willing to adopt a still better *commodity* money such as gold, for instance—this would lead to the rapid replacement of the *bad* East mark by the *good* deutsche mark, to deflationary pressure put on deutsche mark prices, and to the welcome lowering of East German import prices.

[35]While a vast body of literature dealing with the socialization of private property exists, hardly anything has been written on how to de-socialize. Most likely, one would suspect, because of most Western intellectuals' explicit or implicit socialist predilections, which preclude any treatment of this problem as simply irrelevant. For why should anyone ever want to go back from an allegedly *higher stage of social evolution*, i.e., socialism, to a lower one, i.e., capitalism? As one of the few exceptions see Murray N. Rothbard, "How To Desocialize?," *Free Market*, vol. 7 (Auburn, Ala.: The Ludwig von Mises Institute, September 1989).

diately revert to the original victims, and their repossession of government property must take place without their being required to pay anything. In fact, to charge a victimized population a price for the reacquisition of what was originally its own would itself be a crime and once and forever take away any innocence the new East German government previously might have had.

More specifically, all original property titles should be immediately recognized, regardless of whether they are presently held by East or West Germans. Insofar as the claims of original private owners or their heirs clash with those of the current asset users, the former should in principle override the latter. Only if a current user can prove that an original owner-heir's claim is illegitimate, i.e., that the title to the property in question had been acquired initially by coercive or fraudulent means, should a user's claim prevail and should he be recognized as owner.[36] In the case of East Germany—in contrast to that of the Soviet Union, for instance,—where the policy of expropriation started only some 40 years ago, where most land registers have been preserved, and where the practice of government authorized murder of private-property owners was relatively 'moderate', this measure would quickly result in the reprivatization of most, though by no means all, of East Germany. Regarding governmentally controlled resources that are not reclaimed in this way, syndicalist ideas should be implemented. Assets should become owned immediately by those who use them—the farmland by the farmers, the factories by the workers, the streets by the street workers, the schools by the teachers, the bureaus by the bureaucrats (insofar as they are not subject to criminal prosecution), and so on.[37] To break up the mostly over-sized East German production conglomerates, the syndicalist principle should be applied to those production units in which a given individual's work is actually performed, i.e., to individual office buildings, schools, streets or blocks of streets, factories and farms. Unlike syndicalism, yet of the utmost importance, the so acquired individual property shares should be freely tradeable and a stock market established, so as to allow a separation

[36]In those cases in which current users actually bought expropriated assets from the government, they should seek compensation from those responsible for this sale of loot, and the government officials accountable for it should be compelled to repay the purchase price, if necessary through forced labor.

[37]On the economics and ethics of privatization see Murray N. Rothbard, *For A New Liberty*; for the privatization of streets in particular Walter Block, "Free Market Transportation: Denationalizing the Roads," *Journal of Libertarian Studies* (1979); idem, "Public Goods and Externalities: The Case of Roads," *Journal of Libertarian Studies* (1983).

of the functions of owner-capitalists and non-owning employees, and the smooth and continuous transfer of assets from less into more value-productive hands.[38]

Two problems are connected with this privatization strategy. For one thing, what is to be done in the case of newly erected structures—which according to the proposed scheme would be owned by their current productive users—built on land that is to revert to a different original owner? While it may appear straightforward enough to award each current producer with an equal property share, how many shares should go to the land owner? Structures and land cannot be physically separated. In terms of economic theory, they are absolutely specific complementary production factors whose relative contribution to their joint value product cannot be disentangled. In these cases there is no alternative but to bargain.[39] Yet this—contrary to the first impression that it might lead to permanent, unresolvable conflict—should hardly cause many headaches. For invariably there are only two parties and strictly limited resources involved in any such dispute. Moreover, to find a quick, mutually agreeable compromise is in both parties' interest, and if either party possesses a weaker bargaining position it is clearly the landowner (because he cannot sell the land without the structure owners' consent while they could dismantle the structure without needing the landowner's permission).

Secondly, the syndicalist privatization strategy implies that producers in capital intensive industries would have a relative advantage as compared to those in labor intensive industries. For the value of the property shares received by the former would exceed the wealth awarded to the latter, and this unequal distribution of wealth would require justification, or so it seems. In fact, such justification is readily available. Contrary to widespread 'liberal' myths, there is nothing ethically wrong with inequality.[40] Indeed, the problem of privatizing formerly socialized property is almost perfectly analogous to that of establishing private property in a *state of nature*, i.e., when resources previously had been unowned. In this situation, according

[38]For an economic analysis of syndicalism see Ludwig von Mises, *Socialism*, chap. 16, sec. 4.

[39]On the economic theory of bargaining see Ludwig von Mises, *Human Action*, pp. 338-39; and Murray Rothbard, *Man, Economy, and State*, pp. 308-12.

[40]See Murray N. Rothbard, *Egalitarianism As A Revolt Against Nature and other Essays*, (Washington, D.C.: Libertarian Review Press, 1974); also: Robert Nozick, *Anarchy, State, and Utopia* (New York: Basic Books, 1974), chap. 8; Helmut Schoeck, *Der Neid. Eine Theorie der Gesellschaft* (Munich, 1966); idem, *Das Recht auf Ungleichheit* (Munich, 1979); Erik von Kuehnelt-Leddhin, *Freiheit oder Gleichheit* (Salzburg, 1953).

to the central Lockean idea of natural rights which coincides with most people's natural sense of justice, private property is established through acts of homesteading: by mixing one's labor with nature-given resources before anyone else has done so[41]; and insofar as any differences between the quality of nature-given resources exist, as is surely the case, the outcome generated by the homesteading ethic is inequality rather than equality.[42] The syndicalist privatization approach is merely the application of this homesteading principle to slightly changed circumstances. The socialized factors of production are already homesteaded by particular individuals. Only their property right regarding particular production factors has so far been ignored, and all that would occur under the proposed scheme is that this unjustifiable situation would finally be rectified. If such rectification results in inequalities, this is no more unfair than the inequalities that would emerge under a regime of original, unadulterated homesteading.[43]

Moreover, our syndicalist proposal is economically more efficient than the only conceivable privatization alternative in line with the basic requirement of justice (that the government does not legitimately own the socialized economy and hence its selling or auctioning it off should be out of the question). According to the latter alternative, the entire population would receive equal shares in all of the country's assets not reclaimed by an original, expropriated owner. Aside from the questionable moral quality of this policy,[44] it would be

[41]See John Locke, *Two Treatises of Government*, Peter Laslett, ed. (Cambridge: Cambridge University Press, 1960), pp. 305-07.

[42]For an attempt to justify an *egalitarian* homesteading ethic see H. Steiner, "The Natural Right to the Means of Production," *Philosophical Quarterly* 27 (1977); for a refutation of this theory as inconsistent see Jeffrey Paul, "Historical Entitlement and the Right to Natural Resources," in Walter Block and Llewellyn H. Rockwell, eds., *Man, Economy, and Liberty: Essays in Honor of Murray N. Rothbard* (Auburn, Ala.: The Ludwig von Mises Institute, 1988); Fred D. Miller, "The Natural Right to Private Property," in Tibor R. Machan, ed., *The Libertarian Reader* (Totowa: Rowman & Littlefield, 1982).

[43]For the most consistent and complete Lockean property rights theory see Murray Rothbard, *The Ethics of Liberty*; idem, "Law, Property Rights, and Air Pollution," *Cato Journal* 2, no. 1 (Spring 1982); for a theoretical justification of the homesteading principle in particular, as the indisputable, axiomatic foundation of ethics see Hans-Hermann Hoppe, *Eigentum, Anarchie und Staat*, chap. 4; idem, *A Theory of Socialism and Capitalism*, chaps. 2 and 7; idem, "From the Economics of Laissez Faire to the Ethics of Libertarianism," in Walter Block and Llewellyn H. Rockwell, eds., *Man, Economy, and Liberty*; idem, "The Justice of Economic Efficiency," *Austrian Economics Newsletter* 9, no. 2 (Winter 1988).

[44]How can one justify that ownership of productive assets should be assigned without considering a given individual's actions or inactions in relation to the owned asset? More specifically, how can it be justified, for instance, that someone who has contributed literally nothing to the existence or maintenance of a particular asset—and

extremely inefficient. For one thing, in order for such countrywide distributed shares to become tradeable property titles, they must specify to which particular resource they refer. Hence, to implement this proposal, first a complete inventory of all of the country's assets would be required, or at least an inventory of all its distinctively separable production units. Secondly, even if such an inventory were finally assembled, the owners would consist by and large of individuals who knew next to nothing about the assets they owned. In contrast, under the non-egalitarian syndicalist privatization scheme no inventory is necessary. Furthermore, initial ownership comes to rest exclusively with individuals who, because of their productive involvement with the assets owned by them, are by and large best informed to make a first realistic appraisal of such assets.

In conjunction with the privatization of all of East Germany according to the principles outlined, the current East German government should adopt a private property constitution and declare it the immutable basic law for the entire East German territory. This constitution should be extremely brief and lay down the following principles in terms as unambiguous as possible: Every person, apart from being the sole owner of his physical body, has the right to employ his private property in any way he sees fit so long as in so doing he does not uninvitedly change the physical integrity of another person's body or property. All interpersonal exchanges and all exchanges of property titles between private owners are to be voluntary (contractual). These rights of a person are absolute. Any person's infringement on them is subject to lawful prosecution by the victim of this infringement or his agent, and is actionable in accordance with the principles of the proportionality of punishment and of strict liability.[45]

As implied by this constitution, then, all existing wage and price controls, all property regulations and licensing requirements, and all import and export restrictions should be immediately abolished and complete freedom of contract, occupation, trade and migration introduced. Subsequently, the East German government, now property-

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who might not even know that any such asset exists—should own it in the same way as someone else who actively, objectifiably contributed to its existence or maintenance?

[45]On the proportionality principle of punishment see Murray Rothbard, *The Ethics of Liberty*, chap. 13; Hans-Hermann Hoppe, *Eigentum, Anarchie und Staat*, pp. 106-28; on the principle of strict liability also Richard A. Epstein, "A Theory of Strict Liability," *Journal of Legal Studies* 2 (January 1973); idem, "Medical Malpractice: The Case for Contract," *Center for Libertarian Studies: Occasional Paper Series*, no.9 (Burlingame, 1979); Judith J. Thomson, *Rights, Restitution, and Risk* (Cambridge: Harvard University Press, 1986), esp. chaps. 12 ("Remarks on Causation and Liability") and 13 ("Liability and Individualized Evidence").

less, should declare its own continued existence unconstitutional—insofar as it would have to rest on non-contractual property acquisitions, that is, taxation—and abdicate.[46]

The result of this complete abolition of socialism and the establishment of a pure private-property society—an anarchy of private-property owners, regulated exclusively by private-property law—would be the quickest economic recovery of East Germany. From the outset, East Germany's population would, by and large, be made amazingly rich. For while the East German economy is in shambles, the country is not destroyed. High real-estate values exist, and in spite of all capital consumption of the past there are still massive amounts of capital goods in East Germany. With no government sector left and the entire national wealth in private hands, East Germans could soon become the envied objects of their West German counterparts.[47]

Moreover, with factors of production released from political control and handed over to private individuals who are allowed to use them as they see fit—independent of whatever anyone else may want—provided only that they do not physically damage the resources owned by others, the ultimate stimulus for future production is provided. With an unrestricted market for capital goods, rational cost-accounting is made possible. With profits as well as losses individualized, and reflected in an owner's capital- and sales-account, every single producer's incentive to increase the quantity and/or quality of his output and to avoid any over- or underutilization of his capital is maximized. In particular, the constitutional provision that only the physical integrity of property (not property values) be protected guarantees that every owner will undertake the greatest value-productive efforts—efforts to promote favorable changes in property values and to prevent and counter any unfavorable ones (as might result from another person's actions regarding his property).

Specifically, the abolishment of all price controls would almost instantaneously eliminate all present shortages; and output would immediately begin to increase, quantitatively as well as qualitatively.

[46]On the ethics and economics of state-less societies see Murray N. Rothbard, "Society Without a State," in J. Roland Pennock and John W. Chapman, eds., *Anarchism (Nomos 19)* (New York: New York University Press, 1978); Bruce Benson, *The Law, The Legal System and The State* (San Francisco: Pacific Institute, 1991).

[47]National wealth statistics are notoriously problematic. However, for illustrative purposes it might be worthwhile to point out that estimates of East Germany's national wealth range from 30 to 800 trillion deutsche marks. Using the lowest estimate and adding to the East German population some 4 million West Germans reclaiming their Eastern property this would amount to per capita assets of about $900,000.

Temporarily, unemployment would drastically increase, as it did in West Germany after World War II. Yet with flexible wage rates, no collective bargaining, and no unemployment subsidies it would quickly begin to disappear again. Initially, average wage rates would remain substantially below West German rates. But this, too, would soon begin to change. Lured by comparatively low wages, by the fact that East Germans will expectedly show a great need for cashing in (liquidating) their newly acquired capital assets so as to finance their current consumption, and above all by the fact that East Germany would be a no-tax, free-trade haven, large numbers of investors and huge amounts of capital, in particular from wealthy neighboring West Germany, would immediately begin to flow in.

The production of security—of police protection and of a judicial system—which is usually (without argument) assumed to lie outside the province of free markets and be the proper function of government, would most likely be taken over by the major West German insurance companies.[48] Providing insurance for personal property, police-action—the prevention and detection of crime as well as the exaction of compensation—is in fact part of this industry's natural business (if it were not for governments preventing it from doing so and arrogating this task to itself, with all the usual and familiar inefficiencies resulting from such a monopolization). Likewise, being already in the business of arbitrating conflicts between claimants of competing insurers, they would naturally assume the function of a judicial system.[49]

Yet more important than the entrance of big business, such as insurance companies in the field of security production, would be the influx of large numbers of small entrepreneurs from West Germany. Facing not only a heavy load of taxation in the West but being stifled

[48]On the economics of competitive, private security production see Gustave de Molinari, "The Production of Security," *Center for Libertarian Studies: Occasional Paper Series*, no. 2 (Burlingame, Calif., 1977); Murray Rothbard, *Power and Market*, chap. 1; idem, *For A New Liberty*, chap. 12; Morris and Linda Tannehill, *The Market For Liberty* (New York: Laissez Faire Books, 1984); W. Wooldridge, *Uncle Sam the Monopoly Man* (New Rochelle: Arlington House, 1970); Bruno Leoni, *Freedom and the Law* (Princeton: Van Nostrand, 1972); Hans-Hermann Hoppe, "Fallacies of the Public Goods Theory and the Production of Security," *Journal of Libertarian Studies* 9, no. 1 (1989); Bruce Benson, *The Law, The Legal System and The State*.

[49]As regards national defense one should note that for the foreseeable future, this is not a problem for East Germany. West Germany would certainly not attack East Germany—public opinion would make this impossible. And insofar as the Soviet Union is concerned, it will continue to station troops on East German territory for the time being under *any* scenario. On the privatization of defense see Murray Rothbard, *For A New Liberty*, chap. 13; also, Jeffrey Rogers Hummel, "National Goods vs. Public Goods: Defense, Disarmament, and Free Riders," *Review of Austrian Economics* 4 (1990).

there by countless regulations (licensing requirements, labor protection laws, mandated working and shop-opening hours), an unregulated East German private-property economy would present an almost irresistible attraction. The large-scale import of entrepreneurial talent and capital would soon begin to raise real wage rates in East Germany, stimulate internal savings, and lead to a rapidly accelerating process of capital accumulation. Rather than people leaving the East, migration would quickly take place in the opposite direction, with increasing numbers of West Germans abandoning welfare socialism for the unlimited opportunities offered in the East. Finally, faced with increasing losses of productive individuals, which would put even more pressure on West Germany's welfare budgets, the West German power elite would be forced to do what it presently is trying desperately to avoid with its own strategy of reunification through incorporation: to begin to de-socialize West Germany as well.